

Anthera Pharmaceuticals Inc  
Form 10-Q  
November 12, 2010

**Table of Contents**

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

**Form 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2010**

**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: 001-34637**

**Anthera Pharmaceuticals, Inc.**

*(Exact Name of Registrant as Specified in Its Charter)*

**Delaware**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**20-1852016**

*(I.R.S. Employer  
Identification No.)*

**25801 Industrial Boulevard, Suite B  
Hayward, California**

*(Address of Principal Executive Offices)*

**94545**

*(Zip Code)*

**(510) 856-5600**

*(Registrant's Telephone Number, Including Area Code)*

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

Indicate by check mark whether the registrant 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. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒  
(Do not check if a smaller  
reporting company)

Smaller reporting  
company ☐

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

As of November 10, 2010, the number of outstanding shares of the registrant's common stock, par value \$0.001 per share, was 32,835,437.



**ANTHERA PHARMACEUTICALS, INC.**  
**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2010**  
**INDEX**

	<b>Page</b>
<b><u>Part I Financial Information</u></b>	
<u>Item 1. Financial Statements (unaudited)</u>	
Condensed Balance Sheets as of September 30, 2010 and December 31, 2009	3
Condensed Statements of Operations for the Three and Nine Months Ended September 30, 2010 and 2009 and for the period from September 9, 2004 (Date of Inception) to September 30, 2010	4
Condensed Statement of Stockholders' Equity (Deficit) and Comprehensive Loss for the period from December 31, 2009 to September 30, 2010	5
Condensed Statements of Cash Flows for the Nine Months Ended September 30, 2010 and 2009 and cumulative period from September 9, 2004 (Date of Inception) to September 30, 2010	6
Notes to Condensed Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Item 3. Quantitative and Qualitative Disclosures About Market Risk	28
Item 4T. Controls and Procedures	28
<b><u>Part II Other Information</u></b>	
Item 1. Legal Proceedings	29
Item 1A. Risk Factors	29
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	47
Item 3. Defaults Upon Senior Securities	47
Item 4. (Removed and Reserved)	47
Item 5. Other Information	47
Item 6. Exhibits	48
Signatures	49
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ANTHERA PHARMACEUTICALS, INC****(A Development Stage Company)****CONDENSED BALANCE SHEETS****(unaudited)**

	<b>September 30, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 51,208,720	\$ 3,803,384
Short term investments	21,878,890	
Prepaid expenses and other current assets	1,813,482	19,825
Total current assets	74,901,092	3,823,209
Property and equipment net	22,113	12,994
Deferred financing cost		1,922,183
Other assets		130,403
<b>TOTAL</b>	<b>\$ 74,923,205</b>	<b>\$ 5,888,789</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 2,798,085	\$ 3,145,706
Accrued clinical study	967,917	565,034
Accrued liabilities	497,785	767,663
Accrued payroll and related costs	573,920	153,235
Warrant and derivative liabilities		406,130
Convertible promissory notes		13,129,877
Total current liabilities	4,837,707	18,167,645
Total liabilities	4,837,707	18,167,645
Commitments and Contingencies (Note 9)		
Stockholders equity (deficit)		
Preferred stock, \$0.001 par value, 5,000,000 and 11,948,557 shares authorized, 0 and 8,146,308 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively; (aggregate liquidation value of \$0 and \$52,597,692 as of September 30, 2010 and December 31, 2009, respectively)		8,146
Common stock, \$0.001 par value, 95,000,000 and 18,443,341 shares authorized; 32,796,690 and 1,566,199 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively	32,796	1,566
Additional paid-in capital	162,494,362	52,941,384
Accumulated comprehensive income	161,987	
Deficit accumulated the during the development stage	(92,603,647)	(65,229,952)

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Total stockholders' equity (deficit)	70,085,498	(12,278,856)
TOTAL	\$ 74,923,205	\$ 5,888,789

See accompanying notes to condensed financial statements.

3

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Table of Contents

**ANTHERA PHARMACEUTICALS, INC.**  
**(A Development Stage Company)**  
**CONDENSED STATEMENTS OF OPERATIONS**  
**(unaudited)**

	Three months ended		Nine months ended		Cumulative Period from September 9, 2004 (Date of Inception) to September 30, 2010
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009	
OPERATING EXPENSES:					
Research and development	\$ 6,885,125	\$ 2,525,948	\$ 18,565,088	\$ 7,727,129	\$ 69,889,069
General and administrative	1,510,021	884,908	4,244,000	2,730,482	14,161,567
Total operating expenses	8,395,146	3,410,856	22,809,088	10,457,611	84,050,636
LOSS FROM OPERATIONS	(8,395,146)	(3,410,856)	(22,809,088)	(10,457,611)	(84,050,636)
OTHER EXPENSE:					
Interest and other income	61,606		76,562	21,559	1,096,322
Interest and other expense		(193,556)	(4,641,169)	(289,776)	(5,340,789)
Beneficial conversion features					(4,308,544)
Total other income (expense)	61,606	(193,556)	(4,564,607)	(268,217)	(8,553,011)
NET LOSS	\$ (8,333,540)	\$ (3,604,412)	\$ (27,373,695)	\$ (10,725,828)	\$ (92,603,647)
Net loss per share basic and diluted	\$ (0.36)	\$ (2.37)	\$ (1.40)	\$ (7.16)	
Weighted-average number of shares used in per share calculation basic and diluted	22,964,279	1,520,875	19,567,058	1,498,108	

See accompanying notes to condensed financial statements.

**Table of Contents**

**Anthera Pharmaceuticals, Inc.**  
**(A Development Stage Company)**  
**STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE LOSS**  
**(unaudited)**

	<b>Convertible</b>		<b>Common Stock</b>		<b>Additional</b>	<b>Accumulated</b>	<b>Deficit</b>	<b>Total</b>
	<b>Preferred Stock</b>	<b>Shares</b>	<b>Shares</b>	<b>Amount</b>	<b>Paid-In</b>	<b>Other</b>	<b>During</b>	<b>Stockholders</b>
	<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>	<b>Capital</b>	<b>Comprehensive</b>	<b>Development</b>	<b>Equity</b>
						<b>Loss</b>	<b>Stage</b>	<b>(Deficit)</b>
BALANCE December 31, 2009	8,146,308	\$ 8,146	1,566,199	\$ 1,566	\$ 52,941,384	\$	\$ (65,229,952)	\$ (12,278,856)
Conversion of convertible preferred stock to common stock at a ratio of 1:1	(8,146,308)	(8,146)	8,146,308	8,146				
Issuance of common stock for cash at \$7.00 per share net of issuance cost of \$3,021,966			6,000,000	6,000	37,075,034			37,081,034
Issuance of common stock upon conversion of convertible promissory notes and accrued interest at \$5.25 and \$6.28 per share			2,511,235	2,511	13,880,601			13,883,112
Issuance of common stock upon release of escrow funds			2,598,780	2,599	17,097,373			17,099,972
Issuance of common stock upon cashless exercise of warrants			194,474	194	218			412
Issuance of common stock to collaborator in lieu of milestone payment			531,914	532	3,499,468			3,500,000
Issuance of common stock upon exercise of overallotment by underwriters net of issuance cost of \$17,291			604,492	605	3,959,662			3,960,267
Issuance of common stock upon exercise of stock options			118,878	119	89,066			89,185
Issuance of common stock upon private placement transaction, net of issuance cost of \$468,964			10,500,000	10,500	23,806,591			23,817,091
					5,323,944			5,323,944



Issuance of warrants in conjunction with private placement transaction							
Net change of early exercise of stock options and liability	24,410	24	(5,336)				(5,312)
Reclass of warrant and derivative liability to equity in conjunction with conversion of convertible promissory notes into common stock			4,473,491				4,473,491
Stock-based compensation expense related to consultant options			8,399				8,399
Stock-based compensation expense related to employee options			344,467				344,467
Change in other comprehensive loss unrealized gain on investments and foreign currency translation				161,987			161,987
Net loss				(27,373,695)			(27,373,695)
Comprehensive loss							(27,211,708)
BALANCE September 30, 2010	32,796,690	\$ 32,796	\$ 162,494,362	\$ 161,987	\$ (92,603,647)	\$	70,085,498

See accompanying notes to financial statements.

**Table of Contents**

**ANTHERA PHARMACEUTICALS, INC.**  
**(A Development Stage Company)**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**(unaudited)**

	<b>Nine Months Ended September 30,</b>		<b>September 9, 2004 (Date of Inception)</b>
	<b>2010</b>	<b>2009</b>	<b>to September 30, 2010</b>
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>			
Net loss	\$ (27,373,695)	\$ (10,725,828)	\$ (92,603,647)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	12,453	14,599	84,780
Amortization of discount on short-term investments			(130,248)
Realized loss on short-term investments		1,160	8,682
Realized gain from disposal of property and equipment			(214)
Stock-based compensation expense employees	344,467	203,215	821,346
Stock-based compensation expense consultants	8,399	2,889	166,344
Issuance of common stock for consulting service			41,366
Issuance of common and preferred stock for service and license fee	3,500,000		5,750,000
Issuance of common and preferred stock in lieu of interest payment	173,194		640,493
Beneficial conversion feature			4,308,544
Amortization of debt issuance cost and discount on convertible promissory notes	768,948	39,266	985,314
Mark to market adjustment on warrant and derivative liability	3,796,491		3,795,776
Changes in assets and liabilities:			
Prepaid expenses and other assets	(1,793,658)	29,812	(1,813,484)
Accounts payable	1,413,408	125,931	2,798,084
Accrued clinical study	402,883	109,007	967,917
Accrued liabilities	(248,095)	348,720	174,179
Accrued payroll and related costs	420,685	29,020	573,920
License fee payable		(500,000)	
Net cash used in operating activities	(18,574,520)	(10,322,209)	(73,430,848)
<b>INVESTING ACTIVITIES:</b>			
Property and equipment purchases	(21,572)	(3,853)	(107,079)
Proceeds from disposal of property and equipment			400
Purchase of short-term investments	(22,458,692)		(37,259,256)
Proceeds from sale of short-term investments	747,000		15,669,132
Net cash provided by (used in) investing activities	(21,733,264)	(3,853)	(21,696,803)

## FINANCING ACTIVITIES:

Proceeds from issuance of convertible notes		10,000,000	26,560,000
Payment of debt issuance cost	(210,282)		(307,599)
Net proceeds from issuance of preferred stock			32,210,278
Payment of financing cost for initial public offering and private offering	(2,949,473)		(3,223,357)
Proceeds from issuance of common stock	90,788,900		90,789,015
Proceeds from exercise of stock options	89,185	15,213	313,244
Net cash provided by financing activities	87,718,330	10,015,213	146,341,581
Effect of exchange rate changes on cash and cash equivalents	(5,210)		(5,210)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	47,405,336	(310,849)	51,208,720
CASH AND CASH EQUIVALENTS Beginning of period	3,803,384	7,895,113	
CASH AND CASH EQUIVALENTS End of period	\$ 51,208,720	\$ 7,584,264	\$ 51,208,720

## SUPPLEMENTAL CASH DISCLOSURES OF CASH FLOW INFORMATION:

Interest paid	\$	\$	\$ 15,229
Taxes paid	\$ 18,972	\$ 2,299	\$ 48,559

## NONCASH INVESTMENT AND FINANCING ACTIVITIES:

Conversion of convertible promissory notes and accrued interest into common stock, Series A-2 convertible preferred stock and Series B-2 convertible preferred stock	\$ 13,883,112	\$	\$ 27,200,493
Beneficial conversion feature	\$	\$	\$ 4,308,544
Unamortized debt discount charged to equity in conjunction with conversion of promissory notes into common stock	\$ 185,883	\$	\$ 185,833
Reclassification of warrant and derivative liabilities to additional paid-in capital	\$ 406,130	\$	\$ 406,130
Reclass of issuance costs charged to equity	\$ 3,508,221	\$	\$ 3,508,221
Accrued and deferred financing costs	\$ 284,864	\$ 837,536	\$ 284,864

See accompanying notes to condensed financial statements.

**Table of Contents**

**ANTHERA PHARMACEUTICALS, INC.  
(A Development Stage Company)  
NOTES TO CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. ORGANIZATION AND DESCRIPTION OF BUSINESS**

Anthera Pharmaceuticals, Inc. (the Company or Anthera) was incorporated on September 9, 2004 in the state of Delaware. During 2006, the Company opened its headquarters in San Mateo, California, and subsequently moved to Hayward, California. Anthera is a biopharmaceutical company focused on developing and commercializing therapeutics to treat serious diseases associated with inflammation, including cardiovascular and autoimmune diseases. Two of the Company's primary product candidates, varespladib and A-001, are inhibitors of the family of human enzymes known as secretory phospholipase A<sub>2</sub>, or sPLA<sub>2</sub>. The Company's other primary product candidate, A-623, targets elevated levels of B-cell activating factor, or BAFF. The Company's activities since inception have consisted principally of acquiring product and technology rights, raising capital, and performing research and development. Accordingly, the Company is considered to be in the development stage as of September 30, 2010, as defined by the Financial Accounting Standard Board (FASB) Accounting Standard Codification (ASC) 915. Successful completion of the Company's development programs and, ultimately, the attainment of profitable operations are dependent on future events, including, among other things, its ability to access potential markets; secure financing; develop a customer base; attract, retain and motivate qualified personnel; and develop strategic alliances. Although management believes that the Company will be able to successfully fund its operations, there can be no assurance that the Company will be able to do so or that the Company will ever operate profitably.

From September 9, 2004 (Date of Inception) through September 30, 2010, the Company accumulated a deficit of \$92.6 million. The Company expects to continue to incur substantial losses over the next several years during its development phase. To fully execute its business plan, the Company will need to complete certain research and development activities and clinical studies. Further, the Company's product candidates will require regulatory approval prior to commercialization. These activities may span many years and require substantial expenditures to complete and may ultimately be unsuccessful. Any delays in completing these activities could adversely impact the Company. The Company plans to meet its capital requirements primarily through issuances of equity securities and, in the longer term, revenue from product sales.

On February 26, 2010, the Company's Registration Statement on Form S-1 was declared effective for its initial public offering (IPO), pursuant to which the Company sold 6,000,000 shares of its common stock at a public offering price of \$7.00 per share. The Company received net proceeds of approximately \$37.1 million from this transaction. Concurrent with the closing of the IPO, the Company received an aggregate of \$17.1 million from the issuance of 2,598,780 shares of its common stock to certain of its investors pursuant to a common stock purchase agreement.

On April 6, 2010, the Company sold 604,492 shares of common stock pursuant to the exercise of the underwriters over-allotment option in connection with the Company's IPO and received net proceeds of approximately \$4.0 million.

On September 24, 2010, the Company closed a private placement transaction with certain accredited investors pursuant to which the Company sold an aggregate of 10,500,000 units at a purchase price of \$3.00 per unit, with each unit consisting of one share of common stock and a warrant to purchase an additional 0.40 shares of common stock. Each warrant is exercisable in whole or in part at any time until September 24, 2015 at a per share exercise price of \$3.30, subject to certain adjustments as specified in the warrant. The Company received net proceeds of approximately \$29.1 million.

**2. BASIS OF PRESENTATION**

The interim condensed financial statements have been prepared and presented by the Company in accordance with accounting principles generally accepted in the United States (GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC), without audit, and reflect all adjustments necessary to present fairly the Company's interim financial information. The accounting principles and methods of computation adopted in these financial statements are the same as those of the audited financial statements for the year ended December 31, 2009.

## **Table of Contents**

Certain information and footnote disclosures normally included in the Company's annual financial statements prepared in accordance with GAAP have been condensed or omitted. The accompanying unaudited financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2009, included in the Company's Registration Statement on Form S-1 (as amended). The financial results for any interim period are not necessarily indicative of financial results for the full year.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### *Unaudited Interim Financial Information*

The accompanying interim condensed balance sheet as of September 30, 2010, the condensed statement of operations and cash flows for the nine months ended September 30, 2009 and 2010, and for the cumulative period from September 9, 2004 (date of inception) to September 30, 2010 and the statements of stockholders' equity (deficit) and comprehensive loss for the nine months ended September 30, 2010 are unaudited. The unaudited interim financial statements have been prepared on the same basis as the audited financial statements. In the opinion of management, the unaudited interim financial statements include all adjustments, consisting of normal recurring adjustments, necessary for the fair presentation of the Company's financial position at September 30, 2010 and the Company's results of operations, cash flows and stockholders' equity (deficit) for the nine months ended September 30, 2009 and 2010 and for the cumulative period from September 9, 2004 (date of inception) to September 30, 2010. The results for the nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the year ending December 31, 2010 or for any future period.

#### *Use of Estimates*

The preparation of the Company's unaudited condensed financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed financial statements and the reported amounts of expenses during the reporting period. Significant estimates include assumptions made in the accrual of clinical costs and stock-based compensation. Actual results could differ from those estimates.

#### *Cash and Cash Equivalents*

The Company considers all highly liquid instruments purchased at date of purchase with an original maturity or remaining maturities of three months or less from the date of purchase to be cash equivalents.

#### *Short-Term Investments*

The Company has designated its investments as available for sale and the investments are carried at fair value. The Company determines the appropriate classification of securities at the time of purchase and reevaluates such classification as of each balance sheet date. Securities with maturity exceeding three months but less than one year are classified as short-term investments. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in the statements of operations. The Company includes any unrealized gains and losses on short-term investments in stockholders' equity as a component of other comprehensive income (loss).

#### *Concentration of Credit Risk*

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and short-term investments. The Company's cash equivalents consist of certificates of deposits with maturities of less than three month and treasury money market funds. The Company's short-term investments consist of certificates of deposits and corporate bonds with maturities exceeding three months but less than one year. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to significant credit risk related to its cash, cash equivalents and short-term investments.

## **Table of Contents**

### *Property and Equipment Net*

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is computed over the estimated useful lives of the respective assets, which range from three to four years, using the straight-line method. Repairs and maintenance costs are expensed as incurred. Leasehold improvements are stated at cost and amortized using the straight-line method over the term of the lease or five years, whichever is shorter.

### *Deferred Financing Cost*

Deferred financing costs included costs directly attributable to the Company's offering of its equity securities. In accordance with FASB ASC 340-10, *Other Assets and Deferred Costs*, these costs are deferred and capitalized as part of other assets. Costs attributable to the equity offerings are charged against the proceeds of the offering once completed.

