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IMMTECH PHARMACEUTICALS, INC.

Form 10-Q

August 09, 2006

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 June 30, 2006.

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: 000-25669

IMMTECH PHARMACEUTICALS, INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware

39-1523370

-----  
(State or other jurisdiction of  
incorporation or organization)

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

One North End Avenue, New York, New York 10282

-----  
(Address of principal executive offices)

(Zip Code)

Registrant's telephone number: (847) 573-0033

-----  
Former name, former address and former fiscal year, if changed since last report

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2.

Large Accelerated filer  Accelerated Filer  Non-Accelerated Filer

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 August 8, 2006, 14,014,356 shares of the Registrant's common stock, par value \$0.01 per share ("Common Stock"), were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.  
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IMMTECH PHARMACEUTICALS, INC. AND  
SUBSIDIARIES  
(A Development Stage Enterprise)

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)  
-----

	June 30, 2006	March 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 11,916,610	\$ 14,130,000
Restricted funds on deposit	4,767,171	53,000
Other current assets	394,877	19,000
	-----	-----
Total current assets	17,078,658	14,862,000

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PROPERTY AND EQUIPMENT - Net	3,550,715	3,550,715
OTHER ASSETS	136,942	136,942
TOTAL	\$ 20,766,315	\$ 18,550,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 2,747,231	\$ 2,747,231
Accrued expenses	234,135	234,135
Deferred revenue	4,103,076	4,103,076
Total current liabilities	7,084,442	7,084,442
Total liabilities	7,084,442	7,084,442
STOCKHOLDERS' EQUITY:		
Preferred stock, par value \$0.01 per share, 3,913,000 shares authorized and unissued as of June 30, 2006 and March 31, 2006.		
Series A convertible preferred stock, par value \$0.01 per share, stated value \$25 per share, 320,000 shares authorized, 58,400 shares issued and outstanding as of June 30, 2006 and March 31, 2006; aggregate liquidation preference of \$1,477,945 as of June 30, 2006.	1,477,945	1,477,945
Series B convertible preferred stock, par value \$0.01 per share, stated value		
Series C convertible preferred stock, par value \$0.01 per share, stated value \$25 per share, 160,000 shares authorized, 45,536 shares issued and outstanding as of June 30, 2006 and March 31, 2006; aggregate liquidation preference of \$341,907 as of June 30, 2006.	341,907	341,907
Series D convertible preferred stock, par value \$0.01 per share, stated value \$25 per share, 200,000 shares authorized, 117,200 shares issued and outstanding as of June 30, 2006 and March 31, 2006; aggregate liquidation preference of \$1,157,639 as of June 30, 2006.	1,157,639	1,157,639

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preference of \$2,967,085 as of June 30, 2006.	2,967,085	3,01
Series E convertible preferred stock, par value \$0.01 per share, stated value \$25 per share, 167,000 shares authorized, 110,600 and 156,600 shares issued and outstanding as of June 30, 2006 and March 31, 2006, respectively; aggregate liquidation preference of \$2,800,031 as of June 30, 2006.	2,800,031	3,97
Common stock, par value \$0.01 per share, 100,000,000 shares authorized, 13,995,666 and 13,758,506 shares issued and outstanding as of June 30, 2006 and March 31, 2006, respectively	139,957	13
Additional paid-in capital	96,378,926	94,29
Deficit accumulated during the developmental stage	(91,581,617)	(88,84
Total stockholders' equity	13,681,873	15,60
	-----	-----
TOTAL	\$ 20,766,315	\$ 18,55
	=====	=====

See notes to condensed consolidated financial statements.

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IMMTECH PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(A Development Stage Enterprise)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30,		October 1984 (Inception June 30 2006
	2006	2005	2006
REVENUES	\$ 1,941,609	\$ 1,478,580	\$ 22,706,
EXPENSES:			
Research and development	2,468,836	2,269,207	53,822,
General and administrative	2,219,855	2,732,273	57,102,
Equity in loss of joint venture			135,

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Total expenses	4,688,691	5,001,480	111,060,
LOSS FROM OPERATIONS	(2,747,082)	(3,522,900)	(88,353,
OTHER INCOME (EXPENSE):			
Interest income	150,361	57,587	1,094,
Interest expense			(1,129,
Loss on sales of investment securities - net			(2,
Cancelled offering costs			(584,
Gain on extinguishment of debt			1,427,
Other income	150,361	57,587	805,
NET LOSS	(2,596,721)	(3,465,313)	(87,548,
CONVERTIBLE PREFERRED STOCK DIVIDENDS AND CONVERTIBLE PREFERRED STOCK PREMIUM DEEMED DIVIDENDS	(142,808)	(118,822)	(6,402,
REDEEMABLE PREFERRED STOCK CONVERSION, PREMIUM AMORTIZATION AND DIVIDENDS			2,369,
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (2,739,529)	\$ (3,584,135)	\$ (91,581,
BASIC AND DILUTED NET LOSS PER SHARE ATTRIBUTABLE			
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TO COMMON STOCKHOLDERS:			
Net loss	\$ (0.19)	\$ (0.30)	
Convertible preferred stock dividends and convertible preferred stock premium deemed dividends	(0.01)	(0.01)	
BASIC AND DILUTED LOSS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (0.20)	\$ (0.31)	

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WEIGHTED AVERAGE SHARES USED IN COMPUTING		
BASIC AND DILUTED NET LOSS PER SHARE	13,920,324	11,390,899
	=====	=====

See notes to condensed consolidated financial statements.

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IMMTECH PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(A Development Stage Enterprise)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended June 30,		October 1984 (Inception June 30 2006
	----- 2006	2005	
OPERATING ACTIVITIES:			
Net loss	\$ (2,596,721)	\$ (3,465,313)	\$ (87,548,
Adjustments to reconcile net loss to net cash used in operating activities:			
Compensation recorded related to issuance of common stock, common stock options and warrants	676,080	37,281	28,417,
Depreciation and amortization of property and equipment	39,262	38,322	1,075,
Equity in loss of joint venture			135,
Loss on sales of investment securities - net			2,
Amortization of debt discounts and issuance			

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costs			134,
Gain on extinguishment of debt			(1,427,
Changes in assets and liabilities:			
Other current assets	(201,818)	(323,002)	(394,
Other assets	399	128	(136,
Accounts payable	418,266	(816,104)	3,074,
Accrued expenses	7,386	986,442	897,
Deferred revenue	3,707,297	(478,580)	4,103,
	-----	-----	-----
Net cash provided by (used in) operating activities	2,050,151	(4,020,826)	(51,667,
	-----	-----	-----
INVESTING ACTIVITIES:			
Purchase of property and equipment	(34,012)	(23,971)	(1,599,
Restricted funds on deposit	(4,236,985)	287,914	(4,767,
Advances to joint venture			(135,
Proceeds from maturities of investment securities			1,800,
Purchases of investment securities			(1,803,
	-----	-----	-----
Net cash provided by (used in) investing activities	(4,270,997)	263,943	(6,504,
	-----	-----	-----
FINANCING ACTIVITIES:			
Advances from stockholders and affiliates			985,
Proceeds from issuance of notes payable			2,645,
Principal payments on notes payable			(218,
Payments for debt issuance costs			(53,
Payments for extinguishment of debt			(203,
Net proceeds from issuance of redeemable preferred stock			3,330,
Net proceeds from issuance of convertible preferred stock and warrants			17,085,
Payments of convertible preferred stock dividends and for fractional shares of common stock resulting from the conversions of convertible preferred stock	(405)	(536)	(5,
Net proceeds from issuance of common stock	(6)	39,441	46,277,
	-----	-----	-----
Additional capital contributed by stockholders			245,
	-----	-----	-----

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Net cash provided by (used in) provided by financing activities	(411)	38,904	70,088,
	-----	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,221,257)	(3,717,979)	11,916,
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	14,137,867	9,471,694	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 11,916,610	\$ 5,753,715	\$ 11,916,
	=====	=====	=====
NON-CASH FINANCING ACTIVITY - DEFERRED OFFERING COSTS FINANCED WITH ACCOUNTS PAYABLE			

See notes to condensed consolidated financial statements.

