

PALATIN TECHNOLOGIES INC
Form 10-Q
February 17, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2008

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 001-15543

PALATIN TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

95-4078884

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

4C Cedar Brook Drive

Cranbury, New Jersey

(Address of principal executive offices)

08512

(Zip Code)

(609) 495-2200

(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 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

Smaller reporting company

(Do not check if a 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 February 13, 2008, 86,662,901 shares of the registrant's common stock, par value \$.01 per share, were outstanding.

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SIGNATURES

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PALATIN TECHNOLOGIES, INC.
Consolidated Balance Sheets
(unaudited)

| | December 31, 2008 | June 30, 2008 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,953,366 | \$ 9,421,770 |
| Available-for-sale investments | 3,375,074 | 3,352,771 |
| Accounts receivable | 4,900,486 | 5,747 |
| Prepaid expenses and other current assets | 554,755 | 484,362 |
| Total current assets | 11,783,681 | 13,264,650 |
| Property and equipment, net | 4,336,327 | 5,128,076 |
| Restricted cash | 475,000 | 475,000 |
| Other assets | 248,785 | 257,198 |
| Total assets | \$ 16,843,793 | \$ 19,124,924 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Capital lease obligations, current portion | \$ 193,034 | \$ 263,128 |
| Accounts payable | 344,447 | 635,183 |
| Accrued expenses | 1,367,961 | 1,666,628 |
| Accrued compensation | - | 767,509 |
| Deferred revenue, current portion | 5,633,335 | 1,666,669 |
| Total current liabilities | 7,538,777 | 4,999,117 |
| Capital lease obligations, net of current portion | 52,646 | 121,629 |
| Deferred rent, net of current portion | 1,280,904 | 1,479,794 |
| Deferred revenue, net of current portion | 5,272,221 | 5,972,220 |
| Total liabilities | 14,144,548 | 12,572,760 |
| Contingencies (Note 6) | | |
| Stockholders' equity: | | |
| Preferred stock of \$.01 par value - authorized 10,000,000 shares; Series A Convertible; issued and outstanding 4,997 shares as of December 31, 2008 and June 30, 2008, respectively | 50 | 50 |
| Common stock of \$.01 par value - authorized 150,000,000 shares; issued and outstanding 86,662,901 and 85,524,077 shares as of December 31, 2008 and June 30, 2008, respectively | 866,629 | 855,241 |
| Additional paid-in capital | 209,060,464 | 208,247,194 |

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| | | |
|--------------------------------------------|---------------|---------------|
| Accumulated other comprehensive income | 51,420 | 29,117 |
| Accumulated deficit | (207,279,318) | (202,579,438) |
| Total stockholders' equity | 2,699,245 | 6,552,164 |
| Total liabilities and stockholders' equity | \$ 16,843,793 | \$ 19,124,924 |

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

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PALATIN TECHNOLOGIES, INC.
Consolidated Statements of Operations
(unaudited)

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--------------------------------------------------------------------------------------------------------------------|------------------------------------|-----------------------|-------------------------------|-----------------------|
| | 2008 | 2007 | 2008 | 2007 |
| REVENUES: | | | | |
| Licenses and contracts | \$ 1,211,405 | \$ 742,835 | \$ 1,965,251 | \$ 9,720,566 |
| OPERATING EXPENSES: | | | | |
| Research and development | 2,839,451 | 3,791,344 | 6,497,450 | 11,735,221 |
| General and administrative | 1,151,475 | 2,329,052 | 2,608,323 | 3,988,062 |
| Total operating expenses | 3,990,926 | 6,120,396 | 9,105,773 | 15,723,283 |
| Loss from operations | (2,779,521) | (5,377,561) | (7,140,522) | (6,002,717) |
| OTHER INCOME (EXPENSE): | | | | |
| Investment income | 77,236 | 314,470 | 160,216 | 711,091 |
| Interest expense | (7,524) | (12,469) | (12,018) | (30,698) |
| Gain on sale of equipment | 550,968 | | 550,968 | |
| Total other income, net | 620,680 | 302,001 | 699,166 | 680,393 |
| Loss before income taxes | (2,158,841) | (5,075,560) | (6,441,356) | (5,322,324) |
| Income tax benefit | 1,741,476 | 1,291,444 | 1,741,476 | 1,291,444 |
| NET LOSS | \$ (417,365) | \$ (3,784,116) | \$ (4,699,880) | \$ (4,030,880) |
| Basic and diluted net loss per common share | \$ 0.00 | \$ (0.04) | \$ (0.05) | \$ (0.05) |
| Weighted average number of common shares outstanding used in computing basic and diluted net loss per common share | 86,640,647 | 85,204,169 | 86,082,481 | 85,190,733 |