### *Long-Lived Assets*

The Company's long-lived assets and other assets are reviewed for impairment in accordance with the guidance of the FASB ASC 360-10, *Property, Plant, and Equipment*, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Recoverability of an asset to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Through September 30, 2010, the Company had not experienced impairment losses on its long-lived assets.

### *Fair Value of Financial Instruments*

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Valuation techniques used to measure fair value, as required by Topic 820 of the FASB ASC, must maximize the use of observable inputs and minimize the use of unobservable inputs.

The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value. The Company's assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of the assets and liabilities being measured and their placement within the fair value hierarchy. The three levels of input are:

*Level 1* Quoted prices in active markets for identical assets or liabilities.

*Level 2* Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3* Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following is a description of the Company's valuation methodologies for assets and liabilities measured at fair value.

Where quoted prices are available in an active market, fair value is based upon quoted market prices and are classified in Level 1 of the valuation hierarchy. If quoted market prices are not available, fair value is based upon observable inputs such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data, the assets or liabilities are classified in Level 2 of the valuation hierarchy. When quoted prices and observable inputs are unavailable, fair values are based on internally developed cash flow models and are classified in Level 3 of the valuation hierarchy. The internally developed cash flow models primarily use, as inputs, estimates for interest rates and discount rates including yields of comparable traded instruments adjusted for illiquidity and other risk factors, amount of cash flows and expected holding periods of the assets. These inputs reflect the Company's own assumptions about the assumptions market participants would use in pricing the assets, including assumptions about risk developed based on the best information available in the circumstances. Other

## **Table of Contents**

financial instruments, including accounts payable and accrued liabilities, are carried at cost, which the Company believes approximates fair value because of the short-term maturity of these instruments.

### *Stock-Based Compensation*

Effective January 1, 2006, the Company adopted the provisions of FASB ASC 718, *Compensation – Stock Compensation*, using the modified prospective method. Compensation costs related to all equity instruments granted after January 1, 2006 are recognized at the grant-date fair value of the awards. Additionally, the Company is required to include an estimate of the number of awards that will be forfeited in calculating compensation costs, which are recognized over the requisite service period of the awards on a straight-line basis. The Company estimates the fair value of its share-based payment awards on the date of grant using an option-pricing model.

The Company uses the Black-Scholes option-pricing model as the method for determining the estimated fair value of stock options. The Black-Scholes model requires the use of highly subjective and complex assumptions, which determine the fair value of share-based awards, including the option's expected term and the price volatility of the underlying stock.

*Expected Term* The Company's expected term represents the period that the Company's stock-based awards are expected to be outstanding and is determined using the simplified method.

*Expected Volatility* Expected volatility is estimated using comparable public company volatility for similar terms.

*Expected Dividend* The Black-Scholes valuation model calls for a single expected dividend yield as an input and the Company has never paid dividends and has no plans to pay dividends.

*Risk-Free Interest Rate* The risk-free interest rate used in the Black-Scholes valuation method is based on the U.S. Treasury zero-coupon issues in effect at the time of grant for periods corresponding with the expected term of option.

*Estimated Forfeitures* The estimated forfeiture rate is determined based on the Company's historical forfeiture rates to date. The Company will monitor actual expenses and periodically update the estimate.

Equity instruments issued to nonemployees are recorded at their fair value as determined in accordance with FASB ASC 505-50, *Equity*, and are periodically revalued as the equity instruments vest and are recognized as expense over the related service period.

### *Research and Development*

Research and development expenses consist of personnel costs, including salaries, benefits and stock-based compensation, clinical studies performed by contract research organizations, or CROs, materials and supplies, licenses and fees and overhead allocations consisting of various administrative and facilities related costs. Research and development activities are also separated into three main categories: research, clinical development and pharmaceutical development. Research costs typically consist of preclinical and toxicology costs. Clinical development costs include costs for Phase 1 and 2 clinical studies. Pharmaceutical development costs consist of expenses incurred in connection with product formulation and chemical analysis.

The Company charges research and development costs, including clinical study costs, to expense when incurred, consistent with the guidance of FASB ASC 730, *Research and Development*. Clinical study costs are a significant component of research and development expenses. All of the Company's clinical studies are performed by third-party CROs. The Company accrues costs for clinical studies performed by CROs on a straight-line basis over the service periods specified in the contracts and adjusts the estimates, if required, based upon the Company's ongoing review of the level of effort and costs actually incurred by the CROs. The Company monitors levels of performance under each significant contract, including the extent of patient enrollment and other activities through communications with the CROs, and adjusts the estimates, if required, on a quarterly basis so that clinical expenses reflect the actual effort expended by each CRO.

All material CRO contracts are terminable by the Company upon written notice and the Company is generally only liable for actual effort expended by the CROs and certain noncancelable expenses incurred at any point of termination.

## **Table of Contents**

Amounts paid in advance related to incomplete services will be refunded if a contract is terminated. Some contracts include additional termination payments that become due and payable if the Company terminates the contract. Such additional termination payments are only recorded if a contract is terminated.

### *Income Taxes*

The Company accounts for income taxes in accordance with FASB ASC 740, *Income Taxes*. FASB ASC 740 prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

FASB ASC 740-10 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, measurement and classification of amounts relating to uncertain tax positions, accounting for and disclosure of interest and penalties, accounting in interim periods, disclosures and transition relating to the adoption of the new accounting standard. FASB ASC 740-10 is effective for fiscal years beginning after December 15, 2006. The Company adopted FASB ASC 740-10 as of January 1, 2007, as required, and determined that the adoption of FASB ASC 740-10 did not have a material impact on the Company's financial position and results of operations.

### *Segments*

The Company operates in only one segment. Management uses cash flow as the primary measure to manage its business and does not segment its business for internal reporting or decision-making.

### *Adoption of Accounting Standards*

In June 2008, the FASB issued ASC 815-40, *Derivatives and Hedging*, which provides guidance on how to determine if certain instruments (or embedded features) are considered indexed to a company's own stock, including instruments similar to warrants to purchase the company's stock. FASB ASC 815-40 requires companies to use a two-step approach to evaluate an instrument's contingent exercise provisions and settlement provisions in determining whether the instrument is considered to be indexed to its own stock and therefore exempt from the application of FASB ASC 815. FASB ASC 815-40 became effective January 1, 2009. Any outstanding instrument at the date of adoption requires a retrospective application of the accounting through a cumulative effect adjustment to retained earnings upon adoption. The Company's adoption of this guidance did not have a material impact on either its financial position or results of operations.

In January 2010, the FASB issued guidance that requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. The guidance is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures that are effective for annual periods beginning after December 15, 2010. We do not expect the adoption of this guidance to have a material impact on our unaudited condensed financial statements.

## **4. NET LOSS PER SHARE**

The Company computes net loss per share in accordance with FASB ASC 260, *Earnings Per Share*, under which basic net loss attributable to common stockholders per share is computed by dividing income available to common stockholders (the numerator) by the weighted-average number of common shares outstanding (the denominator) during the period. Shares issued during the period and shares reacquired during the period are weighted for the portion of the period that they were outstanding. The computation of diluted net loss per share is similar to the computation of basic net loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued. In addition, in computing the dilutive effect of convertible securities, the numerator is adjusted to add back any convertible preferred dividends and the after-tax amount of interest recognized in the period associated with any convertible debt. The numerator is also adjusted for any other changes in income or loss that would result from the assumed conversion of those common shares. Diluted net loss per share is identical to basic net loss per share since common equivalent shares are excluded from the calculation, as their effect is anti-dilutive.





**Table of Contents**

The following table summarizes the Company's calculation of net loss per common share (unaudited):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Net loss per share</b>				
Numerator				
Net loss	\$ (8,333,540)	\$ (3,604,412)	\$ (27,373,695)	\$ (10,725,828)
Denominator Weighted-average common shares outstanding	23,009,288	1,625,884	19,619,670	1,619,650
Less: Weighted-average shares subject to repurchase	(45,009)	(105,009)	(52,612)	(121,542)
Denominator for basic and diluted net loss per share	22,964,279	1,520,875	19,567,058	1,498,108
Basic and diluted net loss per share	\$ (0.36)	\$ (2.37)	\$ (1.40)	\$ (7.16)

The following table shows weighted-average historical dilutive common share equivalents outstanding, which are not included in the above historical calculation, as the effect of their inclusion is anti-dilutive during each period (unaudited).

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Options to purchase common stock	965,977	526,797	749,613	526,102
Common stock subject to repurchase	45,009	105,009	52,612	121,542
Warrants to purchase common stock	676,701	194,474	464,828	194,474
Convertible preferred stock		8,146,308		8,146,308
Restricted stock units	273,652		93,220	
Total	1,961,339	8,972,588	1,360,273	8,988,426

**5. CASH EQUIVALENTS AND INVESTMENTS**

The Company's cash equivalents and short-term investments as of September 30, 2010 are as follows (unaudited):

	<b>Amortized Cost</b>	<b>Gross Unrealized Gain/(Losses)</b>	<b>Fair Value</b>
Cash	\$ 625,961	\$	\$ 625,961
Money market funds	50,582,760		50,582,760
Certificates of deposit	12,851,000	(11,276)	12,839,724
Corporate bonds	9,074,163	(34,998)	9,039,165
Total	\$ 73,133,884	\$ (46,274)	\$ 73,087,610
Less amounts classified as cash and cash equivalents	(51,208,720)		(51,208,720)
Total	\$ 21,925,164	\$ (46,274)	\$ 21,878,890

The contractual maturities of investments are less than one year at September 30, 2010. There were no realized gains or losses recorded for the three and nine months ended September 30, 2010, and immaterial realized losses recorded for the nine months ended September 30, 2009.

**6. FAIR VALUE**

As of September 30, 2010, the Company held \$21.9 million in short-term investments, which consisted of certificates of deposit and FDIC insured corporate bonds. These securities were classified as short-term based on their maturity terms being less than one year. Individual securities with a fair value below the cost basis at September 30, 2010 were evaluated to determine if they were other-than-temporarily impaired.

**Table of Contents**

The following table presents the Company's fair value hierarchy for its financial assets measured at fair value on a recurring basis as of September 30, 2010 (unaudited):

	<b>Estimated Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Cash	\$ 625,961	\$ 625,961	\$	\$
Money market funds	50,582,760	50,582,760		
Certificates of deposit	12,839,724	12,839,724		
Corporate bonds	9,039,165	9,039,165		
<b>Total Investments</b>	<b>\$ 73,087,610</b>	<b>\$ 73,087,610</b>	<b>\$</b>	<b>\$</b>

The Company did not have any financial liabilities, non-financial assets or non-financial liabilities that were required to be measured at fair value as of September 30, 2010.

**7. PROPERTY AND EQUIPMENT**

At September, 2010, property and equipment consist of the following (unaudited):

Computers and software	\$ 77,319
Office equipment and furniture	16,730
Leasehold Improvements	10,802
<b>Total property and equipment</b>	<b>104,851</b>
Less accumulated depreciation	(82,738)
<b>Property and equipment, net</b>	<b>\$ 22,113</b>

Depreciation expense for the three and nine months ended September 30, 2010 and 2009, and for the period from September 9, 2004 (Date of Inception) to September 30, 2010, were \$5,244, \$12,453, \$5,054, \$14,599 and \$84,780, respectively.

**8. DEFERRED FINANCING COST**

At December 31, 2009, the Company capitalized and deferred \$1,922,183 of financing cost attributable to the Company's anticipated initial public offering, which were charged against the proceeds upon the closing of the Company's initial public offering in March 2010.

**9. COMMITMENTS AND CONTINGENCIES**

In July 2006, the Company entered into a license agreement with Shionogi & Co., Ltd. and Eli Lilly and Company, or Eli Lilly, to develop and commercialize certain sPLA<sub>2</sub> inhibitors for the treatment of inflammatory diseases. The agreement granted the Company commercialization rights to Shionogi & Co., Ltd.'s and Eli Lilly's sPLA<sub>2</sub> inhibitors, including varespladib and A-001. Under the terms of the agreement, the Company's license is worldwide, with the exception of Japan where Shionogi & Co., Ltd. has retained rights. Pursuant to this license agreement, the Company paid Shionogi & Co., Ltd. and Eli Lilly a one-time license initiation fee of \$250,000 in the aggregate. Additionally, in consideration for the licensed technology, the Company issued an aggregate of 257,744 shares of Series A-2 convertible preferred stock at \$5.14 per share and an aggregate of 127,297 shares of Series B-1 convertible preferred stock at \$7.28 per share with a total aggregate value of \$2.3 million to Shionogi & Co., Ltd. and Eli Lilly. As there is no future alternative use for the technology and in accordance with the guidance of the Research and Development topic of the FASB ASC, the Company recorded the initiation and license fees in research and development expenses during the year ended December 31, 2006. There was no outstanding obligation pursuant to the license agreement in the periods ended December 31, 2009 and September 30, 2010. The Company is obligated to make additional milestone payments upon the achievement of certain development, regulatory and commercial objectives, which

includes a \$1.5 million milestone payment to each party upon the start of a Phase 3 clinical study. The Company amended the milestone payment terms in 2009 with each of Eli Lilly and Shionogi & Co., Ltd. to no later than 12 months from the enrollment of the first patient in a Phase 3 clinical study for varespladib. In consideration for the extension, the milestone payments increased to \$1.75 million to each party.

On January 28, 2010 and February 24, 2010, the Company entered into separate agreements with Eli Lilly and Shionogi & Co., Ltd. in which the parties agreed that the \$1.75 million milestone payment due to each of Eli Lilly and Shionogi & Co., Ltd. no later than 12

## Table of Contents

months from the enrollment of the first patient in a Phase 3 clinical study for varespladib would be paid in the form of shares of the Company's common stock issued at the price per share at which shares are sold to the public in an IPO, minus any per-share underwriting discounts, commissions or fees. Concurrent with the completion of the Company's IPO on March 4, 2010, the Company issued 265,957 shares of common stock to each of Eli Lilly and Shionogi & Co., Ltd.

The Company is also obligated to make additional milestone payments of up to \$5.0 million and pay tiered royalties, which increase as a percentage from the mid-single digits to the low double digits as net sales increase, of up to \$92.5 million on future net sales of products that are developed and approved as defined by this collaboration. The Company's obligation to pay royalties with respect to each licensed product in each country will expire upon the later of (a) 10 years following the date of the first commercial sale of such licensed product in such country and (b) the first date on which generic version(s) of the applicable licensed product achieve a total market share, in the aggregate, of 25% or more of the total unit sales of wholesalers to pharmacies of licensed product and all generic versions combined in the applicable country.

On December 18, 2007, the Company entered into with Amgen, Inc. ( "Amgen" ), a worldwide, exclusive license agreement, or the Amgen Agreement, to develop and commercialize A-623 for the treatment of systemic lupus erythematosus ( "lupus" ). Under the terms of the Amgen Agreement, the Company was required to pay a nonrefundable, upfront license fee of \$6.0 million, payable in two installments with the first installment due within 90 days from the effective date of the Amgen Agreement and the second installment due on the earlier of (i) termination of the Amgen Agreement by the Company or (ii) February 1, 2009. As there is no future alternative use for the technology, the Company expensed the license fee in research and development expenses during the year ended December 31, 2007.

Under the terms of the Amgen Agreement, the Company is obligated to make additional milestone payments to Amgen of up to \$33.0 million upon the achievement of certain development and regulatory milestones. The Company is also obligated to pay tiered royalties on future net sales of products, ranging from the high single digits to the low double digits, that are developed and approved as defined by this collaboration. The Company's royalty obligations as to a particular licensed product will be payable, on a country-by-country and licensed product-by-licensed product basis, for the longer of (a) the date of expiration of the last to expire valid claim within the licensed patents that covers the manufacture, use or sale, offer to sell, or import of such licensed product by the Company or a sublicense in such country or (b) 10 years after the first commercial sale of the applicable licensed product in the applicable country. There were no outstanding obligations due to Amgen as of September 30, 2010 and December 31, 2009.

## **10. CONVERTIBLE PROMISSORY NOTES AND EQUITY FINANCING**

On July 17, 2009 and September 9, 2009, the Company sold (i) convertible promissory notes, or the 2009 notes, that were secured by a first priority security interest in all of the Company's assets, and (ii) warrants, or the 2009 warrants, to purchase shares of the Company's equity securities to certain of its existing investors for an aggregate purchase price of \$10.0 million. These transactions are collectively referred to as the 2009 bridge financing. The 2009 notes accrued interest at a rate of 8% per annum and had a maturity date of the earliest of (i) July 17, 2010, (ii) the date of the sale of all or substantially all of the Company's equity interests or assets or (iii) an event of default pursuant to the terms of the 2009 notes. The 2009 notes and accrued interest were converted into 1,985,575 shares of common stock upon the completion of the Company's IPO on March 4, 2010 at \$5.25 per share, which reflected a 25% discount to the offering price of the Company's common stock.

On September 25, 2009, the Company executed a stock purchase agreement, which was amended to add an additional purchaser on November 3, 2009, with certain existing investors for the sale of shares of the Company's common stock equal to \$20.5 million divided by the price per share at which shares of the Company's common stock are sold to the public in an IPO, minus any per-share underwriting discounts, commissions or fees. Pursuant to the terms of the stock purchase agreement, the investors deposited \$20.5 million into an escrow account for the purchase of the shares. On December 11, 2009, the Company entered into a note purchase agreement and amended the September 2009 stock purchase and escrow agreements. The agreements provided for the release of \$3.4 million of the \$20.5 million, leaving a balance of \$17.1 million in the escrow account. The Company issued convertible promissory notes, or the escrow notes, for the released amount to the investors. The escrow notes accrued interest at a rate of 8% per annum and had a maturity date of the earlier of (i) July 17, 2010 or (ii) an event of default pursuant to

the terms of the escrow notes. The escrow notes and accrued interest were converted into 525,660 shares of common stock upon the closing of the Company's IPO on March 4, 2010. Additionally, the Company issued 2,598,780 shares of common stock to the investors upon the release of the \$17.1 million held in the escrow account at the closing of the IPO.