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IMMTECH PHARMACEUTICALS, INC. AND SUBSIDIARIES  
(A DEVELOPMENT STAGE ENTERPRISE)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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### 1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared by Immtech Pharmaceuticals, Inc. and its subsidiaries (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of management, include all adjustments necessary for a fair statement of results for each period shown (unless otherwise noted herein, all adjustments are of a normal recurring nature). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such SEC rules and regulations. The Company believes that the disclosures made are adequate to prevent the financial information given from being misleading. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's latest Annual Report on Form 10-K.

### 2. COMPANY BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business - Immtech Pharmaceuticals, Inc. (a development stage enterprise) and its subsidiaries (the "Company") are pharmaceutical companies working to commercialize oral drugs to treat infectious diseases by applying their proprietary aromatic cation technology platform to the treatment of cancer, diabetes and other diseases. The Company has advanced



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clinical programs that include new treatments for malaria, Pneumocystis pneumonia ("PCP") and African sleeping sickness (trypanosomiasis), and drug development programs for fungal infections, hepatitis C, and tuberculosis. The Company has worldwide licensing and exclusive commercialization rights to a large library of well-defined compounds from which a pipeline of therapeutic products could be developed.

The Company holds worldwide patents and patent applications, and licenses and rights to license technology, primarily from a scientific consortium that has granted to the Company exclusive rights to commercialize products from, and license rights to the technology. The scientific consortium includes scientists from The University of North Carolina at Chapel Hill ("UNC-CH"), Georgia State University ("Georgia State"), Duke University ("Duke University") and Auburn University ("Auburn University") (collectively, the "Scientific Consortium"). The Company is a development stage enterprise and, since its inception on October 15, 1984, has engaged in research and development programs, expanded its network of scientists and scientific advisors and licensing technology agreements, and work to commercialize the aromatic cation pharmaceutical technology platform (the Company acquired its rights to the aromatic cation technology platform in 1997 and promptly thereafter commenced development of its current programs). The Company uses the expertise and resources of strategic partners and third parties in a number of areas, including: (i) laboratory research, (ii) animal and human trials and (iii) manufacture of pharmaceutical drugs.

The Company does not have any products currently available for sale, and no products are expected to be commercially available for sale until after March 31, 2007, if at all.

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Since inception, the Company has incurred accumulated net losses of approximately \$87,549,000. Management expects the Company will continue to incur significant losses during the next several years as the Company continues development activities, clinical trials and commercialization efforts. In addition, the Company has various research and development agreements with third parties and is dependent upon such parties' abilities to perform under these agreements. There can be no assurance that the Company's activities will lead to the development of commercially viable products. The Company's operations to date have consumed substantial amounts of cash. The negative cash flow from operations is expected to continue in the foreseeable future. The Company believes it will require substantial additional funds to commercialize its drug candidates. The Company's cash requirements may vary materially from those now planned when and if the following become known: results of research and development, results of clinical testing, responses to grant requests, formation and development of relationships with strategic partners, changes in the focus and direction of development programs, competitive and technological advances, requirements in the regulatory process and other factors. Changes in circumstances in any of the above areas may require the Company to allocate substantially more funds than are currently available or than management intends to raise.

Management believes the Company's existing unrestricted cash and cash equivalents, and the grants received or awarded and awaiting disbursement of, will be sufficient to meet the Company's planned expenditures through at least the next twelve months, although there can be no assurance the

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Company will not require additional funds. Management may seek to satisfy future funding requirements through public or private offerings of securities, by collaborative or other arrangements with pharmaceutical or biotechnology companies or from other sources or by issuance of debt.

The Company's ability to continue as a going concern is dependent upon its ability to generate sufficient funds to meet its obligations as they become due, complete the development and commercialization of drug candidates and, ultimately, to generate sufficient revenues for profitable operations. Management's plans for the forthcoming year, in addition to normal operations, include continuing financing efforts, obtaining additional research grants and entering into research and development agreements with other entities.

Principles of Consolidation - The consolidated financial statements include the accounts of Immtech Pharmaceuticals, Inc. and its wholly owned subsidiaries. All inter-company balances and transactions have been eliminated.

Restricted Funds on Deposit - Restricted funds on deposit consist of cash in two accounts on deposit at banks which are restricted for use in accordance with (i) a clinical research subcontract agreement with UNC-CH and (ii) a malaria drug development agreement with Medicines for Malaria Venture ("MMV").

Concentration of Credit Risk - The Company maintains its cash in commercial banks. Balances on deposit are insured by the Federal Deposit Insurance Corporation ("FDIC") up to specified limits.

Investment - The Company accounts for its investment in NextEra Therapeutics, Inc. ("NextEra") on the equity method. As of June 30, 2006 and March 31, 2006, the Company owned approximately

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28% of the issued and outstanding shares of NextEra common stock. The Company has recognized an equity loss in NextEra to the extent of the basis of its investment, and the investment balance is zero as of June 30, 2006 and March 31, 2006. Recognition of any investment income on the equity method by the Company for its investment in NextEra will occur only after NextEra has earnings in excess of previously unrecognized equity losses. The Company does not provide, and has not provided, any financial guarantees to NextEra.

Property and Equipment - Property and equipment are recorded at cost and depreciated and amortized using the straight-line method over the estimated useful lives of the respective assets, ranging from three to fifty years. Leasehold improvements are amortized over the lesser of the life of the related lease or their useful life.

Long-Lived Assets - The Company periodically evaluates the carrying value of its property and equipment. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of an asset, a loss is recognized for the asset which is measured by the difference between the fair value and the carrying value of the asset.

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Deferred Rental Obligation - Rental obligations with scheduled rent increases are recognized on a straight-line basis over the lease term.

Revenue Recognition - Grants to perform research are the Company's primary source of revenue and are generally granted to support research and development activities for specific projects or drug candidates. Revenue related to grants to perform research and development is recognized as earned based on the performance requirements of the specific grant. Upfront cash payments from research and development grants are reported as deferred revenue until such time as the research and development activities covered by the grant are performed.

Research and Development Costs - Research and development costs are expensed as incurred and include costs associated with research performed pursuant to collaborative agreements. Research and development costs consist of direct and indirect internal costs related to specific projects as well as fees paid to other entities that conduct certain research activities on the Company's behalf.

Income Taxes - The Company accounts for income taxes using an asset and liability approach. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. In addition, a valuation allowance is recognized if it is more likely than not that some or all of the deferred income tax assets will not be realized. A valuation allowance is used to offset the related net deferred income tax assets due to uncertainties of realizing the benefits of certain net operating loss and tax credit carry-forwards and other deferred income tax assets.

Net Income (Loss) Per Share - Net income (loss) per share is calculated in accordance with Statement of Financial Accounting Standard ("SFAS") No. 128, "Earnings Per Share." Basic net income (loss) and diluted net loss per share are computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. Diluted net income per share, when applicable, is computed by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding increased by the number of potential dilutive common shares based on the treasury stock method. Diluted net

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loss per share was the same as the basic net loss per share for the three month periods ended June 30, 2006 and June 30, 2005, as none of the Company's outstanding common stock options, warrants and the conversion features of Series A, B, C, D and E Convertible Preferred Stock were dilutive.