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

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PALATIN TECHNOLOGIES, INC.
Consolidated Statements of Cash Flows
(unaudited)

| | Six Months Ended December 31, | |
|-----------------------------------------------------------------------------|-------------------------------|----------------------|
| | 2008 | 2007 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (4,699,880) | \$ (4,030,880) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 671,749 | 691,257 |
| Gain on sale of property and equipment | (550,968) | |
| Stock-based compensation | 824,658 | 1,054,398 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (4,894,739) | 240,102 |
| Prepaid expenses and other assets | 138,020 | 1,146,184 |
| Accounts payable | (290,736) | (537,702) |
| Accrued expenses and other liabilities | (1,265,066) | (752,617) |
| Deferred revenues | 3,266,667 | (8,585,698) |
| Net cash used in operating activities | (6,800,295) | (10,774,956) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (29,032) | (231,593) |
| Proceeds from sale of equipment | 500,000 | |
| Net cash provided by (used in) investing activities | 470,968 | (231,593) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on capital lease obligations | (139,077) | (145,796) |
| Proceeds from exercise of common stock warrants | | 110,229 |
| Net cash used in financing activities | (139,077) | (35,567) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (6,468,404) | (11,042,116) |
| CASH AND CASH EQUIVALENTS, beginning of period | 9,421,770 | 31,447,615 |
| CASH AND CASH EQUIVALENTS, end of period | \$ 2,953,366 | \$ 20,405,499 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid for interest | \$ 18,018 | \$ 30,698 |
| Equipment acquired under financing agreements | \$ | \$ 186,989 |
| Unrealized gain on available-for-sale investments | \$ 22,303 | \$ 38,442 |

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

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PALATIN TECHNOLOGIES, INC.
Notes to Consolidated Financial Statements
(unaudited)

(1) ORGANIZATION

Nature of Business Palatin Technologies, Inc. (Palatin or the Company) is a biopharmaceutical company dedicated to the development of peptide, peptide mimetic and small molecule agonist compounds with a focus on melanocortin and natriuretic peptide receptor systems. Palatin has a diverse pipeline of active development programs targeting melanocortin and natriuretic receptors. The melanocortin system is involved in a large and diverse number of physiologic functions, and therapeutic agents modulating this system may have the potential to treat a variety of conditions and diseases, including sexual dysfunction, obesity and related disorders, ischemia reperfusion injury, hemorrhagic shock and inflammation-related diseases. The natriuretic peptide receptor system has numerous cardiovascular functions, and therapeutic agents modulating this system may be useful in treatment of heart failure, hypertension and other cardiovascular diseases.

The Company's products in development include PL-3994, a peptidomimetic natriuretic peptide receptor A agonist, for treatment of heart failure and PL-6983, a peptide melanocortin receptor agonists, for treatment of sexual dysfunction. The Company has a licensing and research collaboration agreement with AstraZeneca AB (AstraZeneca) to discover, develop and commercialize compounds that target melanocortin receptors for the treatment of obesity, diabetes and related metabolic syndrome.

Key elements of the Company's business strategy include entering into alliances and partnerships with pharmaceutical companies to facilitate the development, manufacture, marketing, sale and distribution of the Company's product candidates under development, partial funding of the Company's development and discovery programs with the cash flow from collaboration agreements and, depending on the availability of sufficient funding, expansion of the Company's pipeline through the utilization of its melanocortin expertise and drug discovery technologies and opportunistic acquisition of synergistic products and technologies.

