

INCARA PHARMACEUTICALS CORP  
Form 10-K405/A  
July 31, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

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FORM 10-K/A  
Amendment No.1  
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the fiscal year ended September 30, 2000

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 0-27410

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INCARA PHARMACEUTICALS CORPORATION  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

56-1924222  
(I.R.S. Employer  
Identification No.)

P.O. Box 14287  
79 T.W Alexander Drive  
4401 Research Commons, Suite 200  
Research Triangle Park, North Carolina  
27709  
(Address of principal executive offices)

Company's telephone number, including area code: 919-558-8688

Securities registered pursuant to Section 12(B) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$.001 par value per share

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant based upon the closing price of the Common Stock on July 25 2001, on the Nasdaq National Market System was approximately \$12,856,000 as of such date. Shares of Common Stock held by each executive officer and director and by each person who owns 10% or more of the outstanding Common Stock have been excluded in that such persons might be deemed to be affiliates. This determination of affiliate status might not be conclusive for other purposes.

As of July 25, 2001, the Registrant had outstanding 8,380,320 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the 2001 Annual Meeting of Stockholders are incorporated herein by reference into Part III.

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Incara Pharmaceuticals Corporation

Amendment No.1 on Form 10-K/A to the Annual Report on  
Form 10-K for the year ended September 30, 2000.

Explanatory Note

This Amendment No.1 on Form 10-K/A is being Filed in order to amend Items 6 and 8, as described therein, and a new Exhibit 23.1.

2

Item 6. Selected Financial Data.

You should read the following selected financial data in conjunction with our consolidated financial statements and the notes to those statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K. We derived the consolidated statements of operations data for the fiscal years ended September 30, 1996, 1997, 1998, 1999 and 2000 and the consolidated balance sheet data at September 30, 1996, 1997, 1998, 1999 and 2000 from our consolidated financial statements which have been audited by PricewaterhouseCoopers LLP, independent accountants, and, except for the consolidated statements of operations for the fiscal years ended September 30, 1996 and 1997 and the consolidated balance sheet data at September 30, 1996, 1997 and 1998, are included elsewhere in this Form 10-K.

Please be advised that historical results are not necessarily indicative of

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the results to be expected in the future, particularly given our acquisition and disposition history. Our historical cash expenditures prior to December 31, 1999 were significantly higher than our current cash spending rate. This lower level of expenditures has resulted from the discontinuance of the IRL and BEXTRA(R) programs (see "Item 1--Business--Discontinued Programs").

Statement of Operations Data:  
(In thousands, except per share data)

	Year Ended September 30,				
	2000	1999	1998	1997	1996
Revenue:					
Contract and license fee revenue.....	\$ 100	\$ 2,088	\$ 6,121	\$ 5,360	\$ 5,348
Costs and expenses:					
Research and development...	7,645	18,996	16,799	19,972	5,276
Purchase of in-process research and development..	6,664	--	5,343	411	350
General and administrative.....	2,613	3,045	3,509	4,179	3,396
Total costs and expenses.....	16,922	22,041	25,651	24,562	9,022
Loss from operations.....	(16,822)	(19,953)	(19,530)	(19,202)	(3,674)
Gain on sale of division.....	9,751	--	--	--	--
Investment income, net.....	406	355	384	831	719
Income taxes.....	--	--	--	--	(37)
Minority interest.....	--	--	--	568	(568)
Net loss.....	\$ (6,665)	\$ (19,598)	\$ (19,146)	\$ (17,803)	\$ (3,560)
Net loss per common share:					
Basic and diluted.....	\$ (1.21)	\$ (2.98)	\$ (2.69)	\$ (2.55)	\$ (0.59)
Weighted average common shares outstanding:					
Basic and diluted.....	5,522	6,583	7,113	6,982	6,062

Balance Sheet Data:  
(In thousands)

	September 30,				
	2000	1999	1998	1997	1996
Cash and cash equivalents and marketable securities.....	\$ 6,555	\$ 4,960	\$ 23,562	\$ 37,580	\$37,391
Working capital .....	\$ 4,662	\$ 2,207	\$ 14,607	\$ 9,855	\$28,870
Total assets.....	\$ 7,348	\$ 8,044	\$ 27,836	\$ 42,623	\$40,650

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Long-term portion of capital lease obligations and notes payable.....	\$	43	\$	981	\$	1,593	\$	2,128	\$	896
Total liabilities.....	\$	2,536	\$	4,253	\$	8,160	\$	29,167	\$	9,401
Total stockholders' equity...	\$	4,812	\$	3,791	\$	19,676	\$	13,456	\$	30,680

### Unaudited Pro Forma Consolidated Financial Information:

The consolidated financial statements of Incara are included elsewhere in this Form 10-K. You should read the unaudited pro forma consolidated financial information presented herein in conjunction with those financial statements and related notes.

The unaudited pro forma consolidated financial information of Incara for the year ended September 30, 2000 include adjustments to give effect in the unaudited pro forma condensed consolidated statement of operations for the disposition of IRL as if it had occurred on October 1, 1999.

The unaudited pro forma condensed consolidated statements of operations are provided for informational purposes and are not necessarily indicative of the results of operations that would have been achieved had the transactions been in effect as of the beginning of the period presented and are not necessarily indicative of future results of operations.

### Pro Forma Consolidated Statement of Operations: (In thousands, except per share data)

	Fiscal Year Ended September 30, 2000		
	Consolidated Actual	Pro Forma Adjustments-- IRL	Pro Forma As Adjusted
Revenue:			
Contract and license fee revenue.....	\$ 100	\$ 100	\$ --
Costs and expenses:			
Research and development.....	7,645	1,339	6,306
Purchased in-process research and development.....	6,664	--	6,664
General and administrative.....	2,613	--	2,613
Total costs and expenses.....	16,922	1,339	(15,583)
Loss from operations.....	(16,822)	(1,239)	(15,583)
Gain on sale of division.....	9,751	9,751	--
Interest income, net.....	406	(37)	443
Net income (loss).....	\$ (6,665)	\$ 8,475	\$ (15,140)
Net loss per common share:			
Basic.....	\$ (1.21)		\$ (2.74)
Diluted.....	\$ (1.21)		\$ (2.74)
Weighted average common shares			

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outstanding.....	5,522	5,522
	=====	=====

The pro forma adjustments reflect the elimination of revenue and expenses related to IRL for the fiscal year ended September 30, 2000 as if the IRL sale had occurred at the beginning of the fiscal year. The pro forma adjustments also reflect the elimination of the gain recognized on the sale of IRL.

Item 8. Financial Statements and Supplementary Data.

See Index to Consolidated Financial Statements on page F-1.