Comprehensive Loss - There were no differences between comprehensive loss and net loss for the three month periods ended June 30, 2006 and 2005, respectively.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect

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

### 3. STOCKHOLDERS' EQUITY

On January 7, 2004, the stockholders of the Company approved an increase in the number of authorized common stock from 30 million to 100 million shares. On June 14, 2004, the Company filed with the Secretary of State of the State of Delaware an Amended and Restated Certificate of Incorporation implementing, among other things, the approved authorized 70 million share common stock increase from 30 million to 100 million shares of common stock.

Series A Convertible Preferred Stock - On February 14, 2002, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware designating 320,000 shares of the Company's 5,000,000 authorized shares of preferred stock as Series A Convertible Preferred Stock, \$0.01 par value, with a stated value of \$25.00 per share. Dividends accrue at a rate of 6.0% per annum on the \$25.00 stated value per share and are payable semi-annually on April 15 and October 15 of each year while the shares are outstanding. The Company has the option to pay the dividend either in cash or in equivalent shares of common stock, as defined. Included in the carrying value of the Series A Convertible Preferred Stock in the accompanying condensed consolidated balance sheets are \$17,945 and \$39,785 of accrued preferred stock dividends at June 30, 2006 and March 31, 2006, respectively. Each share of Series A Convertible Preferred Stock may be converted by the holder at any time into shares of our common stock at a conversion rate determined by dividing the \$25.00 stated value, plus any accrued and unpaid dividends (the "Liquidation Price"), by a \$4.42 conversion price (the "Conversion Price A"), subject to certain adjustments, as defined in the Series A Certificate of Designation. On April 15, 2006, the Company issued 5,547 shares of common stock and paid \$47 in lieu of fractional common shares as dividends on the preferred shares. On April 15, 2005, the Company issued 3,469 shares of common stock and paid \$117 in lieu of fractional common shares as dividends on the preferred shares. During the three month periods ended June 30, 2006 and 2005 there were no conversions.

The Company may at any time require that any or all outstanding shares of Series A Convertible Preferred Stock be converted into shares of the Company's common stock, provided that the shares of common stock into which the Series A Convertible Preferred Stock are convertible are registered pursuant to an effective registration statement, as defined. The number of shares of common stock to be received by the holders of the Series A Convertible Preferred Stock upon a mandatory conversion by the Company is determined by (i) dividing the Liquidation Price by the Conversion Price A, provided that the closing bid price for the Company's common stock exceeds \$9.00 for 20 consecutive trading days within 180 days prior to notice of conversion, as defined, or (ii) if the requirements of (i) are not met, the number of shares of common stock is determined by dividing

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110% of the Liquidation Price by the Conversion Price A. The Conversion Price is subject to certain adjustments, as defined in the Series A Certificate of Designation.

The Company may at any time, upon 30 days' notice, redeem any or all outstanding shares of the Series A Convertible Preferred Stock by payment of the Liquidation Price to the holder of such shares, provided that the holder does not convert the Series A Convertible Preferred Stock into shares of common stock during the 30 day period. The Series A Convertible Preferred Stock has a preference in liquidation equal to \$25.00 per share, plus any accrued and unpaid dividends, over the common stock and is pari passu with all other outstanding series of preferred stock. Each issued and outstanding share of Series A Convertible Preferred Stock shall be entitled to 5.6561 votes (subject to adjustment) with respect to any and all matters presented to the Company's stockholders for their action or consideration. Except as provided by law or by the provisions establishing any other series of preferred stock, Series A Convertible Preferred stockholders and holders of any other outstanding preferred stock shall vote together with the holders of common stock as a single class.

Series B Convertible Preferred Stock - On September 25, 2002, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware designating 240,000 shares of the Company's 5,000,000 authorized shares of preferred stock as Series B Convertible Preferred Stock, \$0.01 par value, with a stated value of \$25.00 per share. Dividends accrue at a rate of 8.0% per annum on the \$25.00 stated value per share and are payable semi-annually on April 15 and October 15 of each year while the shares are outstanding. The Company has the option to pay the dividend either in cash or in equivalent shares of common stock, as defined. Included in the carrying value of the Series B Convertible Preferred Stock in the accompanying condensed consolidated balance sheets are \$5,307 and \$12,021 of accrued preferred stock dividends as of June 30, 2006 and March 31, 2006, respectively. Each share of Series B Convertible Preferred Stock may be converted by the holder at any time into shares of common stock at a conversion rate determined by dividing the \$25.00 stated value, plus any accrued and unpaid dividends (the "Liquidation Price"), by a \$4.00 conversion price (the "Conversion Price B"), subject to certain adjustments, as defined in the Series B Certificate of Designation. On April 15, 2006, the Company issued 1,703 shares of common stock and paid \$31 in lieu of fractional common shares as dividends on the preferred shares. On April 15, 2005, the Company issued 1,526 shares of common stock and paid \$49 in lieu of fractional common shares as dividends on the preferred shares. During the three month periods ended June 30, 2006 and 2005, there were no conversions.

The Company may at any time require that any or all outstanding shares of Series B Convertible Preferred Stock be converted into shares of the Company's common stock, provided that the shares of common stock into which the Series B Convertible Preferred Stock are convertible are registered pursuant to an effective registration statement, as defined. The number of shares of common stock to be received by the holders of the Series B Convertible Preferred Stock upon a mandatory conversion by the Company is determined by (i) dividing the Liquidation Price by the Conversion Price B, provided that the closing bid price for the Company's common stock exceeds \$9.00 for 20 consecutive trading days within 180 days prior to notice of conversion, as defined, or (ii) if the requirements of (i) are not met, the number of shares of common stock is determined by dividing 110% of the Liquidation Price by the Conversion Price B. The Conversion Price B is subject to certain adjustments, as defined in the Series B Certificate of Designation.

The Company may at any time, upon 30 days' notice, redeem any or all

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outstanding shares of the Series B Convertible Preferred Stock by payment of the Liquidation Price to the holder of such shares, provided that the holder does not convert the Series B Convertible Preferred Stock into shares of common stock during the 30 day period. The Series B Convertible Preferred Stock has a preference in liquidation equal to \$25.00 per share, plus any accrued and unpaid dividends, over the

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common stock and is pari passu with all other outstanding series of preferred stock. Each issued and outstanding share of Series B Convertible Preferred Stock shall be entitled to 6.25 votes (subject to adjustment) with respect to any and all matters presented to the Company's stockholders for their action or consideration. Except as provided by law or by the provisions establishing any other series of preferred stock, Series B Convertible Preferred stockholders and holders of any other outstanding preferred stock shall vote together with the holders of common stock as a single class.

Series C Convertible Preferred Stock - On June 6, 2003, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware designating 160,000 shares of the Company's 5,000,000 authorized shares of preferred stock as Series C Convertible Preferred Stock, \$0.01 par value, with a stated value of \$25.00 per share. Dividends accrue at a rate of 8.0% per annum on the \$25.00 stated value per share and are payable semi-annually on April 15 and October 15 of each year while the shares are outstanding. The Company has the option to pay the dividend either in cash or in equivalent shares of common stock, as defined. Included in the carrying value of the Series C Convertible Preferred Stock in the accompanying condensed consolidated balance sheets are \$19,239 and \$41,945 of accrued preferred stock dividends as of June 30, 2006 and March 31, 2006, respectively. Each share of Series C Convertible Preferred Stock may be converted by the holder at any time into shares of common stock at a conversion rate determined by dividing the \$25.00 stated value, plus any accrued and unpaid dividends (the "Liquidation Price"), by a \$4.42 conversion price (the "Conversion Price C"), subject to certain adjustments, as defined in the Series C Certificate of Designation. On April 15, 2006, the Company issued 5,761 shares of common stock and paid \$95 in lieu of fractional common shares as dividends on the preferred shares. On April 15, 2005, the Company issued 4,625 shares of common stock and paid \$212 in lieu of fractional common shares as dividends on the preferred shares. During the three month period ended June 30, 2006 there were no conversions. During the three month period ended June 30, 2005, certain preferred stockholders converted 9,116 shares of Series C Convertible Preferred stock, including accrued dividends, for 51,622 shares of common stock.