**Table of Contents****11. STOCKHOLDERS EQUITY****Preferred Stock**

In connection with the completion of the Company's IPO on March 4, 2010, all of the Company's shares of preferred stock outstanding at the time of the offering were converted into 8,146,308 shares of common stock. As of September 30, 2010, no liquidation preference remained. Liquidation preference as of December 31, 2009 was \$52.6 million.

The Company's Fifth Amended and Restated Certificate of Incorporation designated 5,000,000 shares of the Company's capital stock as undesignated preferred stock.

**Common Stock**

The Company is authorized to issued 100,000,000 shares of capital stock, of which 95,000,000 shares are designated as common stock, par value \$0.001 per share. Holders of common stock are entitled to one vote per share on all matters to be voted upon by the stockholders of the Company. Subject to the preferences that may be applicable to any outstanding shares of preferred stock, the holders of common stock are entitled to receive ratably such dividends, if any, as may be declared by the Board of Directors. No dividends have been declared to date.

At September 30, 2010, the Company had reserved the following shares for future issuance (unaudited):

Warrants for purchase of common stock	4,557,136
Common stock options outstanding	1,307,066
Restricted stock units outstanding	333,000
Common stock options available for future grant under stock option plan	24,314
Total	6,221,516

**Reverse Stock Split**

On November 8, 2009, the Company's board of directors approved a 1-for-1.712 reverse split of the Company's common stock that was effected on February 22, 2010. The financial statements give retroactive effect to the reverse split.

**Warrants**

In August 2008, in connection with the issuance of Series B-2 convertible preferred stock, the Company issued 240,516 warrants for the purchase of common stock at \$1.34 per share to two new investors. The warrants expired upon the earliest of (i) seven years from the issuance date, (ii) the closing date of the Company's IPO or (iii) upon consummation by the Company of any consolidation or merger. The Company valued the warrants using the Black-Scholes valuation model with the following assumptions: expected volatility of 72%, risk-free interest rate of 3.46% and expected term of seven years. The fair value of the warrants was calculated to be \$224,478 and recorded as issuance cost and an increase to additional paid-in capital. As of December 31, 2009, 240,516 warrants remain outstanding. Each of the warrants contained a net issuance feature, which allowed the warrant holder to pay the exercise price of the warrant by forfeiting a portion of the exercised warrant shares with a value equal to the aggregate exercise. The warrants were exercised upon the closing of the Company's IPO on March 4, 2010.

In connection with the issuance of the 2009 notes discussed in Note 10, the Company issued warrants to each note holder to purchase shares of its equity securities. Each 2009 warrant is exercisable for the security into which each 2009 note is converted, at the price at which that security is sold to other investors. Depending on when the 2009 notes are converted, each 2009 warrant may be exercisable for a number of shares equal to the quotient obtained by dividing (x) (i) 25% of the principal amount of the accompanying 2009 notes, in the event the conversion occurs prior to April 1, 2010, or (ii) 50% of the principal amount of the accompanying 2009 notes, in the event the conversion occurs on or after April 1, 2010, by (y) the purchase price of the securities into which the note is ultimately converted. The Company accounted for the 2009 warrants in accordance with FASB ASC 480, *Distinguishing Liabilities from Equity*, which requires that a financial instrument, other than outstanding shares, that, at inception, is indexed to an obligation to repurchase the issuer's equity shares, regardless of the timing of the redemption feature, and may require the issuer to settle the obligation by transferring assets, be classified as liability through the completion of the Company's IPO.



The Company measured the fair value of the 2009 warrants using

15

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**Table of Contents**

the Black-Scholes valuation model on issuance date and adjusted the fair value at the end of each reporting period based on the following assumptions:

	<b>March 31, 2010</b>	<b>December 31, 2009</b>	<b>September 30, 2009</b>
Expected Volatility	94%	78%	78%
Dividend Yield	0%	0%	0%
Risk-Free Interest Rate	2.28%	2.34%	2.38%
Expected Term (years)	4.50	5.00	5.00

The Company then applied probability factors to the different possible conversion scenarios and calculated the initial fair value of the 2009 warrants to be \$320,000, which amount was recorded as a discount to the 2009 notes. The discount is amortized as interest expense over the terms of the 2009 notes. The Company re-measured the fair value of the 2009 warrants on December 31, 2009 and recorded the change in fair value in non-operating income. Upon conversion of the 2009 notes into shares of common stock at the completion of the Company's IPO, the fair value of the 2009 warrants was re-measured again by the Company and the aggregate fair value of \$1.5 million was recorded in non-operating expense during the three months ended March 31, 2010. Concurrent with the conversion of the 2009 notes, the Company calculated the number of warrant shares to be 357,136 based on 25% of the principal amount of the accompanying 2009 notes and the IPO price of the Company's common stock of \$7.00 per share. The warrant liability and unamortized discount were reclassified to additional paid-in-capital as a result of the conversion of the 2009 notes.

In connection with the issuance of the escrow notes, which are exchangeable for exchange notes, each exchange note that is issued would be accompanied by a warrant, which is exercisable for the security into which the accompanying exchange note, if any, is converted, at the price at which that security is sold to other investors. Depending on when the exchange notes are converted, each warrant may be exercisable for a number of shares equal to the quotient obtained by dividing (x) (i) 25% of the principal amount of the accompanying exchange notes, in the event the conversion occurs prior to April 1, 2010, or (ii) 50% of the principal amount of the accompanying exchange notes, in the event the conversion occurs on or after April 1, 2010, by (y) the purchase price of the securities into which the exchange note is ultimately converted. The Company accounts for the potential issuance of the warrants in accordance with FASB ASC 480, which requires that a financial instrument, other than outstanding shares, that, at inception, is indexed to an obligation to repurchase the issuer's equity shares, regardless of the timing of the redemption feature, and may require the issuer to settle the obligation by transferring assets, be classified as liability through the completion of the Company's IPO. The Company measured the fair value of its derivative using the Black-Scholes valuation model with the following assumptions: expected volatility of 78%, risk-free interest rate of 2.34% and expected term of five years. The Company then applied probability factors to the different possible exchange and conversion scenarios and calculated the fair value of the warrants to be \$86,845, which amount was recorded as a discount to the escrow notes. The discount is amortized as interest expense over the terms of the escrow notes. The escrow notes were converted into shares of the Company's common stock upon the closing of its IPO. As a result of the conversion taking place prior to the exchange of the escrow notes into exchange notes, the Company's obligation to issue the warrants was eliminated. Consequently, the Company reclassified the unamortized discount into additional paid-in capital and reduced the fair value of the warrant liability to zero.

On September 24, 2010, the Company closed a private placement transaction with certain accredited investors pursuant to which the Company sold an aggregate of 10,500,000 units at a purchase price of \$3.00 per unit, with each unit consisting of one share of common stock and a warrant to purchase an additional 0.40 shares of common stock. Each warrant is exercisable in whole or in part at any time until September 24, 2015 at a per share exercise price of \$3.30, subject to certain adjustments as specified in the warrant. The Company valued the warrant using the Black-Scholes valuation model with the following assumptions: expected volatility of 64%, risk-free interest rate of 1.37% and expected term of five years. The fair value of the warrants was calculated to be \$5,323,944 and recorded as issuance cost and an increase to additional paid-in capital. As of September 30, 2010, 4,200,000 warrants remain

outstanding. Each of the warrants contains a net issuance feature, which allows the warrant holder to pay the exercise price of the warrant by forfeiting a portion of the exercised warrant shares with a value equal to the aggregate exercise.

**Embedded Derivative**

The 2009 notes and the escrow notes discussed in Note 10 contained a contingent automatic redemption feature and a contingent put option that meet the definition of an embedded derivative as defined in the Derivatives and Hedging topic of FASB ASC 815 because these notes contain features with implicit or explicit terms that affect some or all of the cash flows or the value of other exchanges required by a contract in a manner similar to a derivative instrument. As a result, the Company evaluated these embedded derivative features under the guidance of FASB ASC 815 and determined that the embedded derivative features should be separated from the 2009

**Table of Contents**

notes and escrow notes and recognized as derivative instruments. Pursuant to the guidance of FASB ASC 815, if a hybrid instrument contains more than one embedded derivative feature that would individually warrant separate accounting as a derivative instrument, those embedded derivative features shall be bundled together as a single, compound embedded derivative that shall then be bifurcated and accounted for separately from the host contract unless a fair value election is made. Since the Company may not make a fair value election, the contingent automatic redemption and the contingent put option should be bundled together as a single, compound embedded derivative and separated from the 2009 notes and escrow notes. The Company recognized the bundled embedded derivative as a derivative liability with initial and subsequent measurements at fair value and changes in fair value recorded in earnings. Upon conversion of the 2009 notes and escrow notes into shares of common stock at the completion of the Company's IPO, the Company re-measured the fair value of the embedded derivative and recorded a charge of \$2.5 million in non-operating expense during the nine months ended September 30, 2010.

**12. STOCK OPTIONS***Option Plan*

On February 1, 2010, the Company's board of directors adopted the 2010 Stock Option and Incentive Plan (the 2010 Plan) effective upon consummation of the IPO, which was also approved by the Company's stockholders. The Company initially reserved 233,644 shares of common stock for issuance under the 2010 Plan, plus additional shares returned under the Company's 2005 Equity Incentive Plan (the 2005 Plan) as a result of the cancellation of options or the repurchase of shares issued pursuant to the 2005 Plan. On July 9, 2010, the Company's shareholders approved an increase to the aggregate number of shares initially available for grant under the 2010 Plan by 200,000 shares to 433,644 shares of common stock. In addition, the 2010 Plan provides for annual increases in the number of shares available for issuance thereunder on the first day of each fiscal year, beginning with the 2011 fiscal year, equal to four percent (4%) of the outstanding shares of the Company's common stock on the last day of the immediately preceding fiscal year. The maximum aggregate number of shares of stock that may be issued in the form of incentive stock options shall not exceed the lesser of (i) the number of shares reserved and available for issuance under the Plan or (ii) 1,460,280 shares of stock, subject in all cases to adjustment including reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock split or other similar changes in the Company's capital stock. The 2010 Plan permits the granting of incentive and non-statutory stock options, restricted and unrestricted stock awards, restricted stock units, stock appreciation rights, performance share awards, cash-based awards and dividend equivalent rights to eligible employees, directors and consultants. The option exercise price of an option granted under the 2010 Plan may not be less than 100% of the fair market value of a share of the Company's Common Stock on the date the stock option is granted. Options granted under the 2010 Equity Plan have a maximum term of 10 years and generally vest over four years. In addition, in the case of certain large stockholders, the minimum exercise price of incentive options must equal 110% of fair market value on the date of grant and the maximum term is limited to five years. The 2010 Plan does not allow the option holders to exercise their options prior to vesting.

*Early Exercise of Employee Options*

Stock options granted under the Company's 2005 Plan provide employee option holders the right to elect to exercise unvested options in exchange for restricted common stock. Unvested shares, which amounted to 38,747 and 69,424 at September 30, 2010, and December 31, 2009, respectively, were subject to a repurchase right held by the Company at the original issuance price in the event the optionee's employment is terminated either voluntarily or involuntarily. For exercises of employee options, this right lapses 25% on the first anniversary of the vesting start date and in 36 equal monthly amounts thereafter. These repurchase terms are considered to be a forfeiture provision and do not result in variable accounting. The shares purchased by the employees pursuant to the early exercise of stock options are not deemed to be outstanding until those shares vest. In addition, cash received from employees for exercise of unvested options is treated as a refundable deposit shown as a liability in the Company's financial statements. For the nine months ended September 30, 2010, and the year ended December 31, 2009, cash received for early exercise of options totaled \$24,714 and \$6,615, respectively. As the shares vest, the shares and liability are released into common stock and additional paid-in capital.

**Table of Contents**

The activity of unvested shares for the period ended September 30, 2010 as a result of early exercise of options granted to employees is as follows (unaudited):

<b>Unvested Shares</b>	<b>Shares</b>	<b>Weighted-Average Grant Price</b>
Balance as of December 31, 2009	69,424	\$ 0.45
Early exercise of options	18,011	\$ 1.37
Vested	(42,421)	\$ 0.34
Repurchases	(6,267)	\$ 0.26
Balance as of September 30, 2010	38,747	\$ 1.11

The following table summarizes stock option activity for the nine months ended September 30, 2010 (unaudited):

	<b>Number of Options</b>	<b>Weighted-Average Exercise Price</b>	<b>Weighted-Average Remaining Contractual Life in Years</b>	<b>Aggregate Intrinsic Value</b>
Balance as of December 31, 2009	1,323,776	\$ 0.92	7.94	\$ 17,312,745
Options granted	112,000	\$ 4.82		
Options exercised	(118,878)	\$ 0.75		
Options cancelled	(9,832)	\$ 1.50		
Balance as of September 30, 2010	1,307,066	\$ 1.27	6.85	\$ 3,932,101
Ending Vested Stock Options as of September 30, 2010	1,012,144	\$ 0.90	7.01	\$ 3,374,209
Ending Vested and Expected to Vest Stock Options as of September 30, 2010	1,307,066	\$ 1.27	6.85	\$ 3,932,101

Information about stock options outstanding, vested and expected to vest as of September 30, 2010 (unaudited), is as follows:

Outstanding, Vested and Expected to Vest			Options Vested		
			Weighted-Average Remaining Contractual Life	Weighted-Average	
Range of Exercise Price		Number of Shares	(in Years)	Exercise Price	Number of Shares
\$0.14	\$0.14	4,672	5.55	\$0.14	4,672
\$0.26	\$0.26	567,161	6.40	\$0.26	555,351
\$1.34	\$1.34	266,352	7.41	\$1.34	183,771
\$1.51	\$1.51	345,199	8.40	\$1.51	242,168
\$4.19	\$7.70	123,682	3.48	\$5.76	26,182

1,307,066	6.85	\$0.90	1,012,144
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*Restricted Stock Units*

During 2010, the Company granted restricted stock unit awards under its 2010 Plan representing an aggregate of 333,000 shares of common stock. The restricted stock units granted represent a right to receive shares of common stock at a future date determined in accordance with the participant's award agreement. An exercise price and monetary payment are not required for receipt of restricted stock units or the shares issued in settlement of the award. Instead, consideration is furnished in the form of the participant's services to the Company. Substantially all of the restricted stock units vest over four years. Compensation cost for these awards is based on the closing price of the Company's common stock on the date of grant and recognized as compensation expense on a straight-line basis over the requisite service period. Compensation expense recognized was \$176,933 for the three and nine months ended September 30, 2010. At September 30, 2010, the unrecognized compensation cost related to these awards was \$1.54 million, which is expected to be recognized on a straight-line basis over 2.96 years.

**Table of Contents***2010 Employee Stock Purchase Plan*

On July 9, 2010, the Company's stockholders approved the Anthera Pharmaceuticals, Inc. 2010 Employee Stock Purchase Plan (the "2010 ESPP"). The Company has reserved 100,000 shares of common stock for issuance thereunder plus on January 1, 2011 and each January 1 thereafter, the number of shares of stock reserved and available for issuance under the Plan shall be cumulatively increased by the lesser of (i) one percent (1%) of the number of shares of common stock issued and outstanding on the immediately preceding December 31 or (ii) 250,000 shares of common stock.

Under the 2010 ESPP, eligible employees of the Company and certain designated subsidiaries of the Company may authorize the Company to deduct amounts from their compensation, which amounts are used to enable the employees to purchase shares of the Company's common stock. The purchase price per share will be 85% of the fair market value of the common stock as of the first date or the ending date of the applicable semi-annual purchase period, whichever is less (the "Look-Back Provision"). The 15% discount and the Look-Back Provision make the 2010 ESPP compensatory under ASC 718-50-25-2, *Compensation - Stock Compensation - Employee Share Purchase Plans Recognition*. The Black-Scholes option pricing model was used to value the employee stock purchase rights. For the nine months ended September 30, 2010 and the period from September 9, 2004 (Inception Date) through September 30, 2010, the following weighted-average assumptions were used in the valuation of the stock purchase rights:

	<b>Three Months Ended</b>	<b>Nine Months Ended</b>	<b>Period from September 9, 2004 (Date of Inception) to September 30, 2010</b>
	<b>September 30, 2010</b>	<b>September 30, 2010</b>	<b>2010</b>
Expected Volatility	67%	67%	67%
Dividend Yield	0%	0%	0%
Risk-Free Interest Rate	0.16%	0.16%	0.16%
Expected Term (years)	0.33	0.33	0.33

The Company received \$14,433 in contribution from participants during the three and nine months ended September 30, 2010. Compensation expense recognized for the three and nine months ended September 30, 2010 was \$5,139. As of September 30, 2010, no shares have been issued and 100,000 shares were available for future purchase under the 2010 ESPP.

*Stock-Based Compensation Expense*

Total employee stock-based compensation expense recognized under FASB ASC 718 was as follows (unaudited):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>		<b>Period from September 9, 2004 (Date of Inception) to September 30, 2010</b>
	<b>September 30, 2010</b>	<b>2009</b>	<b>September 30, 2010</b>	<b>2009</b>	<b>2010</b>
Research and development	\$ 81,614	\$ 26,096	\$ 114,476	\$ 83,712	\$ 308,478
General and administrative	157,026	43,595	229,991	119,503	512,868

Total stock-based compensation	\$ 238,640	\$ 69,691	\$ 344,467	\$ 203,215	\$ 821,346
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The grant date total fair value of employee options vested during the three and nine months ended September 30, 2010 and 2009, and for the period from September 9, 2004 (Date of Inception) to September 30, 2010, was \$72,050, \$145,294, \$49,017, \$316,453 and \$729,628, respectively. Total intrinsic value of options exercised during the three and nine months ended September 30, 2010 and for the period from September 9, 2004 (Date of Inception) to September 30, 2010, was \$50,380, \$667,566 and \$796,400, respectively. There were no options exercised during the three and nine months ended September 30, 2009.



**Table of Contents**

As of September 30, 2010 and December 31, 2009, total compensation cost related to unvested stock options not yet recognized was \$629,035 and \$456,288, respectively, which are expected to be allocated to expenses over a weighted-average period of 1.49 and 2.25 years, respectively.