33

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

(a) The following Financial Statements, Financial Statement Schedules and Exhibits are filed as part of this report or incorporated herein by reference:

(1) Financial Statements.

See Index to Consolidated Financial Statements on page F-1.

(2) Financial Statement Schedules.

All financial statement schedules for which provision is made in Regulation S-X are omitted because they are not required under the related instructions, are inapplicable, or the required information is given in the financial statements, including the notes thereto.

(3) Exhibits.

Exhibit No. -----	Description -----
23.1	Consent of PricewaterhouseCoopers LLP

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Accountants.....	F-2
Consolidated Balance Sheets--As of September 30, 2000 and 1999.....	F-3
Consolidated Statements of Operations--For the fiscal years ended September 30, 2000, 1999 and 1998.....	F-4
Consolidated Statements of Stockholders' Equity--For the fiscal years ended September 30, 2000, 1999 and 1998.....	F-5

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Consolidated Statements of Cash Flows--For the fiscal years ended  
September 30, 2000, 1999 and 1998..... F-6

Notes to Consolidated Financial Statements..... F-7

F-1

## REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF  
INCARA PHARMACEUTICALS CORPORATION

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Incara Pharmaceuticals Corporation and its subsidiaries (the "Company") at September 30, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note M, the Company has revised its earnings per share calculation.

PricewaterhouseCoopers LLP

Raleigh, North Carolina

November 15, 2000, except with regard to Note M, for which the date is July 27, 2001

F-2

## INCARA PHARMACEUTICALS CORPORATION

### CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	September 30,	
	2000	1999
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 1,877	\$ 2,407
Marketable securities.....	4,678	2,553

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Accounts receivable.....	197	282
Prepays and other current assets.....	403	237
	-----	-----
Total current assets.....	7,155	5,479
Property and equipment, net.....	193	2,483
Other assets.....	--	82
	-----	-----
	\$ 7,348	\$ 8,044
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable.....	\$ 637	\$ 654
Accrued expenses.....	1,807	1,933
Current portion of capital lease obligations.....	22	488
Current portion of notes payable.....	27	197
	-----	-----
Total current liabilities.....	2,493	3,272
Long-term portion of capital lease obligations.....	43	399
Long-term portion of notes payable.....	--	582
Stockholders' equity:		
Common stock, \$.001 par value per share, 40,000,000 shares authorized, 7,365,849 and 5,226,969 shares issued and outstanding at September 30, 2000 and 1999, respectively.....		
	7	5
Additional paid-in capital.....	88,951	81,772
Restricted stock.....	(239)	(744)
Accumulated deficit.....	(83,907)	(77,242)
	-----	-----
Total stockholders' equity.....	4,812	3,791
	-----	-----
	\$ 7,348	\$ 8,044
	=====	=====

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

F-3

INCARA PHARMACEUTICALS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share data)

	Fiscal Year Ended		
	September 30,		
	2000	1999	1998
	-----	-----	-----
Revenue:			
Contract and license fee revenue.....	\$ 100	\$ 2,088	\$ 6,121
	-----	-----	-----
Costs and expenses:			
Research and development.....	7,645	18,996	16,799
Purchase of in-process research and development.....	6,664	--	5,343
General and administrative.....	2,613	3,045	3,509
	-----	-----	-----

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Total costs and expense.....	16,922	22,041	25,651
	-----	-----	-----
Loss from operations.....	(16,822)	(19,953)	(19,530)
Gain on sale of division.....	9,751	--	--
Investment income, net.....	406	355	384
	-----	-----	-----
Net loss.....	\$ (6,665)	\$ (19,598)	\$ (19,146)
	=====	=====	=====
Net loss per common share:			
Basic.....	\$ (1.21)	\$ (2.98)	\$ (2.69)
	=====	=====	=====
Diluted.....	\$ (1.21)	\$ (2.98)	\$ (2.69)
	=====	=====	=====
Weighted average common shares outstanding.....	5,522	6,583	7,113
	=====	=====	=====

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

F-4

INCARA PHARMACEUTICALS CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(Dollars in thousands)

	Common Stock		Additional	Restricted	Deferred	Accumulated	Stock
	Number	Par	Paid-in	Stock	Compensation	Deficit	Equity
	of Shares	Value	Capital				
	-----	-----	-----	-----	-----	-----	-----
Balance at September 30, 1997.....	6,956,545	\$ 7	\$52,243	\$ --	\$ (296)	\$ (38,498)	\$ 1
Exercise of common stock options.....	15,576	--	59	--	--	--	
Grants of common stock options at below fair value.....	--	--	1,450	--	(1,450)	--	
Stock-based compensation.....	--	--	464	--	--	--	
Amortization of deferred compensation.....	--	--	--	--	660	--	
Proceeds from offerings of Employee Stock Purchase Plan.....	13,592	--	142	--	--	--	
Contribution to Transcell capital by Interneuron.....	--	--	18,698	--	--	--	1
Common stock issued to unrelated parties in conjunction with Transcell Merger.....	303,440	--	5,343	--	--	--	
Net loss for the fiscal year ended September 30, 1998.....	--	--	--	--	--	(19,146)	(1
	-----	-----	-----	-----	-----	-----	-----
Balance at September 30,							

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1998.....	7,289,153	7	78,399	--	(1,086)	(57,644)	1
Exercise of common stock options.....	21,851	--	53	--	--	--	
Amortization of deferred compensation.....	--	--	--	--	827	--	
Proceeds from offerings of Employee Stock Purchase Plan.....	67,851	--	134	--	--	--	
Contribution of payables to capital by Interneuron.....	--	--	2,421	--	--	--	
Cancellation of common stock returned by Interneuron.....	(4,229,381)	(4)	4	--	--	--	
Common stock issued to unrelated parties in conjunction with Transcell Merger.....	867,583	1	(1)	--	--	--	
Write-off of deferred compensation related to common stock options cancelled.....	--	--	(259)	--	259	--	
Restricted common stock sold to employees and consultants.....	1,209,912	1	755	(755)	--	--	
Stock-based compensation and amortization of Restricted Stock.....	--	--	266	11	--	--	
Net loss for the fiscal year ended September 30, 1999.....	--	--	--	--	--	(19,598)	(1)
Balance at September 30, 1999.....	5,226,969	5	81,772	(744)	--	(77,242)	
Exercise of common stock options.....	140,000	--	50	--	--	--	
Proceeds from offerings of Employee Stock Purchase Plan.....	208,744	--	122	--	--	--	
Common stock issued in conjunction with Transcell Merger.....	856,861	1	(1)	--	--	--	
Common stock issued in conjunction with Aeolus and Renaissance mergers.....	1,220,041	1	6,663	--	--	--	
Stock-based compensation and amortization of Restricted Stock.....	--	--	838	424	--	--	
Restricted Stock forfeited.....	(146,666)	--	(81)	81	--	--	
Common stock repurchased.....	(140,100)	--	(412)	--	--	--	
Net loss for the fiscal year ended September 30, 2000.....	--	--	--	--	--	(6,665)	(
Balance at September 30, 2000.....	7,365,849	\$ 7	\$88,951	\$ (239)	\$ --	\$ (83,907)	\$