The Company may at any time require that any or all outstanding shares of Series C Convertible Preferred Stock be converted into shares of the Company's common stock, provided that the shares of common stock into which the Series C Convertible Preferred Stock are convertible are registered pursuant to an effective registration statement, as defined. The number of shares of common stock to be received by the holders of the Series C Convertible Preferred Stock upon a mandatory conversion by the Company is determined by (i) dividing the Liquidation Price by the Conversion Price C provided that the closing bid price for the Company's common stock exceeds \$9.00 for 20 consecutive trading days within 180 days prior to notice of

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conversion, as defined, or (ii) if the requirements of (i) are not met, the number of shares of common stock is determined by dividing 110% of the Liquidation Price by the Conversion Price C. The Conversion Price C is subject to certain adjustments, as defined in the Series C Certificate of Designation.

The Company may at any time, upon 30 days' notice, redeem any or all outstanding shares of the Series C Convertible Preferred Stock by payment of the Liquidation Price to the holder of such shares, provided that the holder does not convert the Series C Convertible Preferred Stock into shares of common stock during the 30 day period. The Series C Convertible Preferred Stock has a preference in liquidation equal to \$25.00 per share, plus any accrued and unpaid dividends, over the common stock and is pari passu with all other outstanding series of preferred stock. Each issued and outstanding share of Series C Convertible Preferred Stock shall be entitled to 5.6561 votes (subject to adjustment) with respect to any and all matters presented to the Company's stockholders for their action or consideration. Except as provided by law or by the provisions establishing any other series of preferred stock, Series C Convertible Preferred stockholders and holders of any other outstanding preferred stock shall vote together with the holders of common stock as a single class.

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Series D Convertible Preferred Stock - On January 15, 2004, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware designating 200,000 shares of the Company's 5,000,000 authorized shares of preferred stock as Series D Convertible Preferred Stock, \$0.01 par value, with a stated value of \$25.00 per share. Dividends accrue at a rate of 6.0% per annum on the \$25.00 stated value per share and are payable semi-annually on April 15 and October 15 of each year while the shares are outstanding. The Company has the option to pay the dividend either in cash or in equivalent shares of common stock, as defined. Included in the carrying value of the Series D Convertible Preferred Stock in the accompanying condensed consolidated balance sheets are \$37,084 and \$80,914 of accrued preferred stock dividends as of June 30, 2006 and March 31, 2006, respectively. Each share of Series D Convertible Preferred Stock may be converted by the holder at any time into shares of common stock at a conversion rate determined by dividing the \$25.00 stated value, plus any accrued and unpaid dividends (the "Liquidation Price"), by a \$9.00 conversion price (the "Conversion Price D"), subject to certain adjustments, as defined in the Series D Certificate of Designation. On April 15, 2006, the Company issued 11,134 shares of common stock and paid \$79 in lieu of fractional common shares as dividends on the preferred shares. On April 15, 2005, the Company issued 9,219 shares of common stock and paid \$135 in lieu of fractional common shares as dividends on the preferred shares. During the three month periods ended June 30, 2006 and 2005, there were no conversions.

The Company may at any time, require that any or all outstanding shares of Series D Convertible Preferred Stock be converted into shares of our common stock, provided that the shares of common stock into which the Series D Convertible Preferred Stock are convertible are registered pursuant to an effective registration statement, as defined. The number of shares of common stock to be received by the holders of the Series D Convertible Preferred Stock upon a mandatory conversion by us is determined by (i)

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dividing the Liquidation Price by the Conversion Price D provided that the closing bid price for the Company's common stock exceeds \$18.00 for 20 consecutive trading days within 180 days prior to notice of conversion, as defined, or (ii) if the requirements of (i) are not met, the number of shares of common stock is determined by dividing 110% of the Liquidation Price by the Conversion Price D. The Conversion Price D is subject to certain adjustments, as defined in the Certificate of Designation.

The Series D Convertible Preferred Stock has a preference in liquidation equal to \$25.00 per share, plus any accrued and unpaid dividends, over the common stock and is pari passu with all other outstanding series of preferred stock. Each issued and outstanding share of Series D Convertible Preferred Stock shall be entitled to 2.7778 votes (subject to adjustment) with respect to any and all matters presented to the Company's stockholders for their action or consideration. Except as provided by law or by the provisions establishing any other series of preferred stock, Series D Convertible Preferred stockholders and holders of any other outstanding preferred stock shall vote together with the holders of common stock as a single class.

Series E Convertible Preferred Stock -On December 13, 2005, the Company filed a Certificate of Designation with the Secretary of State of the State of Delaware designating 167,000 shares of the Company's 5,000,000 authorized shares of preferred stock as Series E Convertible Preferred Stock, \$0.01 par value, with a stated value of \$25.00 per share. Dividends accrue at a rate of 6.0% per annum on the \$25.00 stated value per share and are payable semi-annually on April 15 and October 15 of each year while the shares are outstanding. The Company has the option to pay the dividend either in cash or in equivalent shares of common stock, as defined. Included in the carrying value of the Series E Convertible Preferred Stock in the accompanying condensed consolidated balance sheets are \$35,031 and \$60,528 of accrued preferred stock dividends as of June 30, 2006 and March 31, 2006, respectively. Each share of Series E Convertible Preferred Stock may be converted by the holder at any time into shares of common stock at a conversion rate determined

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by dividing the \$25.00 stated value, plus any accrued and unpaid dividends (the "Liquidation Price"), by a \$7.04 conversion price (the "Conversion Price E"), subject to certain adjustments, as defined in the Series E Certificate of Designation. On April 15, 2006, the Company issued 8,819 shares of common stock and paid \$135 in lieu of fractional common shares as dividends on the preferred shares. During the three month period ended June 30, 2006, certain preferred stockholders converted 46,000 shares of Series E Convertible Preferred Stock, including accrued dividends, for 163,847 shares of common stock.

The Company may at any time after December 1, 2006, require that any or all outstanding shares of Series E Convertible Preferred Stock be converted into shares of our common stock, provided that the shares of common stock into which the Series E Convertible Preferred Stock are convertible are registered pursuant to an effective registration statement, as defined. The number of shares of common stock to be received by the holders of the Series E Convertible Preferred Stock upon a mandatory conversion by us is determined by (i) dividing the Liquidation Price by the Conversion Price E provided that the closing bid price for the Company's common stock exceeds



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\$10.56 for 20 out of 30 consecutive trading days within 180 days prior to notice of conversion, as defined, or (ii) if the requirements of (i) are not met, the number of shares of common stock is determined by dividing 110% of the Liquidation Price by the Conversion Price E. The Conversion Price E is subject to certain adjustments, as defined in the Certificate of Designation.

The Series E Convertible Preferred Stock has a preference in liquidation equal to \$25.00 per share, plus any accrued and unpaid dividends, over the common stock and is parri passu with all other outstanding series of preferred stock. Each issued and outstanding share of Series E Convertible Preferred Stock is entitled to 3.5511 votes (subject to adjustment) with respect to any and all matters presented to the Company's stockholders for their action or consideration. Except as provided by law or by the provisions establishing any other series of preferred stock, Series E Convertible Preferred stockholders and holders of any other outstanding preferred stock shall vote together with the holders of common stock as a single class.

The Company will, on December 13, 2008, at the Company's election, (i) redeem the Series E Convertible Preferred Stock plus any accrued and unpaid interest for cash, (ii) convert the Series E Convertible Preferred Stock and any accrued and unpaid interest into common stock, or (iii) redeem and convert the Series E Convertible Preferred Stock in any combination of (i) or (ii).