Business Risk and Liquidity The Company has incurred negative cash flows from operations since its inception, and has expended, and expects to continue to expend in the future, substantial funds to complete its planned product development efforts. As shown in the accompanying consolidated financial statements, the Company has an accumulated deficit as of December 31, 2008 and incurred a net loss for the three and six months ended December 31, 2008. The Company anticipates incurring additional losses in the future as a result of spending on its development programs. To achieve profitability, the Company, alone or with others, must successfully develop and commercialize its technologies and proposed products, conduct successful preclinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture and market such technologies and proposed products. The time required to reach profitability is highly uncertain, and there can be no assurance that the Company will be able to achieve profitability on a sustained basis, if at all.

The Company believes that its cash and cash equivalents, available-for-sale investments and accounts receivable, together with expected receipts from collaboration and license agreements and other income, will be adequate to fund the Company's projected operations through calendar year 2009.

The nature and timing of the Company's development activities are highly dependent on its financing activities. Management plans to continue to refine its operations, control expenses, evaluate alternative methods to conduct its business, and seek available sources of public or private financing and sharing of development costs through collaborative agreements or other arrangements. Should appropriate sources of financing not be available, management will curtail operations and delay clinical trials and research activities until such time, if ever, as appropriate financing is available. There can be no assurance that the Company will be able to obtain financing when required or that financing efforts will be successful.

Concentrations Concentrations in the Company's assets and operations subject it to certain related risks. Financial instruments that subject the Company to concentrations of credit risk primarily consist of cash and cash equivalents, available-for-sale investments and accounts receivable. The Company's cash and cash equivalents are primarily invested in one money market fund sponsored by a large financial institution. The Company's accounts receivable balance as of December 31, 2008 consists of amounts due from AstraZeneca.

Revenues from collaboration partners as a percentage of total revenues were as follows:

| Three Months Ended December | | Six Months Ended December | |
|-----------------------------|------|---------------------------|------|
| 31, | | 31, | |
| 2008 | 2007 | 2008 | 2007 |

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| | | | | |
|-------------|------|-----|------|-----|
| AstraZeneca | 100% | 99% | 100% | 15% |
| King | -% | -% | -% | 84% |

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(2) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnote disclosures required to be presented for complete financial statements. In the opinion of management, these consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary to present fairly the Company's financial position as of December 31, 2008, and its results of operations and its cash flows for the three and six months ended December 31, 2008 and 2007. The results of operations for the three and six month periods ended December 31, 2008 may not necessarily be indicative of the results of operations expected for the full year, except that the Company expects to incur a significant loss for the fiscal year ending June 30, 2009.

The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended June 30, 2008, filed with the Securities and Exchange Commission (SEC), which includes consolidated financial statements as of June 30, 2008 and 2007 and for each of the fiscal years in the three-year period ended June 30, 2008.

(3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation The consolidated financial statements include the accounts of Palatin and its wholly-owned inactive subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents Cash and cash equivalents include cash on hand, cash in banks and all highly liquid investments with a purchased maturity of less than three months. Restricted cash secures letters of credit for security deposits on leases.

Investments The Company classifies its investments as available-for-sale investments and all such investments are recorded at fair value based on quoted market prices. Unrealized holding gains and losses, net of the related tax effect, if any, are generally excluded from earnings and are reported in accumulated other comprehensive income/loss until realized. Interest and dividends on securities classified as available-for-sale are included in investment income. Gains and losses are recorded in the statement of operations when realized or when unrealized holding losses are determined to be other than temporary, on a specific-identification basis.

Fair Value of Financial Instruments The Company's financial instruments consist primarily of cash and cash equivalents, available-for-sale investments, accounts receivable, accounts payable, and capital lease obligations. Management believes that the carrying value of these assets and liabilities are representative of their respective fair values based on quoted market prices for investments and the short-term nature of the other instruments.