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

F-5

### INCARA PHARMACEUTICALS CORPORATION

#### CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands)

	Fiscal Year Ended September 30,		
	2000	1999	1998
Cash flows from operating activities:			
Net loss.....	\$ (6,665)	\$ (19,598)	\$ (19,146)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization.....	260	771	1,837
Noncash compensation.....	1,262	1,105	1,125
Purchase of in-process research and development.....	6,664	--	5,343
Gain on sale of division.....	(9,751)	--	--
Loss on disposal of property and equipment....	36	--	--
Interest expense on notes to Interneuron.....	--	--	918
Change in assets and liabilities:			
Accounts receivable.....	85	814	31
Prepays and other assets.....	(170)	(117)	120
Accounts payable and accrued expenses.....	(653)	(1,356)	(10,054)
Deferred revenue.....	--	--	(500)
Net cash used in operating activities.....	(8,932)	(18,381)	(20,326)
Cash flows from investing activities:			
Proceeds from sale of division.....	11,000	--	--
Proceeds from sales and maturities of marketable securities.....	6,468	11,406	20,400
Purchases of marketable securities.....	(8,593)	(1,044)	(13,920)
Purchases of property and equipment.....	(114)	(278)	(1,110)
Net cash provided by investing activities.....	8,761	10,084	5,370
Cash flows from financing activities:			
Net proceeds from issuance of stock and warrants.....	172	187	201
Proceeds from capital leases.....	38	--	--
Repurchase of common stock.....	(412)	--	--
Proceeds from notes payable.....	2	2	460
Principal payments on notes payable.....	(58)	(194)	(117)
Principal payments on capital lease obligations.....	(101)	(494)	(345)
Advances from Interneuron, net.....	--	556	7,219
Net cash provided by (used by) financing activities.....	(359)	57	7,418

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Net decrease in cash and cash equivalents.....	(530)	(8,240)	(7,538)
Cash and cash equivalents at beginning of period..	2,407	10,647	18,185
	-----	-----	-----
Cash and cash equivalents at end of period.....	\$ 1,877	\$ 2,407	\$ 10,647
	=====	=====	=====
Supplemental disclosure of investing and financing activities:			
Cash payments of interest.....	\$ 37	\$ 251	\$ 222
	=====	=====	=====
Contribution of payables to capital by Interneuron.....	\$ --	\$ 2,421	\$ --
	=====	=====	=====
Property and equipment acquired through financing arrangements.....	\$ 38	\$ --	\$ 110
	=====	=====	=====

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

F-6

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

##### A. NATURE OF THE BUSINESS

The Company conducts discovery and development programs in three areas: (1) inflammatory bowel disease, using an ultra-low molecular weight heparin; (2) liver disorders, using a novel form of hepatic progenitor cell therapy; and (3) novel small molecule catalytic antioxidants for disorders such as stroke and heart attack.

The "Company" refers collectively to Incara Pharmaceuticals Corporation ("Incara") and its wholly owned subsidiaries, Aeolus Pharmaceuticals, Inc., a Delaware corporation ("Aeolus"), and Renaissance Cell Technologies, Inc., a Delaware corporation ("Renaissance"). At September 30, 2000, the Company also owned a 35.0% interest in CPEC LLC, a Delaware limited liability company ("CPEC").

Until July 15, 1999, Incara was a majority-owned subsidiary of Interneuron Pharmaceuticals, Inc. ("Interneuron"). On July 15, 1999, Incara restructured its corporate relationship with Interneuron to reduce Interneuron's majority ownership of Incara in exchange for an increased ownership by Interneuron of CPEC (the "Restructuring"). Prior to the Restructuring, CPEC was owned 80.1% by Incara and 19.9% by Interneuron. Subsequent to the Restructuring, CPEC became owned 35.0% by Incara and 65.0% by Interneuron (see Note I).

Until July 1999, the Company's most advanced product was BEXTRA(R) (bucindolol HCl), a beta-blocker that was being evaluated in a Phase 3 clinical trial conducted by the National Institutes of Health and the U.S. Department of Veterans Affairs for use in treating congestive heart failure patients. The agencies terminated the study in July 1999, prior to its scheduled termination date, because an interim data analysis indicated there was no significant survival advantage of treatment with bucindolol for the patient population as a whole. In August 1999, the Company agreed to end the collaboration (the "Knoll Collaboration") with BASF Pharma/Knoll AG ("Knoll") for BEXTRA for countries outside the United States and Japan (the "Knoll Territory"), and terminated the European trial of BEXTRA. The Company does not expect to pursue the compound

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further for this or any other indication.

In May 1998, Incara acquired all of the outstanding stock of Transcell Technologies, Inc. ("Transcell"), a majority-owned subsidiary of Interneuron, in a merger of Transcell with and into Incara and also acquired certain related technology rights held by Interneuron in exchange for Incara common stock, stock options and stock warrants (the "Transcell Merger"). The purchase of Interneuron's 77.9% interest in Transcell by Incara was treated in a manner similar to a "pooling-of-interests," because it represented a transfer of stock between entities under common control, and the acquisition of the non-Interneuron ownership interest was accounted for by using the "purchase" method of accounting. All of Transcell's past results of operations have been combined with the results of operations for the Company, and the Company's financial statements for all prior periods presented have been restated to reflect the Transcell Merger.

On December 29, 1999, the Company sold the former Transcell operation, which is referred to as Incara Research Laboratories ("IRL"), to a private pharmaceutical company for \$11,000,000 and the right to receive up to an additional \$4,000,000 in the event a compound originating from the Research Collaboration and Licensing Agreement (the "Merck Collaboration"), originally entered into among Transcell, Interneuron and Merck & Co., Inc. ("Merck"), reaches certain preclinical and clinical trial milestones. The Company currently does not expect to receive any additional payments from the purchaser. The transaction involved the sale of assets associated with IRL, including rights under the Merck Collaboration and the assumption of certain related liabilities by the purchaser. The Company remains contingently liable through May 2007 on debt and lease obligations of approximately \$8,328,000 assumed by the purchaser, including the IRL facility lease in Cranbury, New Jersey.