Common Stock - On May 26, 2006, restricted shares in the amount of 5,000 shares of common stock were issued to Tulane University as part of the Tulane License Agreement granting to us an exclusive license to develop, manufacture and commercialize a group of 4 - aminoquinoline drugs for treatment, prophylaxis and diagnosis of infectious diseases. The lead candidate, AQ-13, is targeted as a candidate for treatment and prophylaxis for malaria.

On May 26, 2006, restricted shares in the amount of 5,000 shares of common stock were issued to T. Stephen Thompson as part of his retirement and consulting agreement dated May 1, 2006.

Warrants - No warrants were exercised in the three month period ended June 30, 2006. During the three month period ended June 30, 2005, warrants to purchase 1,800 shares of common stock were exercised, resulting in proceeds to the Company of \$11,646.

Incentive Stock Programs - At the stockholders' meeting held November 12, 2004, the stockholders approved the second amendment to the 2000 Stock Incentive Plan which increased the number of shares of common stock reserved for issuance from 1,100,000 shares to 2,200,000 shares. Options granted under the 2000 Stock Incentive Plan that expire are available to be reissued. During the

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three month periods ended June 30, 2006 and 2005, 9,166 and 42,750 options, respectively, previously granted under the 2000 Stock Incentive Plan expired and were available to be reissued. During the three month periods ended June 30, 2006 and 2005, the Company issued 56,000 and 30,000 options,

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respectively, to purchase shares of common stock. Additionally, the Company granted 5,000 restricted stock awards. As of June 30, 2006, there were a total of 710,249 shares available for grant. The purchase price of shares must be at least equal to the fair market value of the common stock on the date of grant, and the maximum term of an option is 10 years. The options generally vest over periods ranging from 0 to 4 years. During the three month period ended June 30, 2006, 32,263 options were exercised on a cashless basis resulting in 30,349 common shares being issued with an exercise price of \$0.47, while for the three month period ended June 30, 2005, 10,900 options were exercised with an exercise price of \$2.55.

The following table summarizes information about stock options outstanding as of June 30, 2006:

	Options Outstanding			Options Exercisable		
	Shares Outstanding	Weighted Average Remaining Contractual Life-Years	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Remaining Contractual Life-Years	Weighted Average Exercise Price
April 1, 2006	1,554,380	5.75	\$9.25	1,115,167	5.75	\$9.25
Granted	56,000		7.35			
Exercised			0.47			
(total intrinsic value was \$237,942)....	(32,263)					
Lapsed	(9,166)		9.56			
June 30, 2006	1,568,951	6.05	\$9.76	1,150,740	5.93	\$9.25

The aggregate intrinsic value of options outstanding and exercisable at June 30, 2006 was approximately \$1,598,000 and \$1,597,000, respectively. The total unrecognized compensation cost related to all share-based compensation plans at June 30, 2006 amounted to approximately \$2,530,000 and is expected to be recognized over the next two years.

On April 1, 2006, the company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") no. 123 (revised 2004), "Share-Based Payment," which requires that the fair value of share-based awards be recorded in the results of operations. Under the revised standard, awards issued prior to 2007 for which the requisite service has not been rendered are charged to expense under the prior rules, and awards issued after 2006 are charged to expense under the revised rules. Total non-cash compensation expense charged against income in the period ended June 30, 2006 for share-based plans totaled approximately \$605,000. Through March 31, 2006, the Company measured compensation cost using the intrinsic value-based method of accounting for stock options granted to employees and directors. The Company used the modified prospective method of adoption. Under this method, prior years' financial results do not include the impact of recording stock options using fair value. Had compensation cost been determined using the fair

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value-based accounting method in the three month period ended June 30, 2005, pro forma net income and earnings per share ("EPS") amounts would have been as follows:

	Three Months Ended June 30, ----- 2005
Net loss attributable to common shareholders - as reported	\$(3,584,834)
Add: stock-based compensation expense included in reported net loss	0
Deduct: total stock-based compensation expense determined under fair value method for all awards	(1,022,828)
Net loss attributable to common stockholders - pro forma	----- \$(4,606,963) =====
Basic and diluted net loss per share attributable to common stockholders - as reported	\$ (0.31) =====
Basic and diluted net loss per share attributable to common stockholders - pro forma	\$ (0.40) =====

The weighted average fair value of an option granted in the three month periods ended June 30, 2006 and 2005 was \$7.35 and \$11.86, respectively. The fair value of an option grant was estimated using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended June 30,	
	2006	2005
Risk free interest rate	4.89%	4.12%
Average life of options (years)	6.0	10.0
Volatility	69%	92%
Dividend yield	-0-	-0-

The average risk-free interest rate is based on yields on ten-year zero coupons - U.S. Treasury strips in effect as of the grant date. The average life of the options is based upon historical data. We determined expected volatility in the Black-Scholes model based upon two year historical data at the end of each month for the three months ended June 30, 2005, and

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implied volatility based upon exchange traded options for our common stock for the three months ended June 30, 2006. Implied volatility better reflects future market conditions and better indicates expected volatility than purely historical volatility. There is no dividend yield.

#### 4. COLLABORATIVE RESEARCH AND DEVELOPMENT ACTIVITIES

The Company earns revenue under various collaborative research agreements. Under the terms of these arrangements, the Company generally has agreed to perform best efforts research and development and, in exchange, the Company may receive advanced cash funding, an allowance for management overhead, and may also earn additional fees for the attainment of certain milestones.

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The Company initially acquired its rights to the aromatic cation technology platform developed by a consortium of universities consisting of UNC-CH, Georgia State University, Duke University and Auburn University pursuant to an agreement, dated January 15, 1997 (as amended, the "Consortium Agreement") among the Company, UNC-CH and a third-party (to which each of the other members of the scientific consortium shortly thereafter joined) (the "original licensee"). The Consortium Agreement commits the parties to collectively research, develop, finance the research and development of, manufacture and market both the technology and compounds owned by the scientific consortium and previously licensed or optioned to the original licensee and licensed to the Company in accordance with the Consortium Agreement (the "Current Compounds"), and all technology and compounds developed by the scientific consortium after January 15, 1997, through use of Company-sponsored research funding or National Cooperative Drug Development grant funding made available to the scientific consortium (the "Future Compounds" and, collectively with the Current Compounds, the "Compounds").

The Consortium Agreement contemplated that upon the completion of our initial public offering ("IPO") of shares of its common stock with gross proceeds of at least \$10,000,000 by April 30, 1999, the Company, with respect to the Current Compounds, and UNC-CH, (on behalf of the Scientific Consortium), with respect to Current Compounds and Future Compounds, would enter into license agreements for the intellectual property rights relating to the Compounds pursuant to which the Company would pay royalties and other payments based on revenues received for the sale of products based on the Compounds.

The Company completed an IPO on April 26, 1999, with gross proceeds in excess of \$10,000,000 thereby earning a worldwide license and exclusive rights to commercially use, manufacture, have manufactured, promote, sell, distribute, or otherwise dispose of any products based directly or indirectly on all of the Current Compounds and Future Compounds.

As a result of the closing of the IPO, the Company issued an aggregate of 611,250 shares of common stock, of which 162,500 shares were issued to the Scientific Consortium and 448,750 shares were issued to the original licensee or persons designated by the original licensee.

As contemplated by the Consortium Agreement, on January 28, 2002, the Company entered into a License Agreement with the Scientific Consortium whereby the Company received the exclusive license to commercialize the

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aromatic cation technology platform and compounds developed or invented by one or more of the Consortium scientists after January 15, 1997 and which also incorporated into such License Agreement the Company's existing license with the Scientific Consortium with regard to the Current Compounds. Also pursuant to the Consortium Agreement, the original licensee transferred to the Company the worldwide license and exclusive right to commercially use, manufacture, have manufactured, promote, sell, distribute or otherwise dispose of any and all products based directly or indirectly on aromatic cations developed by the Scientific Consortium on or prior to January 15, 1997 and previously licensed (together with related technology and patents) to the third-party.