The assumptions used in the Black-Scholes option-pricing model for the three and nine months ended September 30, 2010 and 2009, and for the period from September 9, 2004 (Date of Inception) to September 30, 2010, are as follows (unaudited):

	<b>Three Months Ended</b>	<b>Nine Months Ended</b>		<b>Period from September 9, 2004 (Date of Inception) to September 30, 2010</b>
	<b>September 30, 2010</b>	<b>September 30, 2010</b>	<b>2009</b>	
Expected Volatility	63%	69%	74%	79%
Dividend Yield	0%	0%	0%	0%
Risk-Free Interest Rate	1.59%	1.91%	2.10%	3.86%
Expected Term (years)	6.25	6.25	6.25	6.25

The weighted-average grant date fair values of stock options granted during the three months ended September 30, 2010 and 2009, nine months ended September 30, 2010 and 2009, and for the period from September 9, 2004 (Date of Inception) to September 30, 2010, were \$2.47, \$0.59, \$3.10, \$1.01 and \$0.57 per share, respectively.

*Nonemployee Stock-Based Compensation*

The Company accounts for stock options granted to nonemployees as required by the Equity Topic of the FASB ASC 718. In connection with stock options granted to consultants, the Company recorded \$8,399, \$2,899 and \$166,344 for nonemployee stock-based compensation during the nine months ended September 30, 2010 and 2009, and for the period from September 9, 2004 (Date of Inception) to September 30, 2010, respectively. These amounts were based upon the fair value of the vested portion of the grants.

The assumptions used in the Black-Scholes option-pricing model for the three and nine months ended September 30, 2010 and 2009, and for the period from September 9, 2004 (Date of Inception) to September 30, 2010, are as follows (unaudited):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>		<b>Period from September 9, 2004 (Date of Inception) to September 30, 2010</b>
	<b>September 30, 2010</b>	<b>2009</b>	<b>September 30, 2010</b>	<b>2009</b>	
Expected Volatility	N/A	98%	98%	98%	98%
Dividend Yield	N/A	0%	0%	0%	0%
Risk-Free Interest Rate	N/A	3.32%	3.16%	3.13%	3.67%
Expected Term (years)	N/A	8.80	7.86	9.09	9.63

Amounts expensed during the remaining vesting period will be determined based on the fair value at the time of vesting.

**13. RELATED PARTY TRANSACTIONS**

For the three and nine months ended September 30, 2010, and the period from September 9, 2004 (Date of Inception) to September 30, 2010, the Company paid \$330,428, \$489,630 and \$621,203, respectively, for clinical management services rendered by an outside organization where one of the founders is employed. There was no payment made to this organization for the three and nine months ended September 30, 2009.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which are subject to the "safe harbor" created by those sections. Forward-looking statements are based on our management's beliefs and assumptions and on information currently available to our management. All statements other than statements of historical facts are forward-looking statements for purposes of these provisions. In some cases you can identify forward-looking statements by terms such as may, will, should, could, would, expect, plan, anticipate, believe, estimate, project, predict, and potential, and similar expressions. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" in this report. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.*

**Overview**

Anthera Pharmaceuticals, Inc. (the Company, we, our, or us) is a biopharmaceutical company focused on developing and commercializing products to treat serious diseases associated with inflammation, including cardiovascular and autoimmune diseases. We currently have one Phase 3 clinical program, varespladib, and two Phase 2 clinical programs, A-623 and A-001. Two of our product candidates, varespladib and A-001, are designed to inhibit a novel enzyme target known as secretory phospholipase A<sub>2</sub>, or sPLA<sub>2</sub>. Elevated levels of sPLA<sub>2</sub> have been implicated in a variety of acute inflammatory conditions, including acute coronary syndrome and acute chest syndrome associated with sickle cell disease, as well as in chronic diseases, including stable coronary artery disease. In addition, our Phase 2 product candidate, A-623, targets elevated levels of BAFF which has been associated with a variety of B-cell mediated autoimmune diseases, including systemic lupus erythematosus (lupus), lupus nephritis, rheumatoid arthritis, multiple sclerosis, Sjögren's Syndrome, Graves' Disease and others.

We have generated significant losses since inception. As of September 30, 2010, we had an accumulated deficit of approximately \$92.6 million. We recognized net losses of \$8.3 million and \$27.4 million for the three and nine months ended September 30, 2010, compared to the same period in 2009 when we recognized net losses of \$3.6 million and \$10.7 million, respectively. These losses have resulted primarily from expense incurred in connection with research and development activities, consisting primarily of clinical trials, preclinical studies and manufacturing services associated with our current production candidates. We expect our net losses to increase as we continue to advance our clinical trials, expand our research and development efforts, and add personnel for our anticipated growth.

On February 26, 2010, our Registration Statement on Form S-1 was declared effective by the SEC for our IPO, pursuant to which we sold 6,000,000 shares of our common stock at a public offering price of \$7.00 per share. We received net proceeds of approximately \$37.1 million from this transaction. Concurrent with the closing of the IPO, we received an aggregate of \$17.1 million from the issuance of 2,598,780 shares of our common stock to certain of our investors pursuant to a common stock purchase agreement. On April 6, 2010, pursuant to the terms and conditions of the underwriting agreement, the underwriters of our IPO exercised their over-allotment option and purchased 604,492 shares of common stock at our public offering price of \$7.00 per share, less the underwriting discount and commissions, resulting in gross proceeds of approximately \$4.2 million.

On September 24, 2010, the Company closed a private placement transaction with certain accredited investors pursuant to which the Company sold an aggregate of 10,500,000 units at a purchase price of \$3.00 per unit, with each unit consisting of one share of common stock and a warrant to purchase an additional 0.40 shares of common stock. Each warrant is exercisable in whole or in part at any time until September 24, 2015 at a per share exercise price of \$3.30, subject to certain adjustments as specified in the warrant. The Company received net proceeds of approximately \$29.1 million.

***Revenue***

To date, we have not generated any revenue. We do not expect to generate revenue unless or until we obtain regulatory approval of, and commercialize, our product candidates or in- license additional products that generate revenue. We intend to seek to generate revenue from a combination of product sales, up-front fees and milestone payments in connection with collaborative or strategic relationships and royalties resulting from the licensing of the commercial rights to our intellectual property. We expect that any revenue we generate will fluctuate from quarter to quarter as a result of the nature, timing and amount of milestone payments we may receive

**Table of Contents**

upon the sale of our products, to the extent any are successfully commercialized, as well as any revenue we may receive from our collaborative or strategic relationships.

***Research and Development Expenses***

Since our inception, we have focused our activities on our product candidate development programs. We expense research and development costs as they are incurred. Research and development expenses consist of personnel costs, including salaries, benefits and stock-based compensation, clinical studies performed by contract research organizations, or CROs, materials and supplies, licenses and fees and overhead allocations consisting of various administrative and facilities-related costs. Research and development activities are also separated into three main categories: licensing, clinical development and pharmaceutical development. Licensing costs consist primarily of fees paid pursuant to license agreements. Historically, our clinical development costs have included costs for preclinical and clinical studies. We expect to incur substantial clinical development costs for our anticipated Phase 3 clinical study named VISTA-16 for varespladib, our Phase 2b clinical study named PEARL-SC for A-623, as well as for the development of our other product candidates. Pharmaceutical development costs consist of expenses incurred relating to clinical studies and product formulation and manufacturing.

We expense both internal and external research and development costs as incurred. We are developing our product candidates in parallel, and we typically use our employee and infrastructure resources across several projects. Thus, some of our research and development costs are not attributable to an individually named project, but rather are allocated across our clinical stage programs. These unallocated costs include salaries, stock-based compensation charges and related fringe benefit costs for our employees, consulting fees and travel.

The following table shows our total research and development expenses for the three and nine months ended September 30, 2010 and 2009, and for the period from September 9, 2004 (Date of Inception) through September 30, 2010:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>		<b>For the</b>
	<b>September 30,</b>		<b>September 30,</b>		<b>Period</b>
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>September 9,</b>
					<b>2004 (Date of</b>
					<b>Inception)</b>
					<b>to September</b>
					<b>30,</b>
					<b>2010</b>
Allocated costs:					
A-001	\$ 12,847	\$ 26,760	\$ 125,954	\$ 148,220	\$ 6,646,000
Varespladib	3,923,255	1,674,306	11,885,724(1)	5,503,466	39,746,369
A-623	1,485,707	5,741	3,643,827	15,699	9,787,244(2)
Unallocated costs	1,463,316	819,141	2,909,583	2,059,744	13,709,456
Total development	\$ 6,885,125	\$ 2,525,948	\$ 18,565,088	\$ 7,727,129	\$ 69,889,069

(1) Includes milestone payments of \$3.5 million pursuant to amendments to the license agreements with each of Eli Lilly and Shionogi & Co. Ltd.

(2) Includes a one-time license initiation fee of \$6.0 million pursuant to a license agreement with Amgen.

We expect our research and development expenses to increase significantly as we continue to develop our product candidates. We initiated the VISTA-16 study of varespladib in June 2010. Also in July 2010, we initiated the PEARL-SC study of A-623. PEARL-SC is a randomized, double-blind, placebo-controlled, Phase 2b clinical study that will enroll up to 600 patients in up to 70 centers worldwide. Patients will be randomized into three active treatment arms and one placebo treatment arm for a minimum of 24 weeks. The primary endpoint of the PEARL-SC

study is clinical improvement at 24 weeks in the systemic lupus erythematosus (SLE) responder index, or SRI, a recently recognized FDA endpoint for demonstrating clinical efficacy. As previously announced, a blinded interim biomarker analysis will be conducted early in the study to establish the drug effect on B-cells and potentially remove any arm that is not demonstrating a biologic effect. We intend to fund our clinical studies with current proceeds and future offerings.

We expect that a large percentage of our research and development expenses in the future will be incurred in support of our current and future clinical development programs. These expenditures are subject to numerous uncertainties in timing and cost to completion. As we obtain results from clinical studies, we may elect to discontinue or delay clinical studies for certain product candidates or

## **Table of Contents**

programs in order to focus our resources on more promising product candidates or programs. Completion of clinical studies may take several years or more, but the length of time generally varies according to the type, complexity, novelty and intended use of a product candidate. The cost of clinical studies may vary significantly over the life of a program as a result of differences arising during clinical development, including:

the number of sites included in the studies;

the length of time required to enroll suitable patient subjects;

the number of patients that participate in the studies;

the number of doses that patients receive;

the drop-out or discontinuation rates of patients; and

the duration of patient follow-up.

Our expenses related to clinical studies are based on estimates of the services received and efforts expended pursuant to contracts with multiple research institutions and clinical research organizations that conduct and manage clinical studies on our behalf. The financial terms of these agreements are subject to negotiation and vary from contract to contract and may result in uneven payment flows. Generally, these agreements set forth the scope of work to be performed at a fixed fee or unit price. Payments under the contracts depend on factors such as the successful enrollment of patients or the completion of clinical study milestones. Expenses related to clinical studies generally are accrued based on contracted amounts and the achievement of milestones such as number of patients enrolled. If timelines or contracts are modified based upon changes to the clinical study design or scope of work to be performed, we modify our estimates of accrued expenses accordingly on a prospective basis.

None of our product candidates has received U.S. Food and Drug Administration, or FDA, or foreign regulatory marketing approval. In order to grant marketing approval, the FDA or foreign regulatory agencies must conclude that clinical data establishes the safety and efficacy of our product candidates and that the manufacturing facilities, processes and controls are adequate. Despite our efforts, our product candidates may not offer therapeutic or other improvement over existing, comparable drugs, be proven safe and effective in clinical studies, or meet applicable regulatory standards.

As a result of the uncertainties discussed above, we are unable to determine the duration and completion costs of our development projects or when and to what extent we will receive cash inflows from the commercialization and sale of an approved product candidate, if ever.

### ***General and Administrative Expenses***

General and administrative expenses consist primarily of compensation for employees in executive and operational functions, including clinical, chemical manufacturing, regulatory, finance and business development. Other significant costs include professional fees for legal services, including legal services associated with obtaining and maintaining patents. We anticipate incurring a significant increase in general and administrative expenses as we operate as a public company. These increases will likely include increased costs for insurance, costs related to the hiring of additional personnel and payment to outside consultants, lawyers and accountants. We also expect to incur significant costs to comply with the corporate governance, internal controls and similar requirements applicable to public companies.

### **Critical Accounting Policies and Estimates**

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses. On an ongoing basis, we evaluate these estimates and judgments, including those described below. We base our estimates on our historical experience and on various other assumptions that we believe to be reasonable under the circumstances. These estimates and assumptions form the basis for making judgments about the





## **Table of Contents**

carrying values of assets and liabilities that are not readily apparent from other sources. Actual results and experiences may differ materially from these estimates.

While our significant accounting policies are more fully described in Note 3 of our financial statements, we believe that the following accounting policies are the most critical to aid you in fully understanding and evaluating our reported financial results and affect the more significant judgments and estimates that we use in the preparation of our financial statements.

### *Accrued Clinical Expenses*

As part of the process of preparing our financial statements, we are required to estimate our accrued expenses. This process involves reviewing open contracts and purchase orders, communicating with our applicable personnel to identify services that have been performed on our behalf and estimating the level of service performed and the associated cost incurred for the service when we have not yet been invoiced or otherwise notified of actual cost. The majority of our service providers invoice us monthly in arrears for services performed. We make estimates of our accrued expenses as of each balance sheet date in our financial statements based on facts and circumstances known to us at that time. We periodically confirm the accuracy of our estimates with the service providers and make adjustments if necessary. Examples of estimated accrued clinical expenses include:

fees paid to CROs in connection with clinical studies;

fees paid to investigative sites in connection with clinical studies;

fees paid to contract manufacturers in connection with the production of clinical study materials; and

fees paid to vendors in connection with the preclinical development activities.

We base our expenses related to clinical studies on our estimates of the services received and efforts expended pursuant to contracts with multiple research institutions and CROs that conduct and manage clinical studies on our behalf. The financial terms of these agreements are subject to negotiation, vary from contract to contract and may result in uneven payment flows. Payments under some of these contracts depend on factors such as the successful enrollment of patients and the completion of clinical study milestones. In accruing service fees, we estimate the time period over which services will be performed and the level of effort to be expended in each period. If the actual timing of the performance of services or the level of effort varies from our estimate, we adjust the accrual accordingly. If we do not identify costs that we have begun to incur or if we underestimate or overestimate the level of services performed or the costs of these services, our actual expenses could differ from our estimates.

### *Stock-Based Compensation*

Effective January 1, 2006, we adopted the provisions of FASB ASC 718, *Compensation – Stock Compensation*, using the modified prospective method. Compensation costs related to all equity instruments granted after January 1, 2006 are recognized at the grant-date fair value of the awards. Additionally, we are required to include an estimate of the number of awards that will be forfeited in calculating compensation costs, which are recognized over the requisite service period of the awards on a straight-line basis. We estimate the fair value of our share-based payment awards on the date of grant using an option-pricing model. We recognized employee stock-based compensation expense of \$74,861 in 2007, \$143,406 in 2008, \$253,964 in 2009 and \$344,467 for the nine months ended September 30, 2010, respectively. As of September 30, 2010, we had \$2.2 million in total unrecognized compensation cost related to non-vested employee stock-based compensation arrangements. The intrinsic value of all outstanding vested and non-vested stock-based compensation arrangements, based on the closing price of \$4.19 per share, is \$3.9 million, based on 1,307,066 shares of outstanding options and 333,000 shares of unvested restricted stock units at September 30, 2010.

We calculate the fair value of stock-based compensation awards using the Black-Scholes option-pricing model. Expense amounts for future awards for any particular quarterly or annual period could be affected by changes in our assumptions. The weighted-average expected option terms for 2010 and 2009 reflect the application of the simplified method set out in FASB ASC 718-10. The simplified method defines the life as the average of the contractual term of the stock-based compensation award and the weighted-average vesting period for all tranches. Estimated volatility for

fiscal 2010 and 2009 also reflects the application of interpretive guidance provided in FASB ASC 718-10 and, accordingly, incorporates historical volatility of similar public entities.

## **Table of Contents**

### **Results of Operations**

#### *Comparison of the Three Months Ended September 30, 2010 and 2009*

**Research and Development Expenses.** Research and development expenses were \$6.9 million for the three months ended September 30, 2010, compared with \$2.5 million for the three months ended September 30, 2009. The \$4.4 million increase in research and development expense was primarily attributable to CRO costs related to the launch of our Phase 3 clinical study of varespladib and Phase 2 clinical study of A-623 as well as increased headcount to support these clinical studies.

**General and Administrative Expenses.** General and administrative expenses were \$1.5 million for the three months ended September 30, 2010, compared with \$0.9 million for the three months ended September 30, 2009. The \$0.6 million increase was primarily attributable to increased headcount and professional services to support growth of the Company after its IPO.

**Interest and Other Income.** Interest and other income was \$61,606 for the three months ended September 30, 2010, compared with \$0 for the three months ended September 30, 2009. The increase in interest and other income was due to higher cash and investment balances in the current year due to proceeds received from the IPO and the September private placement offering as compared to the prior year.

**Interest and Other Expense.** Interest and other expense was \$0 for the three months ended September 30, 2010, compared with \$193,556 for the three months ended September 30, 2009. Interest and other expense recorded during the three months ended September 30, 2009 consisted of interest accrued on outstanding license fees.

#### *Comparison of the Nine Months Ended September 30, 2010 and 2009*

**Research and Development Expenses.** Research and development expenses were \$18.6 million for the nine months ended September 30, 2010, compared with \$7.7 million for the nine months ended September 30, 2009. The \$10.9 million increase in our research and development expenses was primarily attributable to the recognition of a \$3.5 million non-cash charge related to milestone payments recorded in connection with the initiation of our Phase 3 clinical study of varespladib, which was paid through the issuance of 531,914 shares of common stock; and increased CRO and manufacturing cost related to the launch of our Phase 3 clinical study of varespladib and Phase 2 clinical study of A-623, as well as increased headcount to support these clinical studies.

**General and Administrative Expenses.** General and administrative expenses were \$4.2 million for the nine months ended September 30, 2010, compared with \$2.7 million for the nine months ended September 30, 2009. The \$1.5 million increase was primarily attributable to increased headcount and professional services incurred in connection with our financial audit and other costs associated with operating as a public company.

**Interest and Other Income.** Interest and other income was \$76,562 for the nine months ended September 30, 2010, compared with \$21,559 for the nine months ended September 30, 2009. The increase in interest and other income was due to higher cash and investment balances in the current year due to proceeds received from the IPO and the September private placement offering as compared to the prior year.