F-7

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

On March 31, 2000, Incara purchased all of the minority interests of Renaissance and Aeolus. Prior to the acquisitions, Incara owned 78.0% of Renaissance and 65.8% of Aeolus. Incara issued 1,220,041 shares of its common stock in exchange for the subsidiaries' minority ownership. The acquisitions have been accounted for using the purchase method of accounting. The total purchase price of \$6,664,000 consisted of 1,220,041 shares of Incara's common stock with a fair value of \$5.46 per share, based on the price of the Company's common stock at the date of acquisition. The total purchase price was allocated to purchased in-process research and development and immediately charged to operations because at the date of the acquisition the in-process research purchased was in preclinical stages, feasibility had not been established and it was deemed to have no alternative future use.

#### B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation:** The consolidated financial statements include the accounts of Incara and its wholly owned subsidiaries. The Company uses the equity method to account for its 35.0% ownership interest in CPEC. All significant intercompany accounts and transactions have been eliminated.

**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 reported amounts of assets and liabilities and

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disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents:** The Company invests available cash in short-term bank deposits, money market funds, commercial paper and U.S. Government securities. Cash and cash equivalents include investments with maturities of three months or less at the date of purchase. The carrying value of cash and cash equivalents approximate their fair market value at September 30, 2000 and 1999 due to their short-term nature.

**Marketable Securities:** The Company considers its investment portfolio available-for-sale. Debt and equity securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of related income taxes. Premiums are amortized and discounts accreted using the interest method over the remaining terms of the related securities. Gains and losses on the sale of securities are determined using the specific identification method. The amortized cost of marketable securities approximates their market value, yielding no unrealized holding gains or losses at September 30, 2000 and 1999. At September 30, 2000, the Company owned \$4,678,000 of bank certificates of deposit due within one year. At September 30, 1999 the Company owned \$2,553,000 of corporate notes due within one year.

**Accounts Receivable:** The accounts receivable balances at September 30, 2000 and 1999 are primarily comprised of amounts due from Interneuron for a portion of the amount payable by the Company to Knoll for bucindolol-related liabilities.

**Property and Equipment:** Property and equipment are stated at cost. Depreciation and amortization are provided using the straight-line method based on estimated useful lives or, in the case of leasehold improvements and equipment under capital leases, over the lesser of the estimated useful lives or the lease terms. The estimated useful lives are two years for computers and five years for equipment. No impairments of property and equipment were required to be recognized during the fiscal years ended September 30, 2000 and 1999. Subsequent to the Transcell Merger in May 1998, the Company wrote off \$856,000 of property and equipment acquired from Transcell because certain items did not meet the Company's minimum cost per item capitalization criteria. The majority of the Company's property and equipment at September 30, 1999 related to the IRL operations, which was sold in December 1999.

F-8

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Expenses for repairs and maintenance are charged to operations as incurred. Upon retirement or sale, the cost of the assets disposed of and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is credited or charged to operations.

**Revenue Recognition:** Revenue is recognized under collaboration or research and development agreements when services are performed or when contractual obligations are met. Cash received in advance of revenue recognition is recorded as deferred revenue.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial

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Statements" ("SAB 101"), which provides guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC. SAB 101, as amended by SAB 101A and SAB101B, outlines the basic criteria that must be met to recognize revenue and provides guidance for disclosures related to revenue recognition policies. Adoption is required by the Company no later than the quarter ending September 30, 2001. The Company does not expect SAB 101 to have a significant impact on the Company's revenue recognition policies.

**Research and Development:** Research and development costs are expensed in the period incurred. Payments related to the acquisition of in-process research and development are either capitalized or expensed based upon the stage of development of the acquired compound or technology at the date of acquisition.

**Income Taxes:** Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce net deferred tax assets to the amounts expected to be realized.

**Net Loss Per Common Share:** Basic net loss per common share is computed using the weighted average number of shares of common stock outstanding during the period. Diluted net loss per common share is computed using the weighted average number of shares of common and dilutive potential common shares outstanding during the period. Potential common shares consist of stock options, restricted common stock, warrants and convertible preferred stock using the treasury stock method and are excluded if their effect is antidilutive. At September 30, 2000, diluted weighted average common shares excluded incremental shares of approximately 1,876,000 related to stock options, unvested shares of restricted common stock and warrants to purchase common stock.

**Accounting for Stock-Based Compensation:** The Company accounts for stock-based compensation based on the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), which states that no compensation expense is recorded for stock options or other stock-based awards to employees that are granted with an exercise price equal to or above the estimated fair value per share of the Company's common stock on the grant date. The Company has adopted the disclosure requirements of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), which requires compensation expense to be disclosed based on the fair value of the options granted at the date of the grant.

**Segment Reporting:** The Company currently operates in only one segment.

**Recent Accounting Pronouncements:** In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 138 was issued in June 2000 and provides certain amendments to SFAS 133 and must be implemented at the same time as SFAS 133. SFAS 133 and SFAS 138 establish accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. As issued, SFAS 133 is effective for all fiscal quarters of all fiscal years beginning after June 15,

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

1999, with earlier application encouraged. In May 1999, the FASB delayed the effective date of SFAS 133 for one year, to fiscal quarters of all fiscal years beginning after June 15, 2000. The Company does not currently use, nor does it intend in the future to use, derivative instruments and, therefore, does not expect that the adoption of SAFS 133 and SFAS 138 will have any impact on its financial position or results of operations.

#### C. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at September 30, 2000 and 1999 (in thousands):

	2000	1999
	-----	-----
Office equipment.....	\$ 428	\$ 735
Laboratory equipment.....	341	1,411
Leasehold improvements.....	58	1,774
	-----	-----
	827	3,920
Less: accumulated depreciation and amortization.....	(634)	(1,437)
	-----	-----
	\$ 193	\$ 2,483
	=====	=====

The above amounts included equipment under capital lease obligations with a cost of \$268,000 and \$930,000 at September 30, 2000 and 1999, respectively, and a net book value of \$57,000 and \$394,000 at September 30, 2000 and 1999, respectively. Depreciation expense was \$260,000 and \$771,000 for the fiscal years ended September 30, 2000 and 1999, respectively.

#### D. ACCRUED EXPENSES

At September 30, 2000 and 1999, accrued expenses consisted of the following (in thousands):

	2000	1999
	-----	-----
Payroll-related liabilities.....	\$ 446	\$ 305
Bucindolol development costs.....	1,350	1,619
Other.....	11	9
	-----	-----
	\$1,807	\$1,933
	=====	=====

#### E. COMMITMENTS

The Company leases office and laboratory space under non-cancelable operating leases. Rent expense under non-cancelable operating leases was \$423,000, \$1,147,000 and \$1,154,000 for the fiscal years ended September 30, 2000, 1999 and 1998, respectively. The Company also leases equipment under capital leases.