The Consortium Agreement provides that the Company is required to pay to UNC-CH on behalf of the Scientific Consortium reimbursement of patent and patent-related fees, certain milestone payments and royalty payments based on revenue derived from the Scientific Consortium's aromatic cation technology platform. Each month on behalf of the inventor scientist or university, as the case may be, UNC-CH submits an invoice to the Company for payment of patent-related fees related to current compounds or future compounds incurred prior to the invoice date. The Company is also required to make milestone payments in the form of the issuance of 100,000 shares of its common stock to the Consortium when it files its first initial New Drug Application ("NDA") or an

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Abbreviated New Drug Application ("ANDA") based on Consortium technology. The Company is also required to pay to UNC-CH on behalf of the Scientific Consortium (other than Duke University) (i) royalty payments of up to 5% of our net worldwide sales of "current products" and "future products" (products based directly or indirectly on current compounds and future compounds, respectively) and (ii) a percentage of any fees we receive under sublicensing arrangements. With respect to products or licensing arrangements emanating from Duke University technology, the Company is required to negotiate in good faith with UNC-CH (on behalf of Duke University) royalty, milestone or other fees at the time of such event, consistent with the terms of the Consortium Agreement.

Under the License Agreement, the Company must also reimburse the cost of obtaining patents and assume liability for future costs to maintain and defend patents so long as the Company chooses to retain the license to such patents.

During the three month periods ended June 30, 2006 and 2005, the Company expensed approximately \$237,000 and \$211,000, respectively, of payments to UNC-CH and certain other Scientific Consortium universities for patent related costs and other contracted research. Included in accounts payable as of June 30, 2006 and March 31, 2006, were approximately \$660,000, and \$601,000, respectively, due to UNC and certain other Scientific Consortium universities.

In November 2000, The Bill & Melinda Gates Foundation ("Foundation") awarded a \$15,114,000 grant to UNC to develop new drugs to treat Human Trypanosomiasis (African sleeping sickness) and leishmaniasis. On March 29, 2001, UNC-CH entered into a clinical research subcontract agreement with the Company, whereby the Company was to receive up to \$9,800,000, subject to certain terms and conditions, over a five year period to conduct certain

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clinical and research studies related to the Foundation grant.

In April 2003, the Foundation awarded a supplemental grant of approximately \$2,700,000 to UNC-CH for the expansion of phase IIB/III clinical trials to treat human Trypanosomiasis (African sleeping sickness) and improved manufacturing processes. The Company has received, pursuant to the clinical research subcontract with UNC-CH, inclusive of its portion of the supplemental grant, a total amount of funding of approximately \$11,700,000. Grant funds paid in advance of the Company's delivery of services are treated as restricted funds and must be segregated from other funds and used only for the purposes specified. In March 2006, the Company amended and restated the clinical research subcontract with UNC-CH and UNC-CH in turn obtained an expanded funding commitment for the Company of approximately \$13.6 million from the Foundation. Under the amended and restated agreement, the Company received on May 24, 2006 the first payment of approximately \$5,649,000 of the five year approximately \$13,601,000 contract.

Approximately \$829,000 and \$852,000 was utilized for clinical and research purposes conducted and expensed during the three months ended June 30, 2006 and 2005, respectively. The Company has recognized revenues of approximately \$1,759,000 and \$852,000 during the three months ended June 30, 2006 and 2005, respectively. The remaining amount (approximately \$3,890,000 as of June 30, 2006) has been deferred and will be recognized as revenue over the term of the agreement as the services are performed.

On November 26, 2003, the Company entered into a testing agreement ("Testing Agreement") with Medicines for Malaria Venture ("MMV"), a foundation established in Switzerland, and UNC,

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pursuant to which the Company, with the support of MMV and UNC-CH, pursuant to which the Company, with the support of MMV and UNC-CH, conducted a proof of concept study of the dicationic first drug candidate pafuramidine for the treatment of malaria.

Under the terms of the Testing Agreement, MMV committed to pay for human clinical trials and, subject to certain milestones, regulatory preparation and filing costs for the approvals to market pafuramidine to treat malaria. In return for MMV's funding, the Company is required, when selling malaria drugs derived from this research into "malaria-endemic countries," as defined, to sell such drugs at affordable prices. An affordable price is defined in the Testing Agreement to mean a price not to be less than the cost to manufacture and deliver the drugs plus administrative overhead costs (not to exceed 10% of the cost to manufacture) and a modest profit. There are no price constraints on product sales into non-malaria-endemic countries. The Company must, however, pay to MMV a royalty not to exceed 7% of net sales, as defined, on product sales into non-malaria-endemic countries, until the amount funded under the Testing Agreement and amounts funded under a related discovery agreement between MMV and UNC-CH is refunded to MMV at face value. The Company and MMV agreed to terminate the Testing Agreement effective as of February 10, 2006. The Company has received approximately \$5,636,000 under this contract.

The Company recognized revenues of approximately \$182,000 and \$627,000 during the three month periods ended June 30, 2006 and 2005, respectively,

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for expenses incurred related to activities within the scope of the Testing Agreement. At June 30, 2006, the Company has approximately \$213,000 recorded as deferred revenue with respect to this agreement.

As discussed elsewhere in the document, the Company received notification of an award by the Arbitral Tribunal on June 9, 2006 finding that Neurochem has breached the testing agreement and awarded the Company approximately \$1.9 million in damages and attorney's fees and costs, subject to review and corrections by both parties within 30 days of the notification date. In July the Company requested certain corrections to the award. The Company is awaiting final resolution from the tribunal prior to recording the award in the Company's consolidated financial statements.

\* \* \* \* \*

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

#### Forward Looking Statements

Certain statements contained in this quarterly report and in the documents incorporated by reference herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements frequently, but not always, use the words "may", "intends", "plans", "believes", "anticipates" or "expects" or similar words and may include statements concerning our strategies, goals and plans. Forward-looking statements involve a number of significant risks and uncertainties that could cause our actual results or achievements or other events to differ materially from those reflected in such forward-looking statements. Such factors include, among others described in this quarterly report, the following: (i) we are in an early stage of product development, (ii) the possibility that favorable relationships with collaborators cannot be established or, if established, will be abandoned by the collaborators before completion of product development, (iii) the possibility that we or our collaborators will not successfully develop any marketable products, (iv) the possibility that advances by competitors will cause our product candidates not to be viable, (v) uncertainties as to the requirement that a drug product be found to be safe and effective after extensive clinical trials and the possibility that the results of such trials, if completed, will not establish the safety or efficacy of our drug product candidates, (vi) risks relating to requirements for approvals by governmental agencies, such as the Food and Drug Administration, before products can be marketed and the possibility that such approvals will not be obtained in a timely manner or at all or will be conditioned in a manner that would impair our ability to market our product candidates successfully, (vii) the risk that our patents could be invalidated or narrowed in scope by judicial actions or that our technology could infringe upon the patent or other intellectual property rights of third parties, (viii) the possibility that we will not be able to raise adequate capital to fund our

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operations through the process of commercializing a successful product or that future financing will be completed on unfavorable terms, (ix) the possibility that any products successfully developed by us will not achieve market acceptance and (x) other risks and uncertainties that may not be described herein. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### Results of Operations

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With the exception of certain research funding agreements and certain grants, we have not generated any revenue from operations. For the period from inception (October 15, 1984) to June 30, 2006, we incurred cumulative net losses of approximately \$87,549,000. We have incurred additional losses since such date and we expect to incur additional operating losses for the foreseeable future. We expect that our cash sources for at least the next year will be limited to:

- o payments from foundations and other collaborators under arrangements that may be entered into in the future;
- o grants from the United States government and other governments and entities; and
- o the issuance of securities or borrowing of funds.