**Interest and Other Expense.** Interest and other expense was \$4.6 million for the nine months ended September 30, 2010, compared with \$0.3 million for the nine months ended September 30, 2009. Interest and other expense recorded during the nine months ended September 30, 2010 included a \$4.5 million non-cash charge recorded as part of interest and other expense related to the amortization of discounts on the Company's convertible promissory notes and the mark-to-market adjustment relating to warrants and embedded derivative connected to the Company's convertible promissory notes. Interest and other expense recorded during the comparable period in 2009 consisted of interest accrued on past due license fee obligations.

### **Liquidity and Capital Resources**

To date, we have funded our operations primarily through equity offerings, private placements of convertible debt and public financing. As of September 30, 2010, we had received net proceeds of approximately \$119.7 million from the sale of equity securities, and net proceeds of approximately \$26.3 million from the issuance of convertible promissory notes. As of September 30, 2010, we had cash, cash equivalents and short-term investments of approximately \$73.1 million.

**Table of Contents***Cash Flows**Nine Months Ended September 30, 2010*

For the nine months ended September 30, 2010, we incurred a net loss of approximately \$27.4 million.

Net cash used in operating activities was approximately \$18.6 million. The net loss is higher than cash used in operating activities by \$8.8 million. The primary drivers for the difference are adjustments for non-cash charges such as stock-based compensation of approximately \$352,866, amortization of note discount and debt issuance cost of approximately \$769,000, issuance of \$3.5 million worth of common stock in lieu of cash milestone payments due to Eli Lilly and Shionogi & Co., Ltd., the conversion of approximately \$300,000 of accrued interest into shares of common stock upon conversion of certain convertible promissory notes, mark to market adjustments relating to warrant and derivative liability of \$3.8 million, and increase in operating assets and liabilities of approximately \$195,000.

Net cash used by investing activities was \$21.7 million and was primarily driven by the purchase of short-term investments during the period.

Net cash provided by financing activities was approximately \$87.7 million and consisted of proceeds of \$61.2 million received from the issuance of common stock at our IPO, the exercise of the overallotment option by our underwriters in connection with our IPO, the release of funds held in an escrow account concurrent with the closing of our IPO, and proceeds of \$29.6 million received from the issuance of common stock and warrants in connection with the private placement offering, offset by approximately \$2.9 million of issuance cost paid during the period.

*Nine Months Ended September 30, 2009*

For the nine months ended September 30, 2009, we incurred a net loss of approximately \$10.7 million.

Net cash used in operating activities was approximately \$10.3 million. The net loss is higher than cash used in operating activities by \$0.4 million. The primary drivers for the difference are adjustments for non-cash charges such as depreciation and amortization of approximately \$15,000, stock-based compensation of \$206,000 due to increased headcount and corresponding equity grants made to new and existing employees, and increase in current liabilities of approximately \$613,000 due to increased expense relating to our Phase 2 clinical study activity and a decrease in license fee payable by \$500,000, partially offset by decrease in current assets of approximately \$30,000.

Net cash provided by financing activities was approximately \$10 million and consisted of proceeds received from the issuance of convertible promissory notes.

**Contractual Obligations and Commitments**

The following table summarizes our long-term contractual obligations and commitments as of September 30, 2010:

	<b>Total</b>	<b>Payments Due by Period</b>			
		<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 Years</b>
Operating lease obligations (1)	\$ 40,536	\$ 34,296	\$ 6,240	\$	\$

- (1) Operating lease obligations reflect our obligation to make payments in connection with a sublease that commenced in October 2008 and will expire on January 31, 2011 for approximately 7,800 square feet of office space and office equipment leases that commenced in October 2007 and will expire in June 2013.

The above amounts exclude potential payments to be made under our license agreements to our licensors that are based on the progress of our product candidates in development, as these payments are not determinable. Under our license agreement with Eli Lilly and Shionogi & Co., Ltd. to develop and commercialize certain sPLA<sub>2</sub> inhibitors, we are obligated to make additional milestone payments upon the achievement of certain development, regulatory and commercial objectives. We are also obligated to pay royalties on

## **Table of Contents**

future net sales of products that are developed and approved as defined by this collaboration. Our obligation to pay royalties with respect to each licensed product in each country will expire upon the later of (a) 10 years following the date of the first commercial sale of such licensed product in such country and (b) the first date on which generic version(s) of the applicable licensed product achieve a total market share, in the aggregate, of 25% or more of the total unit sales of wholesalers to pharmacies of licensed product and all generic versions combined in the applicable country.

Also excluded from the table above are potential milestone payments on the development of A-623. Under our license agreement with Amgen to develop and commercialize A-623, we are obligated to make additional milestone payments upon the achievement of certain development, regulatory and commercial objectives. We are also obligated to pay royalties on future net sales of products that are developed and approved as defined by this collaboration. Our royalty obligations as to a particular licensed product will be payable, on a country-by-country and licensed product-by-licensed product basis, for the longer of (a) the date of expiration of the last to expire valid claim within the licensed patents that covers the manufacture, use or sale, offer to sell, or import of such licensed product by us or a sublicensee in such country or (b) 10 years after the first commercial sale of the applicable licensed product in the applicable country.

### *Funding Requirements*

We expect to incur substantial expenses and generate significant operating losses as we continue to advance our product candidates into preclinical studies and clinical studies and as we:

continue clinical development of the Phase 3 VISTA-16 study for varespladib;

continue clinical development of the Phase 2b PEARL-SC study for A-623;

hire additional clinical, scientific and management personnel; and

implement new operational, financial and management information systems.

Our future capital uses and requirements depend on numerous forward-looking factors. These factors include the following:

the progress of preclinical development and clinical studies of our product candidates;

the time and costs involved in obtaining regulatory approvals;

delays that may be caused by evolving requirements of regulatory agencies;

the costs involved in filing and prosecuting patent applications and enforcing or defending patent claims;

our ability to establish, enforce and maintain selected strategic alliances; and

the acquisition of technologies, product candidates and other business opportunities that require financial commitments.

To date, we have not generated any revenue. We do not expect to generate revenue unless or until we obtain regulatory approval of, and commercialize, our product candidates. We expect our continuing operating losses to result in increases in cash used in operations over the next several years. Our future capital requirements will depend on a number of factors including the progress and results of our clinical studies; the costs, timing and outcome of regulatory review of our product candidates; our revenue, if any, from successful development and commercialization of our product candidates; the costs of commercialization activities; the scope, progress, results and costs of preclinical development, laboratory testing and clinical studies for other product candidates; the emergence of competing therapies and other market developments; the costs of preparing, filing and prosecuting patent applications and maintaining, enforcing and defending intellectual property rights, the extent to which we acquire or invest in other product candidates and technologies; and our ability to establish collaborations and obtain milestone, royalty or other

payments from any collaborators.

We expect the proceeds from our IPO and recent private placement offering, together with our existing resources, to be sufficient to fund our planned operations, including our continued product candidate development, for at least the next 12 months. However, we may require significant additional funds earlier than we currently expect to conduct additional or extended clinical studies and seek regulatory

## **Table of Contents**

approval of our product candidates. Because of the numerous risks and uncertainties associated with the development and commercialization of our product candidates, we are unable to estimate the amounts of increased capital outlays and operating expenditures associated with our current and anticipated clinical studies.

Additional funding may not be available to us on acceptable terms or at all. In addition, the terms of any financing may adversely affect the holdings or the rights of our stockholders. For example, if we raise additional funds by issuing equity securities or by selling convertible debt securities further dilution to our existing stockholders may result. To the extent our capital resources are insufficient to meet our future capital requirements, we will need to finance our future cash needs through public or private equity offerings, collaboration agreements, debt financings or licensing arrangements.

If adequate funds are not available, we may be required to terminate, significantly modify or delay our development programs, reduce our planned commercialization efforts, or obtain funds through collaborators that may require us to relinquish rights to our technologies or product candidates that we might otherwise seek to develop or commercialize independently. We may elect to raise additional funds even before we need them if the conditions for raising capital are favorable.

### **Off-Balance Sheet Arrangements**

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

As of September 30, 2010, our investment portfolio consists of certificate of deposits, money market funds, FDIC insured corporate bonds, and fixed income securities. The primary objectives of our investment are to preserve capital and maintain liquidity. Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of U.S. interest rates. However, based on our investment portfolio we do not believe we are subject to any material market risk exposure. We do not have any other material derivative financial instruments.

### **ITEM 4T. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive and financial officers, evaluated the effectiveness of our disclosures controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of September 30, 2010. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2010, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

#### **Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting during the quarter ended September 30, 2010 identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

From time to time, we may be involved in routine legal proceedings, as well as demands, claims and threatened litigation, which arise in the normal course of our business.

We believe there is no litigation pending that could, individually or in the aggregate, have a material adverse effect on our results of operations or financial condition.

**ITEM 1A. RISK FACTORS**

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information in this Quarterly Report on Form 10-Q. If any of such risks actually occur, our business, operating results or financial condition could be adversely affected. In those cases, the trading price of our common stock could decline and you may lose all or part of your investment.*

**Risks Related to Our Financial Condition and Capital Requirements**

*We have incurred significant losses since our inception and anticipate that we will incur continued significant losses for the foreseeable future.*

We are a development stage company with only six years of operating history. We have focused primarily on developing our three product candidates, varespladib, A-623 and varespladib sodium (A-001). We have financed our operations exclusively through equity offerings and private placements of convertible debt and we have incurred losses in each year since our inception in September 2004. Our net losses were approximately \$15,000 in 2004, \$540,000 in 2005, \$8.7 million in 2006, \$25.7 million in 2007, \$18.1 million in 2008, \$12.2 million in 2009 and \$27.4 million for the nine months ended September 30, 2010. As of September 30, 2010, we had an accumulated deficit of approximately \$92.6 million. Substantially all of our losses resulted from costs incurred in connection with our product development programs and from general and administrative costs associated with our operations.

We expect to incur additional losses over the next several years, and these losses may increase if we cannot generate revenues. These losses, combined with expected future losses, have had and will continue to have an adverse effect on our stockholders' equity and working capital. We expect our development expenses, as well as our clinical product manufacturing expenses, to increase in connection with our pivotal Phase 3 clinical study named VISTA-16 for varespladib, our Phase 2b clinical study named PEARL-SC for A-623, and other clinical studies related to the development of A-623. In addition, we will incur additional costs of operating as a public company and, if we obtain regulatory approval for any of our product candidates, we may incur significant sales, marketing, in-licensing and outsourced manufacturing expenses as well as continued product development expenses. As a result, we expect to continue to incur significant and increasing losses for the foreseeable future.

***We have never generated any revenue and may never be profitable.***

Our ability to generate revenue and achieve profitability depends on our ability, alone or with collaborators, to successfully complete the development of our product candidates, conduct preclinical tests in animals and clinical studies in human beings, obtain the necessary regulatory approvals for our product candidates and commercialize any approved products. We have not generated any revenue from our development-stage product candidates, and we do not know when, or if, we will generate any revenue. The commercial success of our development-stage product candidates will depend on a number of factors, including, but not limited to, our ability to:

obtain favorable results for and advance the development of our lead product candidate, varespladib, for the treatment of acute coronary syndrome, including successfully launching and completing the VISTA-16 study;

obtain favorable results for and advance the development of our product candidate A-623, for the treatment of B-cell mediated autoimmune diseases, including successfully launching and completing a Phase 2b clinical study in patients with systemic lupus erythematosus, or lupus, or other indications related to the development of A-623;



**Table of Contents**

obtain favorable results for and advance the development of our product candidate A-001, for the prevention of acute chest syndrome associated with sickle cell disease, including completing a multi-center Phase 2 clinical study;

successfully execute our planned preclinical studies in animals and clinical studies in human beings for our other product candidates;

obtain regulatory approval for varespladib, A-623, A-001 and our other product candidates;

if regulatory approvals are obtained, begin the commercial manufacturing of our product candidates with our third-party manufacturers;

launch commercial sales and effectively market our product candidates, either independently or in strategic collaborations with third parties; and

achieve broad market acceptance of our product candidates in the medical community and with third-party payors.

All of our product candidates are subject to the risks of failure inherent in the development of therapeutics based on new technologies. Currently, we have three product candidates in clinical development: varespladib, A-623 and A-001. These product candidates could fail in clinical studies if we are unable to demonstrate that they are effective or if they cause unacceptable adverse effects in the patients we treat. Failure of our product candidates in clinical studies would have a material adverse effect on our ability to generate revenue or become profitable. If we are not successful in achieving regulatory approval for our product candidates or are significantly delayed in doing so, our business will be materially harmed.

Additionally, all of our other product candidates are in preclinical development. Our drug discovery efforts may not produce any other viable or marketable product candidates. We do not expect any of our potential product candidates to be commercially available until at least 2013.

Even if our product candidates are approved for commercial sale, the approved product candidate may not gain market acceptance or achieve commercial success. Physicians, patients, payors or the medical community in general may be unwilling to accept, utilize or recommend any of our products. We would anticipate incurring significant costs associated with commercializing any approved product. Even if we are able to generate product sales, which we cannot guarantee, we may not achieve profitability soon thereafter, if ever. If we are unable to generate product revenues, we will not become profitable and may be unable to continue operations without additional funding.

***Because we will need substantial additional capital in the future to fund our operations, our independent registered public accounting firm included a paragraph regarding concerns about our ability to continue as a going concern in their report on our financial statements. If additional capital is not available, we will have to delay, reduce or cease operations.***

We will need to raise substantial additional capital to fund our operations and to develop our product candidates. Our future capital requirements could be substantial and will depend on many factors including:

the rate of progress of our Phase 3 clinical study named VISTA-16 study for varespladib and our Phase 2b clinical study named PEARL-SC for A-623;

the scope, size, rate of progress, results and costs of our preclinical studies, clinical studies and other development activities for one or more of our other product candidates;

manufacturing campaign of A-623 clinical matters, including formulation development and enhancement;

non-clinical activities that we may pursue parallel to clinical trials for each clinical compound;

the cost, timing and outcomes of regulatory proceedings;

payments received under any strategic collaborations;

30

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## **Table of Contents**

the filing, prosecution and enforcement of patent claims;

the costs associated with commercializing our product candidates if they receive regulatory approval, including the cost and timing of developing sales and marketing capabilities, or entering into strategic collaboration with others relating to the commercialization of our product candidates; and

revenues received from approved products, if any, in the future.

As of the date of this report, we anticipate that our existing cash, cash equivalents and short-term investments will enable us to maintain our currently planned operations through at least the next 12 months. Changing circumstances may cause us to consume capital significantly faster than we currently anticipate. Additional financing may not be available when we need it or may not be available on terms that are favorable to us. If adequate funds are not available to us on a timely basis, or at all, we may be required to:

terminate, reduce or delay preclinical studies, clinical studies or other development activities for one or more of our product candidates; or

terminate, reduce or delay our (i) establishment of sales and marketing capabilities, (ii) pursuit of strategic collaborations with others relating to the sales, marketing and commercialization of our product candidates or (iii) other activities that may be necessary to commercialize our product candidates, if approved for sale.

***The timing of the milestone and royalty payments we are required to make to each of Eli Lilly and Company, Shionogi & Co., Ltd. and Amgen, Inc. is uncertain and could adversely affect our cash flows and results of operations.***

In July 2006, we entered into a license agreement with Eli Lilly and Company, or Eli Lilly, and Shionogi & Co., Ltd. to develop and commercialize certain secretory phospholipase A<sub>2</sub>, or sPLA<sub>2</sub>, inhibitors for the treatment of cardiovascular disease and other diseases. Pursuant to our license agreement with them, we have an obligation to pay to each of Eli Lilly and Shionogi & Co., Ltd. significant milestone and royalty payments based upon how we develop and commercialize certain sPLA<sub>2</sub> inhibitors, including varespladib and A-001, and our achievement of certain significant corporate, clinical and financial events. For varespladib, we are required to pay up to \$32.0 million upon achievement of certain approval and post-approval sales milestones. For A-001, we are required to pay up to \$3.0 million upon achievement of certain clinical development milestones and up to \$25.0 million upon achievement of certain approval and post-approval sales milestones. For other product formulations that we are not currently developing, we would be required to pay up to \$2.0 million upon achievement of certain clinical development milestones and up to \$35.5 million upon achievement of certain approval and post-approval sales milestones. In addition, in December 2007, we entered into a license agreement with Amgen Inc., or Amgen, pursuant to which we obtained an exclusive worldwide license to certain technology and compounds relating to A-623. Pursuant to our license agreement with Amgen, we are required to make various milestone payments upon our achievement of certain development, regulatory and commercial objectives for any A-623 formulation. We are required to pay up to \$10.0 million upon achievement of certain pre-approval clinical development milestones and up to \$23.0 million upon achievement of certain post-approval milestones. We are also required to make tiered quarterly royalty payments on net sales, which increase as a percentage from the high single digits to the low double digits as net sales increase. The timing of our achievement of these events and corresponding milestone payments becoming due to Eli Lilly, Shionogi & Co., Ltd. and Amgen is subject to factors relating to the clinical and regulatory development and commercialization of certain sPLA<sub>2</sub> inhibitors or A-623, as applicable, many of which are beyond our control. We may become obligated to make a milestone payment during a period in which we do not have the cash on hand to make such payment, which could require us to delay our clinical studies, curtail our operations, scale back our commercialization and marketing efforts or seek funds to meet these obligations at terms unfavorable to us.

***Our limited operating history makes it difficult to evaluate our business and prospects.***

We were incorporated in September 2004. Our operations to date have been limited to organizing and staffing our company, acquiring product and technology rights, conducting product development activities for our primary product candidates, varespladib, A-623 and A-001, and performing research and development. We have not yet demonstrated an ability to obtain regulatory approval for or commercialize a product candidate. Consequently, any predictions about

our future performance may not be as accurate as they could be if we had a history of successfully developing and commercializing pharmaceutical products.