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At September 30, 2000, the Company's non-cancelable future minimum payments under lease arrangements were as follows (in thousands):

	Operating Leases	Capital Leases
	-----	-----
2001.....	\$ 116	\$ 28
2002.....	--	28
2003.....	--	19
	-----	-----
Total minimum lease payments.....	\$ 116	75
	=====	
Less: amount representing interest.....		(10)
		-----
Present value of future minimum lease payments.....		\$ 65
		=====

F-10

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

The Company remains contingently liable through May 2007 on debt and lease obligations of approximately \$8,328,000 assumed by the purchaser of IRL, including the IRL facility lease in Cranbury, New Jersey.

#### F. NOTES PAYABLE

Notes payable at September 30, 2000 and 1999 consisted of the following (in thousands):

	2000	1999
	-----	-----
Note payable to North Carolina Biotechnology Center, including accrued interest at 8.75%, principal and interest due in December 2000.....	\$ 27	\$ 25
Note payable to minority stockholder of Renaissance, including accrued interest at 5.79%.....	--	29
Note payable to a financial institution, including accrued interest at 13.4%.....	--	297
Note payable to IRL facility landlord, including accrued interest at 11.5%.....	--	428
	-----	-----
Notes payable, including current maturities.....	27	779
Less: current maturities.....	(27)	(197)
	-----	-----
Long-term notes payable.....	\$ --	\$ 582
	=====	=====

#### G. STOCKHOLDERS' EQUITY

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**Preferred Stock:** The Certificate of Incorporation of Incara authorizes the issuance of up to 3,000,000 shares of Preferred Stock, at a par value of \$.01 per share. The Board of Directors has the authority to issue Preferred Stock in one or more series, to fix the designation and number of shares of each such series, and to determine or change the designation, relative rights, preferences, and limitations of any series of Preferred Stock, without any further vote or action by the stockholders of the Company. No shares of Preferred Stock were outstanding at September 30, 2000 and 1999.

**Common Stock:** In May 1998, Incara issued 494,823 shares of common stock as the first installment of the Transcell Merger (see Note J). In lieu of the second installment payment due to Interneuron, Interneuron retained 281,703 shares of Incara common stock as part of the Restructuring (see Note I). On August 9, 1999, Incara issued 867,583 shares of Incara common stock, valued at approximately \$1.38 per share, to the other former Transcell stockholders as payment for their second installment of the Transcell Merger in the principal amount of \$1,202,000. Incara issued the third and final installment of the purchase price of 856,861 shares of Incara common stock, valued at approximately \$3.36 per share, to the former stockholders of Transcell on February 8, 2000. The issuance of these additional shares did not impact the Company's operating results, because the value of these shares was included in the determination of the purchase price of Transcell in fiscal 1998.

In January and February 2000, Incara repurchased 104,100 shares of its common stock at a cost of \$331,000 through purchases on the stock market. In July 2000, Incara purchased from each of Lola M. Reid, Ph.D. and James D. Crapo, M.D., both of whom are consultants to Incara, 18,000 shares of Incara's common stock at a per share price of \$2.25, the closing price as listed on Nasdaq on July 26, 2000. The shares repurchased had been issued to Drs. Reid and Crapo in the acquisitions of Renaissance and Aeolus on March 31, 2000.

F-11

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

**Restricted Stock:** As an integral component of a management and employee retention program designed to motivate, retain and provide incentive to the Company's management, employees and key consultants, the Company's Board of Directors adopted the 1999 Equity Incentive Plan (the "1999 Plan") in September 1999. The 1999 Plan provides for the grant of restricted stock ("Restricted Stock") awards which entitle employees and consultants to receive up to an aggregate of 1,400,000 shares of common stock upon satisfaction of specified vesting periods. During September 1999, an aggregate of 1,209,912 shares of Restricted Stock were granted to employees and key consultants of the Company (the "Participants") in consideration of services rendered by the Participants to the Company, the cancellation of options for an equal number of shares of common stock and payment of the par value of the shares. A total of 520,600 shares of Restricted Stock were unvested at September 30, 2000. These remaining shares of Restricted Stock vest in equal quarterly installments through October 2002.

The Company has incurred and will continue to incur compensation expense through the vesting period of the Restricted Stock. The value of the Restricted Stock awards of 1,209,912 shares at the date of the grant totaled \$755,000, based on the trading price of the Company's common stock of \$0.625 per share. The value of the Restricted Stock is amortized on a straight-line basis over the vesting period. The Company recognized \$424,000 and \$11,000 of expenses related to these awards during fiscal 2000 and 1999, respectively.

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Employee Stock Purchase Plan: In October 1995, Incara adopted the Employee Stock Purchase Plan (the "ESPP"). In April 2000, the stockholders approved an amendment to increase the common stock reserved for issuance under the ESPP to 400,000 shares. Offerings are for one-year periods beginning on October 1 of each year (an "Offering") and are divided into two six-month Purchase Periods (the "Purchase Periods"). Employees may contribute up to ten percent (10%) of gross wages, with certain limitations, via payroll deduction, to the ESPP. Common stock is purchased at the end of each Purchase Period with employee contributions at the lower of 85% of the closing price of Incara's common stock on the first day of an Offering or the last day of the related Purchase Period. As of September 30, 2000, Incara had sold 319,072 shares of common stock pursuant to the ESPP and 80,928 shares were reserved for future issuances.

Stock Option Plan: Under Incara's 1994 Stock Option Plan (the "1994 Plan"), incentive stock options ("ISOs") or non-qualified stock options to purchase 2,500,000 shares of Incara's common stock may be granted to employees, directors and consultants of the Company. The exercise price of the ISOs granted under the 1994 Plan must not be less than the fair market value of the common stock as determined on the date of the grant. The options may have a term up to 10 years. Options typically vest over three to four years following the date of the grant.

F-12

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Stock option activity under the 1994 Plan was as follows:

	Shares	Weighted Average Exercise Price
	-----	-----
Outstanding at September 30, 1997.....	1,416,710	\$ 9.89
Granted.....	1,901,886	\$ 9.61
Exercised.....	(15,629)	\$ 3.77
Cancelled.....	(1,032,835)	\$19.18
	-----	
Outstanding at September 30, 1998.....	2,270,132	\$ 5.47
Granted.....	95,500	\$ 5.66
Exercised.....	(21,851)	\$ 2.45
Cancelled.....	(1,359,220)	\$ 7.53
	-----	
Outstanding at September 30, 1999.....	984,561	\$ 2.70
Granted.....	781,540	\$ 3.93
Exercised.....	(140,000)	\$ 0.36
Cancelled.....	(288,941)	\$ 5.57
	-----	
Outstanding at September 30, 2000.....	1,337,160	\$ 3.05
	=====	

In August 1998, Incara's Board of Directors approved a resolution whereby current employees and consultants were granted the right to amend the terms of

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stock options with an exercise price greater than \$11.00 per share. The amended options reduced the exercise price to \$8.00 per share, which was the trading value of Incara's stock on the date of the repricing, and extended the vesting period of the stock options.