The timing and amounts of grant and payment revenues, if any, will likely fluctuate sharply and depend upon the achievement of specified milestones, and results of operations for any period may be unrelated to the results of operations for any other period.

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Three Month Period Ended June 30, 2006 Compared with the Three Month Period Ended June 30, 2005.

Revenues under collaborative research and development agreements were approximately \$1,942,000 and \$1,479,000 for the three month periods ended June 30, 2006 and June 30, 2005, respectively. For the three month period ended June 30, 2006, we recognized revenues of approximately \$1,759,000 related to a clinical research subcontract agreement between us and The University of North Carolina at Chapel Hill ("UNC-CH") and approximately \$183,000 related to a grant from Medicines for Malaria Venture ("MMV") to fund clinical studies and licensure of DB289 for treatment of malaria which has since lapsed, while for the three month period ended June 30, 2005, revenues recognized of approximately \$852,000 related to the abovementioned UNC-CH clinical research subcontract and \$627,000 related to the abovementioned MMV grant for treatment of malaria.

The clinical research subcontract agreement relates to a grant from a philanthropic foundation (the "Foundation") to UNC-CH to develop new drugs to treat trypanosomiasis (African sleeping sickness) and leishmaniasis. MMV also receives funding from the Foundation. Grant and research and development agreement revenue is recognized as completed under the terms of the respective agreements, according to Company estimates. Grant and research and development funds received prior to completion under the terms of the respective agreements are recorded as deferred revenues.

Interest income for the three month period ended June 30, 2006 was approximately



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\$150,000. Interest income during the three month period ended June 30, 2005 was approximately \$58,000. The increase is primarily due to an increase in funds invested from the prior corresponding quarter. There were no interest expenses during the three month periods ended June 30, 2006 and June 30, 2005.

Research and development expenses increased to approximately \$2,469,000 from \$2,269,000 for the three month periods ended June 30, 2006 and June 30, 2005, respectively. Expenses relating to the MMV testing agreement and the UNC subcontract, respectively, decreased from approximately \$624,000 and \$849,000 in the three month period ended June 30, 2005 to approximately \$182,000 and \$825,000 in the three month period ended June 30, 2006. Additionally, contract services relating to trials for treatment of pneumocystis pneumonia increased from approximately \$385,000 to approximately \$1,125,000 in the same periods. Non-cash options expense under research and development increased from approximately \$11,000 in the three month period ended June 30, 2005 to approximately \$177,000 in the three month period ended June 30, 2006. Adopting SFAS 123(R) accounted for approximately \$143,000 of the \$177,000 in the three month period ended June 30, 2006. Other research and development expenses decreased approximately \$240,000 from the three month period ended June 30, 2005 to the three month period ended June 30, 2006.

General and administrative expenses decreased to approximately \$2,220,000 from approximately \$2,732,000 during the three month periods ended June 30, 2006, and June 30, 2005, respectively. The decrease was largely due to decreased legal fees, primarily concerning legal proceedings with Neurochem (see Part II, Item 1), which decreased from approximately \$1,400,000 in the three month period ended June 30, 2005, to approximately \$182,000 in the three month period ended June 30, 2006. Patent fees remained fairly constant over the three month periods ended June 30, 2005 and 2006, with charges of approximately \$165,000 and \$163,000, respectively. Payroll and related costs also remained relatively constant having decreased from approximately \$391,000 in the three month period ended June 30, 2005 to approximately \$384,000 in the three month period ended June 30, 2006. Non-cash general and administrative expenses increased from approximately \$26,000 in the three month period ended June 30, 2005 to approximately \$499,000 in the three month period ended June 30, 2006. Adopting SFAS 123 (R) accounted for approximately \$413,000 of the \$499,000 in the three month period ended June 30, 2006. Other general and administrative costs increased by approximately \$242,000 over the same periods.

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Our net loss decreased to approximately \$2,597,000 from approximately \$3,465,000 during the three month periods ended June 30, 2006 and June 30, 2005, respectively. The decrease was primarily attributable to the decrease in legal costs offset by the adoption of SFAS 123(R).

### Liquidity and Capital Resources

As of June 30, 2006, cash and cash equivalents were approximately \$11,917,000.

We spent approximately \$34,000 on equipment purchases during the three month period ended June 30, 2006, compared to \$24,000 for equipment expenditures during the same period in the previous year. No significant purchases of equipment are anticipated by us during the year ending March 31, 2007.

We periodically receive cash from the exercise of common stock options and warrants. During the three month period ended June 30, 2006, we did not receive

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any proceeds for the exercise of options or warrants. During the three month period ended June 30, 2005, we received approximately \$27,000 from the exercise of options. Warrant holders exercised warrants to purchase 1,800 shares of common stock resulting in gross proceeds to us of approximately \$12,000.

We believe our existing unrestricted cash and cash equivalents and the grants we have received or have been awarded and are awaiting disbursement of, will be sufficient to meet our planned expenditures through at least August 2007, although there can be no assurance we will not require additional funds.

Through June 30, 2006, we financed our operations with:

- o proceeds from various private placements of debt and equity securities, an initial public offering, and other cash contributed from stockholders, which in the aggregate raised approximately \$70,089,000;
- o payments from research agreements, foundation grants and SBIR grants and STTR program grants of approximately \$22,706,000; and
- o the use of stock, options and warrants in lieu of cash compensation.

Our cash resources have been used to finance, develop and begin commercialization of drug product candidates, including sponsored research, conduct of human clinical trials, capital expenditures, expenses associated with development of product candidates pursuant to an agreement, dated January 15, 1997, (the "Consortium Agreement"), among us and UNC (to which each of Duke University, Auburn University and Georgia State University agreed shortly thereafter to become a party, and all of which, collectively with UNC, are referred to as the "Consortium") and, as contemplated by the Consortium Agreement, under a license agreement dated January 28, 2002 ("Consortium License Agreement") with the Consortium, and general and administrative expenses. Over the next several years we expect to incur substantial additional research and development costs, including costs related to research in pre-clinical (laboratory) and human clinical trials, administrative expenses to support our research and development operations and marketing expenses to launch the sale of any commercialized product that may be developed.

Our future working capital requirements will depend upon numerous factors, including the progress of research, development and commercialization programs (which may vary as product candidates are added or abandoned), results of pre-clinical testing and human clinical trials, achievement of regulatory

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milestones, third party collaborators fulfilling their obligations to us, the timing and cost of seeking regulatory approvals, the level of resources that we devote to the engagement or development of manufacturing capabilities including the build-out of our subsidiary's facility in China, our ability to maintain existing and to establish new collaborative arrangements with others to provide funding to support these activities, and other factors. In any event, we will require substantial additional funds in addition to our existing resources to develop product candidates and to otherwise meet our business objectives.

Management's plans for the remainder of the fiscal year, in addition to normal operations, include continuing their efforts to create joint ventures, obtain additional grants and to develop and enter into research, development and/or

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commercialization agreements with others. Subject to management's strategic development plan, we are going to continue financing efforts by raising additional capital through equity or debt issuance.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk.

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The exposure of market risk associated with risk-sensitive instruments is not material, as our operations are conducted primarily in U.S. dollars and we invest primarily in short-term government obligations and other cash equivalents. We intend to develop policies and procedures to manage market risk in the future if and when circumstances require.

### Item 4. Controls and Procedures.

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#### Disclosures and Procedures

We maintain controls and procedures designed to ensure that we are able to collect the information we are required to disclose in the reports we file with the SEC, and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Our Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining these procedures and, as required by the rules of the SEC, evaluate their effectiveness. Based on their evaluation of our disclosure controls and procedures, which took place as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer believe that these procedures are effective to ensure that we are able to collect, process and disclose the information we are required to disclose in the reports we file with the SEC within the required time periods.