## Table of Contents

### **Risks Associated with Development and Commercialization of Our Product Candidates**

*We depend substantially on the success of our three primary product candidates, varespladib, A-623 and A-001, which are still under clinical development. We cannot assure you that these product candidates or any of our other product candidates will receive regulatory approval or be successfully commercialized.*

To date, we have not marketed, distributed or sold any product candidates. The success of our business depends primarily upon our ability to develop and commercialize our three primary product candidates successfully. Our lead product candidate is varespladib, which has completed its Phase 2 clinical studies and for which we have received (i) an agreement from the U.S. Food and Drug Administration, or FDA, on a Special Protocol Assessment, or SPA, for the VISTA-16 Phase 3 study protocol, and (ii) scientific advice from the European Medicines Agency on our European development strategy for varespladib. We initiated the VISTA-16 study for varespladib in June 2010.

Our next product candidate is A-623, which has completed several Phase 1 clinical studies and recently began enrollment for our Phase 2b clinical study. In July 2010, we received clearance from the FDA to begin recruitment of lupus patients into the PEARL-SC Phase 2b clinical study.

Our third product candidate, varespladib sodium (A-001), is an intravenously administered inhibitor of sPLA<sub>2</sub>. We have completed a Phase 2 clinical study for the prevention of acute chest syndrome associated with sickle cell disease. A pre-specified interim review of our Phase 2 clinical study results by a Data Safety Monitoring Board, or DSMB, indicate A-001, at a certain dose, reduced sPLA<sub>2</sub> activity by more than 80% from baseline within 48 hours. Furthermore, the incidence of acute chest syndrome appeared to be related to the level of sPLA<sub>2</sub> activity.

Our product candidates are prone to the risks of failure inherent in drug development. Before obtaining regulatory approvals for the commercial sale of any product candidate for a target indication, we must demonstrate with substantial evidence gathered in preclinical and well-controlled clinical studies, and, with respect to approval in the United States, to the satisfaction of the FDA and, with respect to approval in other countries, similar regulatory authorities in those countries, that the product candidate is safe and effective for use for that target indication and that the manufacturing facilities, processes and controls are adequate. Despite our efforts, our product candidates may not:

offer therapeutic or other improvement over existing, comparable therapeutics;

be proven safe and effective in clinical studies;

meet applicable regulatory standards;

be capable of being produced in sufficient quantities at acceptable costs;

be successfully commercialized; or

obtain favorable reimbursement.

We are not permitted to market our varespladib and A-001 product candidates in the United States until we receive approval of a new drug application, or NDA, or with respect to our A-623 product candidate, approval of a biologics license application, or BLA, from the FDA, or in any foreign countries until we receive the requisite approval from such countries. We have not submitted an NDA or BLA or received marketing approval for any of our product candidates.

Preclinical testing and clinical studies are long, expensive and uncertain processes. We may spend several years completing our testing for any particular product candidate, and failure can occur at any stage. Negative or inconclusive results or adverse medical events during a clinical study could also cause the FDA or us to terminate a clinical study or require that we repeat it or conduct additional clinical studies. Additionally, data obtained from a clinical study are susceptible to varying interpretations and the FDA or other regulatory authorities may interpret the results of our clinical studies less favorably than we do. The FDA and equivalent foreign regulatory agencies have substantial discretion in the approval process and may decide that our data are insufficient to support a marketing application and require additional preclinical, clinical or other studies.



**Table of Contents**

***Any termination or suspension of, or delays in the commencement or completion of, clinical testing of our product candidates could result in increased costs to us, delay or limit our ability to generate revenue and adversely affect our commercial prospects.***

Delays in the commencement or completion of clinical testing could significantly affect our product development costs. We do not know whether planned clinical studies will begin on time or be completed on schedule, if at all. The commencement and completion of clinical studies can be delayed for a number of reasons, including delays related to:

- obtaining regulatory approval to commence a clinical study or complying with conditions imposed by a regulatory authority regarding the scope or design of a clinical study;

- reaching agreement on acceptable terms with prospective clinical research organizations, or CROs, and study sites, the terms of which can be subject to extensive negotiation and may vary significantly among different CROs and study sites;

- manufacturing, including manufacturing sufficient quantities of a product candidate or other materials for use in clinical studies;

- obtaining institutional review board, or IRB, approval or the approval of other reviewing entities to conduct a clinical study at a prospective site;

- recruiting and enrolling patients to participate in clinical studies for a variety of reasons, including size of patient population, nature of clinical study protocol, the availability of approved effective treatments for the relevant disease and competition from other clinical study programs for similar indications;

- severe or unexpected drug-related adverse effects experienced by patients in a clinical study; and

- retaining patients who have initiated a clinical study, but may withdraw due to treatment protocol, adverse effects from the therapy, lack of efficacy from the treatment, personal issues or who are lost to further follow-up.

Clinical studies may also be delayed, suspended or terminated as a result of ambiguous or negative interim results, or results that are inconsistent with earlier results. For example, the independent committee that is conducting the data review may recommend that we stop our VISTA-16 study for varespladib if certain biomarkers of inflammation and lipid profiles fail to meet pre-specified reductions from a subset of the first 1,000 or more patients. In addition, a clinical study may be suspended or terminated by us, the FDA, the IRB or other reviewing entity overseeing the clinical study at issue, any of our clinical study sites with respect to that site, or other regulatory authorities due to a number of factors, including:

- failure to conduct the clinical study in accordance with regulatory requirements or our clinical protocols;

- inspection of the clinical study operations or study sites by the FDA or other regulatory authorities resulting in the imposition of a clinical hold;

- unforeseen safety issues or any determination that a clinical study presents unacceptable health risks; and

- lack of adequate funding to continue the clinical study, including the incurrence of unforeseen costs due to enrollment delays, requirements to conduct additional clinical studies and increased expenses associated with the services of our CROs and other third parties.

Product development costs to us and our collaborators will increase if we have delays in testing or approval of our product candidates or if we need to perform more or larger clinical studies than planned. For example, we may need to increase our sample size for our VISTA-16 study for varespladib if the overall major adverse cardiovascular event, or MACE, rate is lower than expected. We typically rely on third-party clinical investigators at medical institutions and

health care facilities to conduct our clinical studies and, as a result, we may face additional delaying factors outside our control.

Additionally, changes in regulatory requirements and policies may occur and we may need to amend clinical study protocols to reflect these changes. Amendments may require us to resubmit our clinical study protocols to IRBs for reexamination, which may impact



## **Table of Contents**

the costs, timing or successful completion of a clinical study. If we experience delays in completion of, or if we, the FDA or other regulatory authorities, the IRB or other reviewing entities, or any of our clinical study sites suspend or terminate any of our clinical studies, the commercial prospects for our product candidates may be harmed and our ability to generate product revenues will be delayed. In addition, many of the factors that cause, or lead to, termination or suspension of, or a delay in the commencement or completion of, clinical studies may also ultimately lead to the denial of regulatory approval of a product candidate. Also, if one or more clinical studies are delayed, our competitors may be able to bring products to market before we do, and the commercial viability of our product candidates could be significantly reduced.

***The results of biomarker assays in earlier clinical studies in varespladib are not necessarily predictive of future results, and therefore the results of biomarker assays in the VISTA-16 study may not be similar to those observed previously.***

Success in our Phase 2 clinical studies in lowering low-density lipoprotein cholesterol, or LDL-C, C-reactive protein, or CRP, sPLA<sub>2</sub> and interleukin-6, or IL-6, during treatment with varespladib does not ensure that later clinical studies, such as our VISTA-16 study, will demonstrate similar reductions in these biomarkers. Each of these biomarkers has been associated with an increased risk for secondary MACE following an acute coronary syndrome. Our inability to demonstrate similar biomarker effects in our VISTA-16 study may reduce our ability to achieve our primary endpoint to reduce MACE and to achieve regulatory approval of varespladib.

***Because the results of preclinical testing or earlier clinical studies are not necessarily predictive of future results, varespladib, A-623, A-001 or any other product candidate we advance into clinical studies may not have favorable results in later clinical studies or receive regulatory approval.***

Success in preclinical testing and early clinical studies does not ensure that later clinical studies will generate adequate data to demonstrate the efficacy and safety of an investigational drug or biologic. A number of companies in the pharmaceutical and biotechnology industries, including those with greater resources and experience, have suffered significant setbacks in Phase 3 clinical studies, even after seeing promising results in earlier clinical studies. Despite the results reported in earlier clinical studies for our product candidates, including varespladib, A-623 and A-001, we do not know whether any Phase 3 or other clinical studies we may conduct will demonstrate adequate efficacy and safety to result in regulatory approval to market any of our product candidates. If later stage clinical studies do not produce favorable results, our ability to achieve regulatory approval for any of our product candidates may be adversely impacted.

***If we breach the license agreements for our primary product candidates, we could lose the ability to continue the development and commercialization of our primary product candidates.***

We are party to an agreement with Eli Lilly and Shionogi & Co., Ltd. containing exclusive, worldwide licenses, except for Japan, of the composition of matter, methods of making and methods of use for certain sPLA<sub>2</sub> inhibitors. We are also party to an agreement with Amgen containing exclusive, worldwide licenses of the composition of matter and methods of use for A-623. These agreements require us to make timely milestone and royalty payments, provide regular information, maintain the confidentiality of and indemnify Eli Lilly, Shionogi & Co., Ltd. and Amgen under the terms of the agreements.

If we fail to meet these obligations, our licensors may terminate our exclusive licenses and may be able to re-obtain licensed technology and aspects of any intellectual property controlled by us that relate to the licensed technology that originated from the licensors. Our licensors could effectively take control of the development and commercialization of varespladib, A-623 and A-001 after an uncured, material breach of our license agreements by us or if we voluntarily terminate the agreements. While we would expect to exercise all rights and remedies available to us, including seeking to cure any breach by us, and otherwise seek to preserve our rights under the patents licensed to us, we may not be able to do so in a timely manner, at an acceptable cost or at all. Any uncured, material breach under the licenses could result in our loss of exclusive rights and may lead to a complete termination of our product development and any commercialization efforts for varespladib, A-623 or A-001.

***Our industry is subject to intense competition. If we are unable to compete effectively, our product candidates may be rendered non-competitive or obsolete.***

The pharmaceutical industry is highly competitive and subject to rapid and significant technological change. Our potential competitors include large pharmaceutical and more established biotechnology companies, specialty pharmaceutical and generic drug companies, academic institutions, government agencies and other public and private research organizations that conduct research, seek

**Table of Contents**

patent protection and establish collaborative arrangements for research, development, manufacturing and commercialization. All of these competitors currently engage in, have engaged in or may engage in the future in the development, manufacturing, marketing and commercialization of pharmaceuticals and biotechnologies, some of which may compete with our present or future product candidates. It is possible that any of these competitors could develop technologies or products that would render our product candidates obsolete or non-competitive, which could adversely affect our revenue potential. Key competitive factors affecting the commercial success of our product candidates are likely to be efficacy, safety profile, reliability, convenience of dosing, price and reimbursement.

The market for inflammatory disease therapeutics is especially large and competitive. All of the sPLA<sub>2</sub> inhibitor compounds we are currently developing, if approved, will face intense competition, either as monotherapies or in combination therapies. We are aware of other companies with products in development that are being tested for anti-inflammatory benefits in patients with acute coronary syndrome, such as Via Pharmaceuticals, Inc. and its 5-lipoxygenase, or 5-LO, inhibitor, which has been evaluated in Phase 2 clinical studies; and GlaxoSmithKline plc and its product candidate, darapladib, which is a lipoprotein associated phospholipase A<sub>2</sub>, or Lp-PLA<sub>2</sub>, inhibitor currently being evaluated in Phase 3 clinical studies. Although there are no sPLA<sub>2</sub> inhibitor compounds currently approved by the FDA for the treatment of acute chest syndrome associated with sickle cell disease, Droxia, or hydroxyurea, is approved for the prevention of vaso-occlusive crisis, or VOC, in sickle cell disease and thus could reduce the pool of patients with VOC at risk for acute chest syndrome. Further, we are aware of companies with other products in development that are being tested for potential treatment of lupus, including Human Genome Sciences, Inc. and GlaxoSmithKline plc, who have a BAFF antagonist monoclonal antibody product candidate, Benlysta, which recently reported favorable results from a Phase 3 clinical study in lupus; ZymoGenetics, Inc. and Merck Serono S.A., whose dual BAFF/APRIL antagonist fusion protein, Atacicept, is in a Phase 3 clinical study for lupus; and Immunomedics, Inc. and UCB S.A., who recently reported favorable results for their CD-22 antagonist humanized antibody, epratuzumab, which completed a Phase 2b clinical study in lupus.

Many of our potential competitors have substantially greater financial, technical and human resources than we do and significantly greater experience in the discovery and development of drug candidates, obtaining FDA and other regulatory approvals of products and the commercialization of those products. Accordingly, our competitors may be more successful than we may be in obtaining FDA approval for drugs and achieving widespread market acceptance. Our competitors' drugs may be more effective, have fewer adverse effects, be less expensive to develop and manufacture or be more effectively marketed and sold than any product candidate we may commercialize and may render our product candidates obsolete or non-competitive before we can recover the expenses of developing and commercializing any of our product candidates. We anticipate that we will face intense and increasing competition as new drugs enter the market and advanced technologies become available. These entities may also establish collaborative or licensing relationships with our competitors. Finally, the development of new treatment methods for the diseases we are targeting could render our drugs non-competitive or obsolete. All of these factors could adversely affect our business.

***Our product candidates may cause undesirable adverse effects or have other properties that could delay or prevent their regulatory approval or limit the commercial profile of any approved label.***

Undesirable adverse effects caused by our product candidates could cause us, IRBs or other reviewing entities, clinical study sites, or regulatory authorities to interrupt, delay or halt clinical studies and could result in the denial of regulatory approval by the FDA or other regulatory authorities. Phase 2 clinical studies conducted by us with our product candidates have generated differences in adverse effects and serious adverse events. The most common adverse effects seen with any of our product candidates versus placebo include diarrhea, headache, nausea and increases in alanine aminotransferase, which is an enzyme that indicates liver cell injury. The most common serious adverse events seen with any of our product candidates include death, VOC and congestive heart failure. While none of these serious adverse events were considered related to the administration of our product candidates by the clinical investigators, if serious adverse events that are considered related to our product candidates are observed in any Phase 3 clinical studies, our ability to obtain regulatory approval for our product candidates may be adversely impacted. Further, if any of our product candidates receives marketing approval and we or others later discover, after approval and use in an increasing number of patients, that our products could have adverse effect profiles that limit their

usefulness or require their withdrawal (whether or not the therapies showed the adverse effect profile in Phase 1 through Phase 3 clinical studies), a number of potentially significant negative consequences could result, including:

- regulatory authorities may withdraw their approval of the product;

- regulatory authorities may require the addition of labeling statements, such as warnings or contraindications;

## **Table of Contents**

we may be required to change the way the product is administered, conduct additional clinical studies or change the labeling of the product;

we could be sued and held liable for harm caused to patients; and

our reputation may suffer.

Any of these events could prevent us from achieving or maintaining market acceptance of the affected product candidate and could substantially increase the costs of commercializing our product candidates.

***After the completion of our clinical studies, we cannot predict whether or when we will obtain regulatory approval to commercialize our product candidates and we cannot, therefore, predict the timing of any future revenue from these product candidates.***

We cannot commercialize any of our product candidates until the appropriate regulatory authorities have reviewed and approved the applications for the product candidates. We cannot assure you that the regulatory agencies will complete their review processes in a timely manner or that we will obtain regulatory approval for any product candidate we develop. Satisfaction of regulatory requirements typically takes many years, is dependent upon the type, complexity and novelty of the product and requires the expenditure of substantial resources. In addition, we may experience delays or rejections based upon additional government regulation from future legislation or administrative action or changes in FDA policy during the period of product development, clinical studies and FDA regulatory review.

***Our agreement with the FDA on an SPA for our VISTA-16 study of varespladib for the potential treatment of acute coronary syndrome does not guarantee any particular outcome from regulatory review of the study or the product candidate.***

The FDA's SPA process creates a written agreement between the sponsoring company and the FDA regarding clinical study design and other clinical study issues that can be used to support approval of a product candidate. The SPA is intended to provide assurance that if the agreed upon clinical study protocols are followed and the clinical study endpoints are achieved, the data may serve as the primary basis for an efficacy claim in support of an NDA. However, the SPA agreement is not a guarantee of an approval of a product or any permissible claims about the product. In particular, the SPA is not binding on the FDA if public health concerns unrecognized at the time of the SPA agreement is entered into become evident, other new scientific concerns regarding product safety or efficacy arise or if the sponsor company fails to comply with the agreed upon clinical study protocols. Although we have an agreement with the FDA on an SPA for our VISTA-16 clinical study of varespladib for the potential short-term (16-week) treatment of acute coronary syndrome, we do not know how the FDA will interpret the commitments under our agreed upon SPA, how it will interpret the data and results or whether it will approve our varespladib product candidate for the short-term (16-week) treatment of acute coronary syndrome. Regardless of our SPA agreement, we cannot guarantee any particular outcome from regulatory review of our VISTA-16 study.

***Even if our product candidates receive regulatory approval, they may still face future development and regulatory difficulties.***

Even if U.S. regulatory approval is obtained, the FDA may still impose significant restrictions on a product's indicated uses or marketing or impose ongoing requirements for potentially costly post-approval studies or post-market surveillance. For example, the label ultimately approved for varespladib, if any, may include restrictions on use. Further, the FDA has indicated that long-term safety data on varespladib may need to be obtained as a post-market requirement. Our product candidates will also be subject to ongoing FDA requirements governing the labeling, packaging, storage, distribution, safety surveillance, advertising, promotion, recordkeeping and reporting of safety and other post-market information. In addition, manufacturers of drug products and their facilities are subject to continual review and periodic inspections by the FDA and other regulatory authorities for compliance with current good manufacturing practices, or cGMP, regulations. If we or a regulatory agency discovers previously unknown problems with a product, such as adverse events of unanticipated severity or frequency, or problems with the facility where the product is manufactured, a regulatory agency may impose restrictions on that product, the manufacturing facility or us, including requiring recall or withdrawal of the product from the market or suspension of manufacturing. If we, our product candidates or the manufacturing facilities for our product candidates fail to comply with applicable

regulatory requirements, a regulatory agency may:

issue warning letters or untitled letters;

seek an injunction or impose civil or criminal penalties or monetary fines;

36

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## **Table of Contents**

suspend or withdraw regulatory approval;

suspend any ongoing clinical studies;

refuse to approve pending applications or supplements to applications filed by us;

suspend or impose restrictions on operations, including costly new manufacturing requirements; or

seize or detain products, refuse to permit the import or export of products, or require us to initiate a product recall.