The details of stock options outstanding at September 30, 2000 were as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at September 30, 2000	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Number Exercisable at September 30, 2000	Weighted Average Exercise Price
\$0.04	17,029	\$ 0.04	6.1 years	--	--
\$0.36	283,048	\$ 0.36	4.4 years	283,048	\$ 0.36
\$0.60 - \$0.81	90,500	\$ 0.63	5.7 years	83,832	\$ 0.63
\$1.00	162,809	\$ 1.00	4.9 years	162,809	\$ 1.00
\$1.75 - \$2.00	141,855	\$ 1.88	9.5 years	66,855	\$ 1.75
\$2.37 - \$5.09	106,517	\$ 3.38	9.4 years	17,571	\$ 4.39
\$5.12	458,000	\$ 5.12	9.5 years	426,998	\$ 5.12
\$7.12 - \$8.00	50,026	\$ 7.62	7.7 years	42,497	\$ 7.64
\$11.03 - \$20.50	27,376	\$14.42	5.6 years	27,376	\$14.42
	1,337,160	\$ 3.05	7.4 years	1,110,986	\$ 3.08

Under the principles of APB No. 25, the Company does not recognize compensation expense associated with the grant of stock options to employees unless an option is granted with an exercise price at less than fair market value. SFAS 123 requires the use of option valuation models to recognize as expense stock option grants to consultants and to provide supplemental information regarding options granted to employees after September 30, 1995.

F-13

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

The Company's pro forma information utilizing the Black-Scholes option valuation model for the fiscal years ended September 30, 2000, 1999 and 1998 is as follows:

	2000	1999	1998
Net loss (in thousands):			
As reported.....	\$6,665	\$19,598	\$19,146
Pro forma.....	\$6,965	\$20,889	\$22,353
Basic and diluted net loss per share:			
As reported.....	\$ 1.21	\$ 2.98	\$ 2.69

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Pro forma..... \$ 1.26 \$ 3.17 \$ 3.14

Pro forma information regarding net loss was determined as if the Company had accounted for its employee stock options and shares sold under the ESPP under the fair value method of SFAS 123. The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option valuation model with the following weighted-average assumptions used for grants:

	2000	1999	1998
Dividend yield.....	0%	0%	0%
Expected volatility.....	133%	85%	70%
Risk-free interest rate.....	6.0% - 6.3%	4.8% - 5.3%	5.3% - 5.6%
Expected option life after shares are vested.....	2 years	3 years	2 years

For the fiscal years ended September 30, 2000, 1999 and 1998, all stock options issued were either issued at fair market value or were replacement stock options issued pursuant to the Transcell Merger. During fiscal 1998, Transcell granted stock options to consultants with an exercise price below fair market value on the date of the grant.

Warrants: In May 1998, Incara issued replacement stock warrants to purchase 17,783 shares of Incara common stock at an exercise price of \$13.49 in connection with the Transcell Merger. As of September 30, 2000, warrants to purchase 66,816 shares were outstanding, 49,033 of which are exercisable at an exercise price of \$8.25 per share until February 2001, and 17,783 of which are exercisable at an exercise price of \$13.49 per share until May 2003.

### H. INCOME TAXES

As of September 30, 2000 and 1999, the Company had federal net operating loss carryforwards of \$57,359,000 and \$56,375,000, respectively, and state operating loss carryforwards of \$18,493,000 and \$17,509,000, respectively. The use of these federal net operating loss carryforwards might be subject to limitation under the rules regarding a change in stock ownership as determined by the Internal Revenue Code. The federal net operating losses will begin to expire in 2010. The state net operating losses will begin to expire in 2001.

F-14

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Significant components of the Company's deferred tax assets at September 30, 2000 and 1999 consisted of the following (in thousands):

	2000	1999
Net operating loss carryforwards.....	\$ 20,448	\$ 20,063
AMT credit carryforwards.....	37	37

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Research and development credit carryforwards.....	1,195	1,195
Accrued payroll related liabilities.....	1,204	1,521
Charitable contribution carryforwards.....	637	441
Other.....	495	533
	-----	-----
Total deferred tax assets.....	24,016	23,790
Valuation allowance for deferred assets.....	(24,016)	(23,790)
	-----	-----
Net deferred tax asset.....	\$ --	\$ --
	=====	=====

Due to the uncertainty surrounding the realization of the favorable tax attributes in future tax returns, all of the deferred tax assets have been fully offset by a valuation allowance. The change in the valuation allowance is primarily a result of the net operating loss carryforwards.

Taxes computed at the statutory federal income tax rate of 34% are reconciled to the provision for income taxes as follows (dollars in thousands):

	2000	1999	1998
	-----	-----	-----
Effective tax rate.....	0%	0%	0%
	=====	=====	=====
United States Federal statutory rate.....	\$ (2,266)	\$ (6,663)	\$ (6,510)
State taxes (net of federal benefit).....	1	(273)	853
Change in valuation reserves.....	226	4,909	4,394
Gain on sale of subsidiary.....	--	2,371	--
Pipeline research and development.....	2,273	--	1,464
Other.....	(234)	(344)	(201)
	-----	-----	-----
Provision for income taxes.....	\$ --	\$ --	\$ --
	=====	=====	=====

I. BUCINDOLOL TRANSACTIONS

In September 1994, Incara acquired 80.0% of the outstanding stock of CPEC. CPEC held the exclusive, worldwide license from Bristol-Myers Squibb Company to develop bucindolol for congestive heart failure and left ventricular dysfunction.