#### Internal Controls

We maintain a system of internal controls designed to provide reasonable assurance that: (1) transactions are executed in accordance with management's general or specific authorization and (2) transactions are recorded as necessary to (a) permit preparation of financial statements in conformity with generally accepted accounting principles and (ii) maintain accountability for assets. Access to assets is permitted only in accordance with management's general or specific authorization and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

#### Changes in Internal Controls

We have not made any material changes in our internal control over financial reporting during the quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings.

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Immtech International, Inc., et al. v. Neurochem, Inc., et al.

On August 12, 2003, the Company filed a lawsuit against Neurochem, Inc. ("Neurochem") alleging that Neurochem misappropriated the Company's trade secrets by filing a series of patent applications relating to compounds synthesized and developed by the scientific consortium with whom Immtech has an exclusive licensing agreement. The misappropriated intellectual property was provided to Neurochem pursuant to a testing agreement under which Neurochem agreed to test the compounds to determine if they could be successfully used to treat amyloid diseases. Pursuant to the terms of the agreement, Neurochem agreed to keep all information confidential, not to disclose or exploit the information without Immtech's prior written consent, to immediately advise Immtech if any invention was discovered and to cooperate with Immtech and its counsel in filing any patent applications.

Since the filing of the complaint, Neurochem had aggressively sought to have an International Chamber of Commerce ("ICC") arbitration panel hear this dispute, as opposed to the federal district court in which the action was originally filed. The Company agreed to have a three member ICC arbitration panel (the "Arbitration Panel") hear and rule on the dispute on the expectation that the Arbitration Panel would reach a more timely and economical resolution.

The ICC hearing was held September 7 to September 20, 2005. Final papers were filed by both parties on November 2, 2005. The ICC tribunal closed the hearing on April 17, 2006. On June 9, 2006, the International Court of Arbitration of the ICC notified the parties that (i) the Arbitral Tribunal found that Neurochem breached the testing agreement and awarded Immtech approximately \$1.9 million in damages and attorneys' fees and costs, and (ii) denied all of Neurochem's claims against Immtech.

Gerhard Von der Ruhr et al. v. Immtech International, Inc. et. al.  
In October 2003, Gerhard Von der Ruhr et al (the "Von der Ruhr Plaintiffs") filed a complaint in the United States District Court for the Northern District of Illinois against the Company and certain officers and directors. The Von der Ruhr Plaintiff's complaint alleged that (i) the Company refused to authorize the Company's transfer agent to remove the restrictive legends from the stock certificates of the Von der Ruhr Plaintiffs, (ii) the Company refused to honor the Von der Ruhr Plaintiffs' exercise of certain stock options and (iii) the Company refused to honor an agreement regarding certain technology. The Von der Ruhr Plaintiffs also allege that certain officers and directors interfered with the Von der Ruhr Plaintiffs' contracts with the Company. The complaint sought unspecified monetary damages and punitive damages, in addition to equitable relief and costs. In a filing made in late February, 2005, the Von der Ruhr Plaintiffs specified damages of approximately \$44.5 million in damages, which includes \$42 million related to the alleged technology agreement claim, which the Company believes is meritless. In 2005, one of the counts in the case was dismissed upon the Company's motion for summary judgment. The Company has filed pre-trial motions regarding the evidence to be introduced at the trial of the remaining counts, including a motion to preclude disclosure of evidence of Von der Ruhr's alleged damages. Those pre-trial motions are pending. The case is likely to be set for trial sometime in 2006 or 2007.

### Item 1A. Risk Factors

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There are no material changes in risk factors previously disclosed in Item 1A to Part I of our Form 10-K for the fiscal year ended March 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.  
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Recent Sales of Unregistered Securities.  
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All such shares of common stock herein described as issuances below were made pursuant to Section 4(2) of the Securities Act of 1933, as amended.

Restricted Stock

On May 26, 2006, restricted stock in the amount of 5,000 common shares was issued to Tulane University under the terms of the license agreement for rights to AQ-13. On May 26, 2006 restricted stock in the amount of 5,000 common shares was issued to an individual for services rendered.

Option Exercise

On April 12, 2006, options to purchase 32,263 shares with an exercise price of \$0.47 per share were exercised on a cashless basis. Common shares in the amount of 30,349 were issued along with a check for \$6 in lieu of fractional shares.

Conversion of Preferred Stock to Common Stock.

During May 2006 certain holders of Series E Convertible Preferred Stock, \$0.01 par value ("Series E Stock") converted an aggregate of 46,000 shares of Series E Preferred Stock into an aggregate of 163,847 shares of our common stock.

Preferred Stock Dividend Payment.

On April 15, 2006, we issued 32,964 shares of common stock as payment of a dividend earned on outstanding preferred stock to the holders thereof: holders of Series A Stock earned 5,547 shares of common stock on 58,400 outstanding shares; holders of Series B Stock earned 1,703 shares of common stock on 13,464 outstanding shares; holders of Series C Stock earned 5,761 shares of common stock on 45,536 outstanding shares; holders of Series D Stock earned 11,134 shares of common stock on 117,200 outstanding shares; and holders of Series E Stock earned 8,819 shares of common stock on 156,600 outstanding shares. We also paid holders of our outstanding preferred stock \$387 in cash in lieu of fractional shares.

Item 3. Defaults Upon Senior Securities.  
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None

Item 4. Submission of Matters to a Vote of Security Holders.  
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None

Item 5. Other Information.  
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None

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Item 6. Exhibits.  
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Exhibits  
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Exhibit Index  
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- 3.1 (5) Amended and Restated Certificate of Incorporation of the Company, dated June 14, 2004
- 3.2 (6) Certificate of Correction to Certificate of Incorporation dated December 14, 2005.
- 3.3 (7) Certificate of Amendment (Name Change) to Certificate of Incorporation dated March 22, 2006.
- 3.4 (1) Certificate of Designation for Series A Convertible Preferred Stock Private Placement, dated February 14, 2002
- 3.5 (2) Certificate of Designation for Series B Convertible Preferred Stock Private Placement, dated September 25, 2002
- 3.6 (3) Certificate of Designation for Series C Convertible Preferred Stock Private Placement, dated June 6, 2003
- 3.7 (4) Certificate of Designation for Series D Convertible Preferred Stock Private Placement, dated January 15, 2004
- 3.8 (6) Certificate of Designation for Series E Convertible Preferred Stock Private Placement, dated December 13, 2005
- 3.9 (7) Amended and Restated Bylaws of the Company effective as of March 22, 2006.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Incorporated by Reference to our Form 8-K (File No. 000-25669), as filed with the Securities and Exchange Commission on February 14, 2002.
- (2) Incorporated by Reference to our Form 8-K (File No. 001-14907), as filed with the Securities and Exchange Commission on September 25, 2002.
- (3) Incorporated by Reference to our Form 8-K (File No. 001-14907), as filed with the Securities and Exchange Commission on June 10, 2003.
- (4) Incorporated by Reference to our Form 8-K (File No. 001-14907), as filed with the Securities and Exchange Commission on January 21, 2004.
- (5) Incorporated by Reference to our Form 10-K (File No. 001-14907), as filed with the Securities and Exchange Commission on June 14, 2004.
- (6) Incorporated by Reference to our Form 8-K (File No. 001-14907), as filed with the Securities and Exchange Commission on December 14, 2005.
- (7) Incorporated by Reference to our Form 8-K (File No. 001-14907), as filed with the Securities and Exchange Commission on March 23, 2006.

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SIGNATURES

Pursuant to 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.

IMMTECH PHARMACEUTICALS, INC.

Date: August 9, 2006

By: /s/ Eric L. Sorkin  
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Eric L. Sorkin  
President and Chief Executive Officer

Date: August 9, 2006

By: /s/ Gary C. Parks  
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Gary C. Parks

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Treasurer, Secretary and Chief Financial Officer  
(Principal Financial and Accounting Officer)