The occurrence of any event or penalty described above may inhibit our ability to commercialize our products and generate revenue.

***New legal and regulatory requirements could make it more difficult for us to obtain approvals for our product candidates and could limit or make more burdensome our ability to commercialize any approved products.***

New federal legislation or regulatory requirements could affect the requirements for obtaining regulatory approvals of our product candidates or otherwise limit our ability to commercialize any approved products or subject our products to more rigorous post-approval requirements. For example, the FDA Amendments Act of 2007, or FDAAA, granted the FDA new authority to impose post-approval clinical study requirements, require safety-related changes to product labeling and require the adoption of risk management plans, referred to in the legislation as risk evaluation and mitigation strategies, or REMS. The REMS may include requirements for special labeling or medication guides for patients, special communication plans to health care professionals, and restrictions on distribution and use. Pursuant to the FDAAA, if the FDA makes the requisite findings, it might require that a new product be used only by physicians with specified specialized training, only in specified designated health care settings, or only in conjunction with special patient testing and monitoring. The legislation also included the following: requirements for providing the public information on ongoing clinical studies through a clinical study registry and for disclosing clinical study results to the public through such registry; renewed requirements for conducting clinical studies to generate information on the use of products in pediatric patients; and substantial new penalties, for example, for false or misleading consumer advertisements. Other proposals have been made to impose additional requirements on drug approvals, further expand post-approval requirements, and restrict sales and promotional activities. The new legislation, and the additional proposals if enacted, may make it more difficult or burdensome for us to obtain approval of our product candidates, any approvals we receive may be more restrictive or be subject to onerous post-approval requirements, our ability to successfully commercialize approved products may be hindered and our business may be harmed as a result.

***If any of our product candidates for which we receive regulatory approval does not achieve broad market acceptance, the revenue that we generate from its sales, if any, will be limited.***

The commercial success of our product candidates for which we obtain marketing approval from the FDA or other regulatory authorities will depend upon the acceptance of these products by the medical community, including physicians, patients and health care payors. The degree of market acceptance of any of our approved products will depend on a number of factors, including:

demonstration of clinical safety and efficacy compared to other products;

the relative convenience, ease of administration and acceptance by physicians and payors of varespladib in the treatment of acute coronary syndrome, A-623 in the treatment of lupus and A-001 in the prevention of acute chest syndrome associated with sickle cell disease;

the prevalence and severity of any adverse effects;

limitations or warnings contained in a product's FDA-approved labeling;

availability of alternative treatments, including, in the case of varespladib, a number of competitive products being studied for anti-inflammatory benefits in patients with acute coronary syndrome or expected to be

commercially launched in the near future;

pricing and cost-effectiveness;



## **Table of Contents**

the effectiveness of our or any future collaborators' sales and marketing strategies;

our ability to obtain and maintain sufficient third-party coverage or reimbursement from government health care programs, including Medicare and Medicaid; and

the willingness of patients to pay out-of-pocket in the absence of third-party coverage.

If our product candidates are approved but do not achieve an adequate level of acceptance by physicians, health care payors and patients, we may not generate sufficient revenue from these products, and we may not become or remain profitable. In addition, our efforts to educate the medical community and third-party payors on the benefits of our product candidates may require significant resources and may never be successful.

***Our future success depends on our ability to retain our chief executive officer and other key executives and to attract, retain and motivate qualified personnel.***

We are highly dependent on Mr. Paul F. Truex, our President and Chief Executive Officer, Dr. Colin Hislop, our Senior Vice President and Chief Medical Officer, and the other principal members of our executive team. The loss of the services of any of these persons might impede the achievement of our research, development and commercialization objectives. Recruiting and retaining qualified scientific personnel and possibly sales and marketing personnel will also be critical to our success. We may not be able to attract and retain these personnel on acceptable terms given the competition among numerous pharmaceutical and biotechnology companies for similar personnel. We also experience competition for the hiring of scientific personnel from universities and research institutions. Failure to succeed in clinical studies may make it more challenging to recruit and retain qualified scientific personnel. In addition, we rely on consultants and advisors, including scientific and clinical advisors, to assist us in formulating our research and development and commercialization strategy. Our consultants and advisors may be employed by employers other than us and may have commitments under consulting or advisory contracts with other entities that may limit their availability to us.

***Recently enacted and future legislation or regulatory reform of the health care system in the United States and foreign jurisdictions may affect our ability to sell our products profitably.***

Our ability to commercialize our future products successfully, alone or with collaborators, will depend in part on the extent to which reimbursement for the products will be available from government and health administration authorities, private health insurers and other third-party payors. The continuing efforts of the U.S. and foreign governments, insurance companies, managed care organizations and other payors of health care services to contain or reduce health care costs may adversely affect our ability to set prices for our products which we believe are fair, and our ability to generate revenues and achieve and maintain profitability.

Specifically, in both the United States and some foreign jurisdictions, there have been a number of legislative and regulatory proposals to change the health care system in ways that could affect our ability to sell our products profitably. In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, or collectively, the Health Care Reform Law, a sweeping law intended to broaden access to health insurance, reduce or constrain the growth of healthcare spending, enhance remedies against fraud and abuse, add new transparency requirements for healthcare and health insurance industries, impose new taxes and fees on the health industry and impose additional health policy reforms.

We will not know the full effects of the Health Care Reform Law until applicable federal and state agencies issue regulations or guidance under the new law. Although it is too early to determine the effect of the Health Care Reform Law, the new law appears likely to continue the pressure on pharmaceutical pricing, especially under the Medicare program, and also may increase our regulatory burdens and operating costs. We expect further federal and state proposals and health care reforms to continue to be proposed by legislators, which could limit the prices that can be charged for the products we develop and may limit our commercial opportunity.

Also in the United States, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, also called the Medicare Modernization Act, or MMA, changed the way Medicare covers and pays for pharmaceutical products. The legislation expanded Medicare coverage for drug purchases by the elderly and introduced a new reimbursement methodology based on average sales prices for drugs. In addition, this legislation authorized Medicare Part D prescription drug plans to use formularies where they can limit the number of drugs that will be covered in any

therapeutic class. As a result of this legislation and the expansion of federal coverage of drug

## Table of Contents

products, we expect that there will be additional pressure to contain and reduce costs. These cost reduction initiatives and other provisions of this legislation could decrease the coverage and price that we receive for any approved products and could seriously harm our business. While the MMA applies only to drug benefits for Medicare beneficiaries, private payors often follow Medicare coverage policy and payment limitations in setting their own reimbursement rates, and any reduction in reimbursement that results from the MMA may result in a similar reduction in payments from private payors.

The continuing efforts of government and other third-party payors to contain or reduce the costs of health care through various means may limit our commercial opportunity. It will be time-consuming and expensive for us to go through the process of seeking reimbursement from Medicare and private payors. Our products may not be considered cost-effective, and government and third-party private health insurance coverage and reimbursement may not be available to patients for any of our future products or sufficient to allow us to sell our products on a competitive and profitable basis. Our results of operations could be adversely affected by the MMA, the Health Care Reform Law, and additional prescription drug coverage legislation, by the possible effect of this legislation on amounts that private insurers will pay and by other health care reforms that may be enacted or adopted in the future. In addition, increasing emphasis on managed care in the United States will continue to put pressure on the pricing of pharmaceutical products. Cost control initiatives could decrease the price that we or any potential collaborators could receive for any of our future products and could adversely affect our profitability.

In some foreign countries, including major markets in the European Union and Japan, the pricing of prescription pharmaceuticals is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take six to 12 months or longer after the receipt of regulatory marketing approval for a product. To obtain reimbursement or pricing approval in some countries, we may be required to conduct a clinical study that compares the cost-effectiveness of our product candidates to other available therapies. Such pharmacoeconomic studies can be costly and the results uncertain. Our business could be harmed if reimbursement of our products is unavailable or limited in scope or amount or if pricing is set at unsatisfactory levels.

***We face potential product liability exposure, and, if successful claims are brought against us, we may incur substantial liability.***

The use of our product candidates in clinical studies and the sale of any products for which we obtain marketing approval expose us to the risk of product liability claims. Product liability claims might be brought against us by consumers, health care providers, pharmaceutical companies or others selling or otherwise coming into contact with our products. If we cannot successfully defend ourselves against product liability claims, we could incur substantial liabilities. In addition, regardless of merit or eventual outcome, product liability claims may result in:

- impairment of our business reputation;
- withdrawal of clinical study participants;
- costs of related litigation;
- distraction of management's attention from our primary business;
- substantial monetary awards to patients or other claimants;
- the inability to commercialize our product candidates; and

decreased demand for our product candidates, if approved for commercial sale.

Our product liability insurance coverage for our clinical studies may not be sufficient to reimburse us for all expenses or losses we may suffer. Moreover, insurance coverage is becoming increasingly expensive, and, in the future, we may not be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability. If and when we obtain marketing approval for any of our product candidates, we intend to expand our insurance coverage to include the sale of commercial products; however, we may be unable to obtain

this product liability insurance on commercially reasonable terms. On occasion, large judgments have been awarded in class action lawsuits based on drugs that had unanticipated adverse effects. A successful product liability claim or series of claims brought against us could cause our stock price to decline and, if judgments exceed our insurance coverage, could decrease our cash and adversely affect our business.

**Table of Contents**

***If we use hazardous and biological materials in a manner that causes injury or violates applicable law, we may be liable for damages.***

Our research and development activities involve the controlled use of potentially hazardous substances, including toxic chemical and biological materials. We could be held liable for any contamination, injury or other damages resulting from these hazardous substances. In addition, our operations produce hazardous waste products. While third parties are responsible for disposal of our hazardous waste, we could be liable under environmental laws for any required cleanup of sites at which our waste is disposed. Federal, state, foreign and local laws and regulations govern the use, manufacture, storage, handling and disposal of these hazardous materials. If we fail to comply with these laws and regulations at any time, or if they change, we may be subject to criminal sanctions and substantial civil liabilities, which may harm our business. Even if we continue to comply with all applicable laws and regulations regarding hazardous materials, we cannot eliminate the risk of accidental contamination or discharge and our resultant liability for any injuries or other damages caused by these accidents.

***We rely on third parties to conduct, supervise and monitor our clinical studies, and those third parties may perform in an unsatisfactory manner, such as by failing to meet established deadlines for the completion of these clinical studies, or may harm our business if they suffer a catastrophic event.***

We rely on third parties such as CROs, medical institutions and clinical investigators to enroll qualified patients and conduct, supervise and monitor our clinical studies. Our reliance on these third parties for clinical development activities reduces our control over these activities. Our reliance on these third parties, however, does not relieve us of our regulatory responsibilities, including ensuring that our clinical studies are conducted in accordance with good clinical practices, or GCP, and the investigational plan and protocols contained in the relevant regulatory application, such as the investigational new drug application, or IND. In addition, the CROs with which we contract may not complete activities on schedule, or may not conduct our preclinical studies or clinical studies in accordance with regulatory requirements or our clinical study design. If these third parties do not successfully carry out their contractual duties or meet expected deadlines, our efforts to obtain regulatory approvals for, and to commercialize, our product candidates may be delayed or prevented. In addition, if a catastrophe such as an earthquake, fire, flood or power loss should affect one of the third parties on which we rely, our business prospects could be harmed. For example, if a central laboratory holding all of our clinical study samples were to suffer a catastrophic loss of their facility, we would lose all of our samples and would have to repeat our studies.

***Any failure by our third-party manufacturers on which we rely to produce our preclinical and clinical drug supplies and on which we intend to rely to produce commercial supplies of any approved product candidates may delay or impair our ability to commercialize our product candidates.***

We have relied upon a small number of third-party manufacturers and active pharmaceutical ingredient formulators for the manufacture of our material for preclinical and clinical testing purposes and intend to continue to do so in the future. We also expect to rely upon third parties to produce materials required for the commercial production of our product candidates if we succeed in obtaining necessary regulatory approvals. If we are unable to arrange for third-party manufacturing sources, or to do so on commercially reasonable terms, we may not be able to complete development of our product candidates or market them.

Reliance on third-party manufacturers entails risks to which we would not be subject if we manufactured product candidates ourselves, including reliance on the third party for regulatory compliance and quality assurance, the possibility of breach of the manufacturing agreement by the third party because of factors beyond our control (including a failure to synthesize and manufacture our product candidates in accordance with our product specifications) and the possibility of termination or nonrenewal of the agreement by the third party, based on its own business priorities, at a time that is costly or damaging to us. In addition, the FDA and other regulatory authorities require that our product candidates be manufactured according to cGMP and similar foreign standards. Any failure by our third-party manufacturers to comply with cGMP or failure to scale up manufacturing processes, including any failure to deliver sufficient quantities of product candidates in a timely manner, could lead to a delay in, or failure to obtain, regulatory approval of any of our product candidates. In addition, such failure could be the basis for action by the FDA to withdraw approvals for product candidates previously granted to us and for other regulatory action, including recall or seizure, total or partial suspension of production or injunction.

We received a request from the FDA for additional information regarding the characterization and qualification of the manufactured vials of A-623 we intend to use in our PEARL-SC clinical study. In addition, the FDA has asked for a proposal to establish comparability

**Table of Contents**

of future manufactured A-623 to be included in clinical studies. Any inability to use A-623 in our inventory would require manufacture of additional A-623 for use in our clinical study and would result in additional expense and potential delay of our clinical development plans.

We rely on our manufacturers to purchase from third-party suppliers the materials necessary to produce our product candidates for our clinical studies. There are a small number of suppliers for certain capital equipment and raw materials that we use to manufacture our drugs. Such suppliers may not sell these raw materials to our manufacturers at the times we need them or on commercially reasonable terms. We do not have any control over the process or timing of the acquisition of these raw materials by our manufacturers. Moreover, we currently do not have any agreements for the commercial production of these raw materials. Although we generally do not begin a clinical study unless we believe we have a sufficient supply of a product candidate to complete the clinical study, any significant delay in the supply of a product candidate or the raw material components thereof for an ongoing clinical study due to the need to replace a third-party manufacturer could considerably delay completion of our clinical studies, product testing and potential regulatory approval of our product candidates. If our manufacturers or we are unable to purchase these raw materials after regulatory approval has been obtained for our product candidates, the commercial launch of our product candidates would be delayed or there would be a shortage in supply, which would impair our ability to generate revenues from the sale of our product candidates.

Because of the complex nature of our compounds, our manufacturers may not be able to manufacture our compounds at a cost or in quantities or in a timely manner necessary to make commercially successful products. If we successfully commercialize any of our drugs, we may be required to establish large-scale commercial manufacturing capabilities. In addition, as our drug development pipeline increases and matures, we will have a greater need for clinical study and commercial manufacturing capacity. We have no experience manufacturing pharmaceutical products on a commercial scale and some of these suppliers will need to increase their scale of production to meet our projected needs for commercial manufacturing, the satisfaction of which on a timely basis may not be met.

***If we are unable to establish sales and marketing capabilities or enter into agreements with third parties to market and sell our product candidates, we may be unable to generate any revenue.***

We do not currently have an organization for the sales, marketing and distribution of pharmaceutical products and the cost of establishing and maintaining such an organization may exceed the cost-effectiveness of doing so. In order to market any products that may be approved by the FDA, we must build our sales, marketing, managerial and other non-technical capabilities or make arrangements with third parties to perform these services. If we are unable to establish adequate sales, marketing and distribution capabilities, whether independently or with third parties, we may not be able to generate product revenue and may not become profitable. We will be competing with many companies that currently have extensive and well-funded marketing and sales operations. Without an internal team or the support of a third party to perform marketing and sales functions, we may be unable to compete successfully against these more established companies.

***Guidelines and recommendations published by various organizations may adversely affect the use of any products for which we may receive regulatory approval.***

Government agencies issue regulations and guidelines directly applicable to us and to our product candidates. In addition, professional societies, practice management groups, private health or science foundations and organizations involved in various diseases from time to time publish guidelines or recommendations to the medical and patient communities. These various sorts of recommendations may relate to such matters as product usage and use of related or competing therapies. For example, organizations like the American Heart Association have made recommendations about therapies in the cardiovascular therapeutics market. Changes to these recommendations or other guidelines advocating alternative therapies could result in decreased use of any products for which we may receive regulatory approval, which may adversely affect our results of operations.

### **Risks Related to Our Intellectual Property**

***If our or our licensors' patent positions do not adequately protect our product candidates or any future products, others could compete with us more directly, which would harm our business.***

We hold a total of four pending U.S. non-provisional patent applications, two pending U.S. provisional patent applications and two pending Patent Cooperation Treaty, or PCT, patent applications. Another PCT application has

entered the national phase in the European Patent Office, the Eurasian Patent Organization and 17 other countries. We have also entered into exclusive license agreements for certain



## **Table of Contents**

composition of matter, method of use and method of making patents and patent applications for certain of our development compounds. These license agreements encompass (i) 13 U.S. patents, one pending U.S. non-provisional patent application, five European, or EP, patents, one pending EP patent application, 20 non-EP foreign patents and four pending non-EP foreign patent applications relating to varespladib and A-001; (ii) more than 30 U.S. patents, one pending U.S. non-provisional patent application, six EP patents, one pending EP patent application, 13 issued non-EP foreign patents and one pending non-EP foreign patent application relating to other sPLA<sub>2</sub> inhibiting compounds including A-003; and (iii) two U.S. patents, one pending U.S. non-provisional patent application, one EP patent, two pending EP patent applications, ten non-EP foreign patents and 14 non-EP foreign patent applications relating to A-623. Our commercial success will depend in part on our and our licensors' ability to obtain additional patents and protect our existing patent positions, particularly those patents for which we have secured exclusive rights, as well as our ability to maintain adequate protection of other intellectual property for our technologies, product candidates and any future products in the United States and other countries. If we or our licensors do not adequately protect our intellectual property, competitors may be able to use our technologies and erode or negate any competitive advantage we may have, which could materially harm our business, negatively affect our position in the marketplace, limit our ability to commercialize our product candidates and delay or render impossible our achievement of profitability. The laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States, and we may encounter significant problems in protecting our proprietary rights in these countries.