In December 1995, the Company entered into a collaboration with Astra Merck Inc. ("Astra Merck") for the development of bucindolol in the United States (the "Astra Merck Collaboration"). During the fiscal year ended September 30, 1998, the Company recognized contract revenue of \$834,000 from payments made by Astra Merck to the Company, exclusive of a termination fee of \$4,000,000 received in September 1998 discussed below. During the fiscal year ended September 30, 1998, Astra Merck funded \$6,065,000 of the Company's research and development expenses. These additional amounts did not flow through the Company's statements of operations, because they were offset against related expenses. Pursuant to the terms of the Astra Merck Collaboration, the Company paid Astra Merck \$10,000,000 in December 1997, which had been accrued as a liability at September 30, 1997. In July 1998, Astra Merck's business was restructured to combine it with Astra AB's wholly-owned subsidiary, Astra USA Inc., in a new limited partnership in which Astra AB had

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## INCARA PHARMACEUTICALS CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

management control as the general partner. The new company, Astra Pharmaceuticals, had an expanded product line that included a beta-blocker (metoprolol succinate). Because metoprolol and bucindolol were both beta-blockers being investigated for heart failure, Astra Pharmaceuticals and the Company agreed in September 1998 to terminate the Astra Merck Collaboration. Pursuant to the Termination and Settlement Agreement, Astra Pharmaceuticals returned to the Company all rights, material and information relating to bucindolol and paid it a termination fee in the amount of \$4,000,000. This payment was immediately recognized as contract and license fee revenue because the Company had no ongoing obligations.

In December 1996, the Company entered into the Knoll Collaboration with Knoll to develop bucindolol for the Knoll Territory. Knoll and the Company had agreed to share the development costs of bucindolol for the Knoll Territory. In general, Knoll was to pay approximately 60% of certain development and marketing costs and the Company was to pay approximately 40% of such costs, subject to certain maximum dollar limitations. The Company recognized contract and license fee revenue from the Knoll Collaboration of \$26,000 and \$149,000 for the fiscal years ended September 30, 1999 and 1998, respectively.

On July 15, 1999, Incara restructured its corporate relationship with Interneuron to reduce Interneuron's majority ownership of Incara in exchange for an increased ownership by Interneuron of CPEC. Prior to the Restructuring, CPEC was owned 80.1% by Incara and 19.9% by Interneuron. As a preliminary step in the Restructuring, Incara acquired Interneuron's 19.9% interest in CPEC. Incara redeemed 4,229,381 of the 4,511,084 shares of Incara Common stock owned by Interneuron, in exchange for a 65.0% ownership of CPEC and cancellation of liabilities owed to Interneuron by Incara and CPEC which totalled \$2,421,000. This cancellation was treated as a contribution to capital by Interneuron to Incara. The Company's net investment in CPEC of \$332,000 at September 30, 2000 is included in Prepaids and other current assets in the accompanying consolidated balance sheet. The Company's share of CPEC's net operating expenses since the date of the Restructuring are included in research and development expenses in the accompanying consolidated statements of operations.

Before the Restructuring, Incara had funded approximately 80.1% of the net worldwide expenses related to bucindolol and Interneuron funded approximately 19.9%, in proportion to their respective ownership interests in CPEC. After the Restructuring, Incara and Interneuron are responsible for funding 35.0% and 65.0%, respectively, of CPEC's expenses related to the development of bucindolol in the United States and Japan (the "CPEC Territory"). As part of the Restructuring, Incara received an exclusive license of CPEC's rights in the Knoll Territory and is responsible for all bucindolol expenses in the Knoll Territory.

On July 29, 1999, the double-blind, placebo-controlled, Phase 3 study of bucindolol known as BEST (Beta-blocker Evaluation of Survival Trial) was terminated earlier than scheduled, based on an interim analysis by the Data and Safety Monitoring Board that treatment with bucindolol did not demonstrate a statistically significant improvement in survival in the patient population as a whole. Based on the information, the Company does not expect to pursue the compound further for this or any other indication. All estimated BEST termination costs were accrued as of September 30, 1999.

On August 3, 1999, Knoll terminated the Knoll Collaboration. Knoll and Incara also terminated the Phase 3 clinical study of bucindolol being conducted in Europe, which was known as BEAT (Bucindolol Evaluation after Acute

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myocardial infarction Trial). All estimated BEAT termination costs were accrued as of September 30, 1999.

F-16

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

##### J. ACQUISITIONS AND DISPOSITION

Renaissance Cell Technologies, Inc. and Aeolus Pharmaceuticals, Inc.

On March 31, 2000, Incara purchased all of the minority interests of Renaissance and Aeolus. Prior to the acquisitions, Incara owned 78.0% of Renaissance and 65.8% of Aeolus. Incara issued 1,220,041 shares of its common stock in exchange for the subsidiaries' minority ownership. The acquisitions have been accounted for using the purchase method of accounting. The total purchase price of \$6,664,000 consisted of 1,220,041 shares of Incara's common stock with a fair value of \$5.46 per share, based on the price of the Company's common stock at the date of acquisition. The total purchase price was allocated to purchased in-process research and development and immediately charged to operations because at the date of the acquisition the in-process research purchased was in preclinical stages, feasibility had not been established and it was deemed to have no alternative future use.

Additionally, Renaissance and Aeolus had no workforce or other tangible fixed assets. Renaissance and Aeolus had incurred approximately \$10,000,000 in research and development costs prior to the acquisition of the minority interests by Incara. Incara expects that it will take until at least 2006 to complete development of all aspects of the research and that Renaissance and Aeolus will need to spend in excess of an additional \$50,000,000 to do so.

Transcell Technologies, Inc.

In May 1998, Incara acquired all of the outstanding stock of Transcell in a merger of Transcell with and into Incara, and also acquired related technology rights held by Interneuron in exchange for Incara common stock with an aggregate market value of \$14,200,000. In addition, Incara issued replacement stock options and warrants to purchase 241,705 shares and 17,783 shares, respectively, of Incara common stock to Transcell employees, consultants and warrant holders, with a total estimated value of \$1,507,000. Prior to the Transcell Merger, Incara and Transcell were both majority-owned subsidiaries of Interneuron. Under the terms of the Agreement and Plan of Merger between Incara, Transcell and Interneuron dated March 2, 1998, Transcell stockholders received Incara common stock in three installments. The first installment of 320,151 shares was issued upon closing the transaction on May 8, 1998 (the "Closing"). In exchange for certain license and technology rights held by Interneuron, and for Interneuron's continuing guarantee of certain of Transcell's lease obligations, Incara issued to Interneuron 174,672 shares of Incara common stock at Closing with a value of \$3,000,000 at the date of issuance and will pay Interneuron a royalty on net sales of certain products that may result from the Merck Collaboration. In lieu of the second installment payment due to Interneuron, Interneuron retained 281,703 shares of Incara common stock as part of the Restructuring. On August 9, 1999, Incara issued 867,583 shares of Incara common stock, valued at approximately \$1.38 per share, to the other former Transcell stockholders as payment for their second installment of the Transcell Merger in the principal amount of \$1,202,000. On February 8, 2000, Incara issued 856,861 shares of Incara common stock, valued at approximately \$3.36 per share, to Interneuron and the other former Transcell

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stockholders as payment for the third and final installment. The acquisition of Interneuron's 77.9% ownership interest in Transcell by Incara was treated in a manner similar to a "pooling-of-interests", because it represented a transfer of stock between entities under common control. The acquisition of the non-Interneuron ownership interest was accounted for using the "purchase" method of accounting. The Company incurred a charge to operations of \$5,343,000 in fiscal 1998 for the purchase of the non-Interneuron interest in Transcell, because feasibility of the in-process research and development was not yet established and the technology had no alternative future use at the date of the acquisition. All of Transcell's prior results of operations were combined with the results of operations of the Company, because Transcell's minority interest owners had no responsibility to fund their share of the losses of Transcell.