Property and Equipment Property and equipment consists of office and laboratory equipment, office furniture and leasehold improvements and includes assets acquired under capital leases. Property and equipment are recorded at cost. Depreciation is recognized using the straight-line method over the estimated useful lives of the related assets, generally five years for laboratory equipment, seven years for office furniture and equipment and the lesser of the term of the lease or the useful life for leasehold improvements. Amortization of assets acquired under capital leases is included in depreciation expense. Maintenance and repairs are expensed as incurred while expenditures that extend the useful life of an asset are capitalized.

Impairment of Long-Lived Assets The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of a long-lived asset, management evaluates whether the estimated future undiscounted net cash flows from the asset are less than its carrying amount. If impairment is indicated, the long-lived asset would be written down to fair value. Fair value is determined by an evaluation of available price information at which assets could be bought or sold, including quoted market prices if available, or the present value of the estimated future cash flows based on reasonable and supportable assumptions.

Deferred Rent The Company's operating leases provide for rent increases over the terms of the leases. Deferred rent consists of the difference between periodic rent payments and the amount recognized as rent expense

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on a straight-line basis, as well as tenant allowances for leasehold improvements. Rent expenses are being recognized ratably over the terms of the leases.

Revenue Recognition Revenue from corporate collaborations and licensing agreements consists of up-front fees, research and development funding, and milestone payments. Non-refundable up-front fees are deferred and amortized to revenue over the related performance period. The Company estimates the performance period as the period in which it performs certain development activities under the applicable agreement. Reimbursements for research and development activities are recorded in the period in which the Company performs the related activities under the terms of the applicable agreements. Revenue resulting from the achievement of milestone events stipulated in the applicable agreements is recognized when the milestone is achieved, provided that i) such milestone is substantive in nature; ii) the milestone payment is non-refundable; iii) achievement of the milestone involves a degree of risk and was not reasonably assured at the inception of the arrangement; iv) the amount of the milestone payment is reasonable in relation to the effort expended or the risk associated with achievement of the milestone; and v) a reasonable amount of time passes between the up-front license payment and the first milestone payment as well as between each subsequent milestone payment. Determination as to whether a milestone meets these conditions involves the judgment of management. If any of these conditions are not met, the resulting payment would not be considered a substantive milestone and, therefore, the resulting payment would be considered part of the up-front consideration and be recognized as revenue as such performance obligations are performed in accordance with the policies described above.

On December 5, 2008, the Company entered into both an amendment to the Research Collaboration and License Agreement (the License Agreement) with AstraZeneca, dated January 30, 2007, and a Clinical Trial Sponsored Research Agreement (the Clinical Trial Agreement). Pursuant to the amendment, the Company will receive an up-front payment of \$1.6 million and quarterly payments totaling up to \$1.4 million over the one year contract period. The up-front payment has been recorded as deferred revenue and the total consideration of up to \$3.0 million will be recognized as revenue over the one year contract period beginning February 1, 2009.

Under the Clinical Trial Agreement, the Company will be responsible for conducting a study of the effects of melanocortin receptor-specific compounds on food intake, obesity and other metabolic parameters. The Company is eligible for milestone payments totaling \$5.0 million in connection with the License Agreement and Clinical Trial Agreement, of which a \$2.5 million was due as of December 31, 2008. The total consideration under the Clinical Trial Agreement will be recognized as revenue as services are provided over the expected six month trial period.

Research and Development Costs The costs of research and development activities are charged to expense as incurred, including the cost of equipment for which there is no alternative future use.

Stock Options Effective July 1, 2005, the Company adopted Statement of Financial Accounting Standards (SFAS) 123(R), Share-Based Payment, using the modified prospective method. SFAS 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services and requires that the compensation cost relating to share-based payment transactions be recognized in financial statements, based on the fair value of the equity or liability instruments issued, adjusted for estimated forfeitures.

The Company accounts for options granted to consultants in accordance with Emerging Issues Task Force (EITF) Issue 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, and SFAS 123(R).

The Company determines the value of stock options utilizing the Black-Scholes option pricing model. Compensation costs for share-based awards with pro rata vesting are allocated to periods on a straight-line basis.

Income Taxes The Company and its subsidiary file consolidated federal and separate-company state income tax returns. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rate