The patent positions of biotechnology and pharmaceutical companies, including our patent position, involve complex legal and factual questions, and, therefore, validity and enforceability cannot be predicted with certainty. Patents may be challenged, deemed unenforceable, invalidated or circumvented. We and our licensors will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies, product candidates and any future products are covered by valid and enforceable patents or are effectively maintained as trade secrets.

The degree of future protection for our proprietary rights is uncertain, and we cannot ensure that:

we or our licensors were the first to make the inventions covered by each of our pending patent applications;

we or our licensors were the first to file patent applications for these inventions;

others will not independently develop similar or alternative technologies or duplicate any of our technologies;

any of our or our licensors' pending patent applications will result in issued patents;

any of our or our licensors' patents will be valid or enforceable;

any patents issued to us or our licensors and collaborators will provide a basis for commercially viable products, will provide us with any competitive advantages or will not be challenged by third parties;

we will develop additional proprietary technologies or product candidates that are patentable; or

the patents of others will not have an adverse effect on our business.

### ***We may be unable to adequately prevent disclosure of trade secrets and other proprietary information.***

We rely on trade secrets to protect our proprietary know-how and technological advances, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to protect. We rely in part on confidentiality agreements with our employees, consultants, outside scientific collaborators, sponsored researchers and other advisors to protect our trade secrets and other proprietary information. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover our trade secrets and proprietary information. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights. Failure to obtain or maintain trade secret protection could enable competitors to use

our proprietary information to develop products that compete with our products or cause additional, material adverse effects upon our competitive business position.

**Table of Contents**

***We license patent rights from third-party owners. If we, or such owners, do not properly maintain or enforce the patents underlying such licenses, our competitive position and business prospects will be harmed.***

We have obtained exclusive, worldwide licenses, except for Japan, of the composition of matter, methods of making and methods of use for certain sPLA<sub>2</sub> compounds from Eli Lilly and Shionogi & Co., Ltd. In addition, we are party to a license agreement with Amgen that provides for the exclusive and worldwide rights to develop and commercialize A-623, a novel BAFF inhibitor, as well as non-exclusive rights to certain technology relating to peptibody compositions and formulations. We may enter into additional licenses to third-party intellectual property in the future.

We depend in part on our licensors to protect the proprietary rights covering our in-licensed sPLA<sub>2</sub> compounds and A-623, respectively. Our licensors are responsible for maintaining certain issued patents and prosecuting certain patent applications. We have limited, if any, control over the amount or timing of resources that our licensors devote on our behalf or the priority they place on maintaining these patent rights and prosecuting these patent applications to our advantage. Our licensors may also be notified of alleged infringement and be sued for infringement of third-party patents or other proprietary rights. We may have limited, if any, control or involvement over the defense of these claims, and our licensors could be subject to injunctions and temporary or permanent exclusionary orders in the United States or other countries. Our licensors are not obligated to defend or assist in our defense against third-party claims of infringement. We have limited, if any, control over the amount or timing of resources, if any, that our licensors devote on our behalf or the priority they place on defense of such third-party claims of infringement.

Our success will depend in part on the ability of us or our licensors to obtain, maintain and enforce patent protection for their intellectual property, in particular, those patents to which we have secured exclusive rights. We or our licensors may not successfully prosecute the patent applications which we have licensed. Even if patents issue in respect of these patent applications, we or our licensors may fail to maintain these patents, may determine not to pursue litigation against other companies that are infringing these patents or may pursue such litigation less aggressively than we would. Without protection for the intellectual property we license, other companies might be able to offer substantially identical products for sale, which could adversely affect our competitive business position and harm our business prospects.

***If we do not obtain protection under the Hatch-Waxman Act and similar foreign legislation to extend our licensed patent terms and to obtain market exclusivity for our product candidates, our business will be materially harmed.***

The United States Drug Price Competition and Patent Term Restoration Act of 1984, more commonly known as the Hatch-Waxman Act, provides for an extension of patent term for drug compounds for a period of up to five years to compensate for time spent in the regulatory approval process. Assuming we gain a five-year patent term extension for each of our current product candidates in clinical development, and that we continue to have rights under our license agreements with respect to these product candidates, we would have exclusive rights to varespladib's U.S. new chemical entity patent (the primary patent covering the compound as a new composition of matter) until 2019 and to A-623's U.S. new chemical entity patent until 2027. In Europe, similar legislative enactments allow patent terms in the European Union to be extended for up to five years through the grant of a Supplementary Protection Certificate. Assuming we gain such a five-year extension for each of our current product candidates in clinical development, and that we continue to have rights under our license agreements with respect to these product candidates, we would have exclusive rights to varespladib's European new chemical entity patents until 2020 and to A-623's European new chemical entity patents until 2027. In addition, since varespladib has not been previously approved in the United States, varespladib could be eligible for up to five years of New Chemical Entity, or NCE, exclusivity from the FDA. NCE exclusivity would prevent the FDA from approving any generic competitor following NDA approval independent of the patent status of varespladib. Further, since A-623 has not been previously approved, A-623 could be eligible for 12 years of data exclusivity from the FDA. During the data exclusivity period, competitors are barred from relying on the innovator biologic's safety and efficacy data to gain approval. Similarly, the European Union provides that companies who receive regulatory approval for a new small molecule compound or biologic will have a 10-year period of data exclusivity for that compound or biologic (with the possibility of a further one-year extension) in most EU countries, beginning on the date of such European regulatory approval, regardless of when the European new chemical entity patent covering such compound expires. A generic version of the approved drug may not be

marketed or sold during such market exclusivity period. However, there is no assurance that we will receive the extensions of our patents or other exclusive rights available under the Hatch-Waxman Act or similar foreign legislation. If we fail to receive such Hatch-Waxman extensions or marketing exclusivity rights or if we receive extensions that are materially shorter than expected, our ability to prevent competitors from manufacturing, marketing and selling generic versions of our products will be materially harmed.

**Table of Contents**

***Our current patent positions and license portfolio may not include all patent rights needed for the full development and commercialization of our product candidates. We cannot be sure that patent rights we may need in the future will be available for license to us on commercially reasonable terms, or at all.***

We typically develop our product candidates using compounds for which we have in-licensed and original composition of matter patents and patents that claim the activities and methods for such compounds' production and use to the extent known at that time. As we learn more about the mechanisms of action and new methods of manufacture and use of these product candidates, we may file additional patent applications for these new inventions or we may need to ask our licensors to file them. We may also need to license additional patent rights or other rights on compounds, treatment methods or manufacturing processes because we learn that we need such rights during the continuing development of our product candidates.

Although our in-licensed and original patents may prevent others from making, using or selling similar products, they do not ensure that we will not infringe the patent rights of third parties. We may not be aware of all patents or patent applications that may impact our ability to make, use or sell any of our product candidates or proposed product candidates. For example, because we sometimes identify the mechanism of action or molecular target of a given product candidate after identifying its composition of matter and therapeutic use, we may not be aware until the mechanism or target is further elucidated that a third party has an issued or pending patent claiming biological activities or targets that may cover our product candidate. U.S. patent applications filed after November 29, 2000 are confidential in the U.S. Patent and Trademark Office for the first 18 months after such applications' earliest priority date, and patent offices in non-U.S. countries often publish patent applications for the first time six months or more after filing. Furthermore, we may not be aware of published or granted conflicting patent rights. Any conflicts resulting from patent applications and patents of others could significantly reduce the coverage of our patents and limit our ability to obtain meaningful patent protection. If others obtain patents with conflicting claims, we may need to obtain licenses to these patents or to develop or obtain alternative technology.

We may not be able to obtain any licenses or other rights to patents, technology or know-how from third parties necessary to conduct our business as described in this report and such licenses, if available at all, may not be available on commercially reasonable terms. Any failure to obtain such licenses could delay or prevent us from developing or commercializing our drug candidates or proposed product candidates, which would harm our business. Litigation or patent interference proceedings may be necessarily brought against third parties, as discussed below, to enforce any of our patents or other proprietary rights or to determine the scope and validity or enforceability of the proprietary rights of such third parties.

***Litigation regarding patents, patent applications and other proprietary rights may be expensive and time consuming. If we are involved in such litigation, it could cause delays in bringing product candidates to market and harm our ability to operate.***

Our commercial success will depend in part on our ability to manufacture, use, sell and offer to sell our product candidates and proposed product candidates without infringing patents or other proprietary rights of third parties. Although we are not currently aware of any litigation or other proceedings or third-party claims of intellectual property infringement related to our product candidates, the pharmaceutical industry is characterized by extensive litigation regarding patents and other intellectual property rights. Other parties may obtain patents in the future and allege that the use of our technologies infringes these patent claims or that we are employing their proprietary technology without authorization. Likewise, third parties may challenge or infringe upon our or our licensors' existing or future patents.

Proceedings involving our patents or patent applications or those of others could result in adverse decisions regarding the patentability of our inventions relating to our product candidates or the enforceability, validity or scope of protection offered by our patents relating to our product candidates.

Even if we are successful in these proceedings, we may incur substantial costs and divert management time and attention in pursuing these proceedings. If we are unable to avoid infringing the patent rights of others, we may be required to seek a license, defend an infringement action or challenge the validity of the patents in court. Patent litigation is costly and time-consuming. We may not have sufficient resources to bring these actions to a successful conclusion. In addition, if we do not obtain a license, develop or obtain non-infringing technology, fail to defend an

infringement action successfully or have infringed patents declared invalid, we may incur substantial monetary damages; encounter significant delays in bringing our product candidates to market; or be precluded from participating in the manufacture, use or sale of our product candidates or methods of treatment requiring licenses.

**Table of Contents**

**Risks Related to the Securities Markets and Investment in Our Common Stock**

***Market volatility may affect our stock price and the value of your investment.***

The market price for our common stock has been, and is likely to continue to be, volatile. In addition, the market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot predict or control, including:

plans for, progress in and results from clinical studies for varespladib, A-623, A-001 and our other product candidates;

announcements of new products, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;

developments concerning proprietary rights, including those pertaining to patents held by Eli Lilly and Shionogi & Co., Ltd. concerning our sPLA<sub>2</sub> inhibitors and Amgen concerning A-623;

failure of any of our product candidates, if approved, to achieve commercial success;

fluctuations in stock market prices and trading volumes of securities of similar companies;

general market conditions and overall fluctuations in U.S. equity markets;

variations in our operating results, or the operating results of our competitors;

changes in our financial guidance or securities analysts' estimates of our financial performance;

changes in accounting principles;

sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;

additions or departures of any of our key personnel;

announcements related to litigation;

changing legal or regulatory developments in the United States and other countries; and

discussion of us or our stock price by the financial press and in online investor communities.

In addition, the stock market in general, and The NASDAQ Global Market in particular, have experienced substantial price and volume volatility that is often seemingly unrelated to the operating performance of particular companies. These broad market fluctuations may cause the trading price of our common stock to decline. In the past, securities class action litigation has often been brought against a company after a period of volatility in the market price of its common stock. We may become involved in this type of litigation in the future. Any securities litigation claims brought against us could result in substantial expenses and the diversion of our management's attention from our business.

***Because a small number of our existing stockholders own a majority of our voting stock, your ability to influence corporate matters will be limited.***

As of September 30, 2010, our executive officers, directors and greater than 5% stockholders, in the aggregate, own approximately 79% of our outstanding common stock. As a result, such persons, acting together, will have the ability to control our management and affairs and substantially all matters submitted to our stockholders for approval, including the election and removal of directors and approval of any significant transaction. These persons will also

have the ability to control our management and business affairs. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control, impeding a merger, consolidation, takeover or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our business, even if such a transaction would benefit other stockholders.



## **Table of Contents**

### ***Future sales of our common stock may cause our stock price to decline.***

As of September 30, 2010, there were 32,835,437 shares of our common stock outstanding. 1,897,728 of the 32,835,437 shares may be sold upon expiration of lock-up agreements on December 4, 2010 (subject in some cases to volume limitations). In addition, as of September 30, 2010, we had outstanding options to purchase 1,307,066 shares of common stock that, if exercised, will result in these additional shares becoming available for sale. A large portion of these shares and options are held by a small number of persons and investment funds. Sales by these stockholders or optionholders of a substantial number of shares could significantly reduce the market price of our common stock. Moreover, certain holders of shares of common stock will have rights, subject to some conditions, to require us to file registration statements covering the shares they currently hold, or to include these shares in registration statements that we may file for ourselves or other stockholders.

We have registered all common stock that we may issue under our Amended and Restated 2010 Stock Option and Incentive Plan, or the 2010 Plan, and our Employee Stock Purchase Plan, or the ESPP. An aggregate of 433,644 shares of our common stock has been reserved for future issuance under the 2010 Plan, plus any shares reserved and unissued under our 2005 Equity Incentive Plan, and an aggregate of 100,000 shares has been reserved for future issuance under our ESPP. These shares can be freely sold in the public market upon issuance, subject to the lock-up agreements referred to above. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock.

### ***We may need to raise additional capital to fund our operations, which may cause dilution to our existing stockholders, restrict our operations or require us to relinquish rights.***

We may seek additional capital through a combination of private and public equity offerings, debt financings and collaboration, strategic and licensing arrangements. To the extent that we raise additional capital through the sale of equity or convertible debt securities, your ownership interest will be diluted, and the terms may include liquidation or other preferences that adversely affect your rights as a stockholder. Debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions such as incurring debt, making capital expenditures or declaring dividends. If we raise additional funds through collaboration, strategic alliance and licensing arrangements with third parties, we may have to relinquish valuable rights to our technologies or product candidates or grant licenses on terms that are not favorable to us.

### ***Being a public company increases our expenses and administrative burden.***

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, our administrative staff will be required to perform additional tasks. For example, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, as well as rules subsequently implemented by the Securities and Exchange Commission, or SEC, and The NASDAQ Global Market, impose various requirements on public companies, including establishment and maintenance of effective disclosure and financial controls and changes in corporate governance practices. We must also bear all of the internal and external costs of preparing and distributing periodic public reports in compliance with our obligations under the securities laws.

In particular, the Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. Commencing in 2011, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our compliance with Section 404 will require that we incur substantial accounting expense and expend significant management time on compliance-related issues. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, our stock price could decline, and we could face sanctions, delisting or investigations by The NASDAQ Global Market, or other material adverse effects on our business, reputation, results of operations, financial condition or liquidity.

### ***We do not intend to pay dividends on our common stock so any returns will be limited to the value of our stock.***

We have never declared or paid any cash dividend on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. Any return to stockholders will therefore be limited to the value of their stock.



## **Table of Contents**

***Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.***

Provisions in our amended and restated certificate of incorporation and amended and restated bylaws may delay or prevent an acquisition of us or a change in our management. These provisions include:

a classified and staggered board of directors whose members can only be dismissed for cause;

the prohibition on actions by written consent of our stockholders;

the limitation on who may call a special meeting of stockholders;

the establishment of advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon at stockholder meetings;

the ability of our board of directors to issue preferred stock without stockholder approval, which would increase the number of outstanding shares and could thwart a takeover attempt; and

the requirement of at least 75% of the outstanding common stock to amend any of the foregoing provisions.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us. Although we believe these provisions collectively provide for an opportunity to obtain greater value for stockholders by requiring potential acquirors to negotiate with our board of directors, they would apply even if an offer rejected by our board were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

***Our ability to use our net operating loss carryforwards may be subject to limitation and may result in increased future tax liability to us.***

Generally, a change of more than 50% in the ownership of a corporation's stock, by value, over a three-year period constitutes an ownership change for U.S. federal income tax purposes. An ownership change may limit a company's ability to use its net operating loss carryforwards attributable to the period prior to such change. We have not performed a detailed analysis to determine whether an ownership change under Section 382 of the Internal Revenue Code has occurred after each of our previous private placements of preferred stock and convertible debt, or our previous issuances of common stock, which if sufficient, taking into account prior or future shifts in our ownership over a three-year period, could cause us to undergo an ownership change. As a result, if we earn net taxable income, our ability to use our pre-change net operating loss carryforwards to offset U.S. federal taxable income may become subject to limitations, which could potentially result in increased future tax liability to us.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Previously reported in a Current Report on Form 8-K.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. (REMOVED AND RESERVED)**

### **ITEM 5. OTHER INFORMATION**

None.

**Table of Contents**

**ITEM 6. EXHIBITS**

The following exhibits are filed as part of this report:

- 3.1 Fifth Amended and Restated Certificate of Incorporation (filed as Exhibit 3.6 to the registrant's Registration Statement on Form S-1/A (File No. 333-161930) filed with the SEC on February 3, 2010, and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws (filed as Exhibit 3.7 to the registrant's Registration Statement on Form S-1/A (File No. 333-161930) filed with the SEC on February 3, 2010, and incorporated herein by reference).
- 10.1 Amended and Restated 2010 Stock Option and Incentive Plan (filed as Appendix A to the registrant's Definitive Proxy Statement on Schedule 14A filed June 8, 2010 and incorporated herein by reference).
- 10.2 2010 Employee Stock Purchase Plan (filed as Appendix B to the registrant's Definitive Proxy Statement on Schedule 14A filed June 8, 2010 and incorporated herein by reference).
- 10.3 Form of Securities Purchase Agreement, among the Company and the purchasers thereto, dated September 20, 2010 (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on September 22, 2010, and incorporated herein by reference).
- 10.4 Form of Registration Rights Agreement, between the Company and the Holders thereto, dated September 20, 2010 (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on September 22, 2010, and incorporated herein by reference).
- 10.5 Form of Warrant sold pursuant to that Securities Purchase Agreement, among the Company and the purchasers thereto, dated September 20, 2010 (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on September 22, 2010, and incorporated herein by reference).
- 10.6 First Addendum to Sublease by and between the Company and Millipore Corporation, as successor in interest to Guara Technologies, dated as of September 24, 2010 (filed as Exhibit 10.40 to the registrant's Registration Statement on Form S-1 (File No. 333-170099) filed with the SEC on October 22, 2010, and incorporated herein by reference).
- 31.1 Certification of President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer and Vice President of Administration pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of President and Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer and Vice President of Administration pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ANTHERA PHARMACEUTICALS, INC.

November 12, 2010

By: /s/ Paul F. Truex  
Paul F. Truex  
President and Chief Executive Officer

November 12, 2010

By: /s/ Christopher P. Lowe  
Christopher P. Lowe  
Chief Financial Officer and  
Vice President of Administration

49