F-17

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

On December 29, 1999, the Company sold the former Transcell operation, known as IRL, to a private pharmaceutical company for \$11,000,000 in cash and the right to receive up to an additional \$4,000,000 if a compound originating from the Merck Collaboration reaches preclinical and clinical trial milestones. The Company currently does not expect to receive any additional payments from the purchaser. The transaction involved the sale of assets associated with IRL, including rights under the Merck Collaboration and the assumption of related liabilities by the purchaser. The Company recognized a gain of \$9,751,000 on the sale of IRL. The Company remains contingently liable through May 2007 on debt and lease obligations of approximately \$8,328,000 assumed by the purchaser, including the IRL facility lease in Cranbury, New Jersey.

#### K. AGREEMENTS

##### UNC License

Renaissance has a sponsored research agreement (the "UNC Agreement") with the University of North Carolina at Chapel Hill ("UNC") which covers research at UNC by scientists in the area of hepatic stem cells and which grants Renaissance a first option to obtain an exclusive license to inventions resulting from the agreement with UNC. Renaissance has agreed to reimburse UNC for certain costs incurred in connection with the research, of which \$338,000 remained to be paid as of September 30, 2000. In August 1999, Renaissance obtained an exclusive worldwide license (the "UNC License") from UNC to make, use and sell products using proprietary information and technology developed under the UNC Agreement. Renaissance paid license fees of \$75,000 to UNC and will also pay milestones on certain development events and royalties on net sales. Renaissance is also obligated to pay patent filing, prosecution, maintenance and defense costs. Unless terminated earlier, the UNC License continues until the last underlying patent expires.

##### Opocrin License

In July 1998, Incara licensed a development compound ("OP2000") from Opocrin S.p.A., of Modena, Italy ("Opocrin"). Incara is investigating the use of OP2000 as a drug for the treatment of inflammatory bowel disease. The license is worldwide except for Japan and Korea. During fiscal 1998, Incara made a \$1,000,000 license fee payment to Opocrin, which was expensed by the Company because the compound was in the early clinical stage of development. Incara is responsible for conducting clinical trials for OP2000 and is required to make additional milestone payments to Opocrin upon initiation of Phase 3 clinical

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trials, upon filing for regulatory approval, upon obtaining regulatory approval and upon achieving specified annual sales.

### Merck Collaboration

In July 1997, Transcell and Interneuron entered into the Merck Collaboration to discover and commercialize certain novel antibacterial agents. The agreement provided for Merck to make initial payments totaling \$2,500,000 which included a non-refundable commitment fee of \$1,500,000 and a non-refundable option payment of \$1,000,000 plus research support during the first two years of the agreement. Based upon estimated relative value of such licenses and rights, the commitment fee and option payment was shared two-thirds by the Company and one-third by Interneuron. The Company's share of revenue in conjunction with this agreement was \$100,000, \$2,063,000 and \$1,138,000 for the fiscal years ended September 30, 2000, 1999 and 1998, respectively, including a \$1,500,000 milestone payment received from Merck in August 1999. In conjunction with the sale of IRL, the Company has transferred its rights and obligations under the Merck Collaboration and its licenses with Princeton University to the purchaser.

F-18

### INCARA PHARMACEUTICALS CORPORATION

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

#### Duke Licenses

Aeolus has obtained exclusive worldwide licenses (the "Duke Licenses") from Duke University ("Duke") to develop, make, have made, use and sell products using certain technology in the field of free radical and antioxidant research, developed by certain scientists at Duke. Future discoveries in the field of antioxidant research from these scientists' laboratories at Duke are also covered by the Duke Licenses. The Duke Licenses require Aeolus to use its best efforts to pursue development of products using the licensed technology and compounds. These efforts are to include the manufacture or production of products for testing, development and sale. Aeolus is also obligated to use its best efforts to have the licensed technology cleared for marketing in the United States by the U.S. Food and Drug Administration and in other countries in which Aeolus intends to sell products using the licensed technology. Aeolus will pay royalties to Duke on net product sales during the term of the Duke Licenses, and milestone payments upon certain regulatory approvals and annual sales levels. In addition, Aeolus is obligated under the Duke Licenses to pay all or a portion of patent prosecution, maintenance and defense costs. Unless earlier terminated, the Duke Licenses continue until the expiration of the last to expire issued patent on the licensed technology.

#### National Jewish Medical and Research Center Agreement

Aeolus has a sponsored research agreement with National Jewish Medical and Research Center ("NJRC") which grants Aeolus an option to negotiate a royalty-bearing exclusive license for certain technology, patents and inventions resulting from research by certain individuals at NJRC within the field of antioxidant, nitrosylating and related areas. Aeolus has agreed to support certain of NJRC's costs incurred in performance of the research, of which \$75,000 remained to be paid as of September 30, 2000.

#### L. EQUITY FINANCING

In August 2000, Incara entered into a definitive agreement with Torneaux

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Fund Ltd. ("Torneaux"), an institutional investor, for an equity financing facility covering the purchase of Incara's common stock over 15 months. Under this facility, Incara will control the amount and timing of stock sold to Torneaux, with the amount of the investment being dependent, in part, on Incara's stock price. Assuming Incara's stock price maintains a minimum threshold, the cumulative potential investment is anticipated to exceed \$3,000,000 and is capped at \$18,900,000. The agreement includes the issuance of warrants to purchase an amount of common stock equal to 15% of the common stock shares purchased and is subject to a number of conditions. Incara's stockholders approved this financing transaction in October 2000.

### M. REVISION OF LOSS PER SHARE

In July 2001, the Company determined its earnings per share calculation required revision as the Company had included certain restricted common shares in the earnings per share calculation which shares should only be considered in calculating earnings per share during periods in which the Company had income. As a result the basic and diluted loss per share for the fiscal year ended September 30, 2000 as reported was \$1.06 and as revised was \$1.21.

F-19

### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report on Form 10-K/A Amendment No. 1 to be signed on its behalf by the undersigned, thereunto duly authorized.

Incara Pharmaceuticals Corporation

/s/ Richard W. Reichow

By: \_\_\_\_\_  
Executive Vice President and  
Chief Financial Officer

Date: July 30, 2001