

Cyclacel Pharmaceuticals, Inc.
Form 10-Q
May 09, 2007
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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 March 31, 2007

OR

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

For the transition period from _____ to _____

Commission file number 0-50626

CYCLACEL PHARMACEUTICALS, INC.

(Exact name of Registrant as Specified in Its Charter)

DELAWARE
(State or Other Jurisdiction
of Incorporation or Organization)

200 CONNELL DRIVE, SUITE 1500, BERKELEY HEIGHTS, NJ
(Address of principal executive offices)

91-1707622
(I.R.S. Employer
Identification No.)
07922
(Zip Code)

Registrant's telephone number, including area code: (908) 517 7330

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" as defined in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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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 May 9, 2007 there were 20,407,659 shares of the registrant's common stock outstanding.

CYCLACEL PHARMACEUTICALS, INC.

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PART I. FINANCIAL INFORMATION

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEETS

| | As of December 31, 2006 (Note 1) \$000 | As of March 31, 2007 (Unaudited) \$000 |
|---|---|--|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | 44,238 | 75,215 |
| Short-term investments | 9,764 | 5,536 |
| Prepaid expenses and other current assets | 4,163 | 4,480 |
| Total current assets | 58,165 | 85,231 |
| Property, plant and equipment (net) | 2,121 | 2,025 |
| Deposits and other assets | 241 | 241 |
| Goodwill | 2,749 | 2,749 |
| Total assets | 63,276 | 90,246 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | 2,175 | 2,076 |
| Accrued liabilities | 3,324 | 2,468 |
| Other current liabilities | 290 | 173 |
| Derivative liability | 1,135 | 867 |
| Current portion of other accrued restructuring charges | 908 | 976 |
| Current portion of equipment financing | 89 | 19 |
| Total current liabilities | 7,921 | 6,579 |
| Other accrued restructuring charges, net of current | 1,436 | 1,229 |
| Warrants liability | — | 6,292 |
| Total liabilities | 9,357 | 14,100 |
| Stockholders' equity: | | |
| Preferred stock, \$0.001 par value; 5,000,000 shares authorized at December 31, 2006 and March 31, 2007, respectively; 2,046,813 shares issued and outstanding at December 31, 2006 and March 31, 2007, respectively. Aggregate preference in liquidation of \$20,673,000 at December 31, 2006 and March 31, 2007 | 2 | 2 |
| Common stock, \$0.001 par value; 100,000,000 shares authorized at December 31, 2006 and March 31, 2007, respectively; 16,157,953 and 20,407,659 shares issued and outstanding at December 31, 2006 and March 31, 2007, respectively | 16 | 20 |
| Additional paid-in capital | 194,714 | 221,861 |
| Accumulated other comprehensive loss | (2,537) | (2,571) |

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| | | |
|--|-----------|-----------|
| Deficit accumulated during the development stage | (138,276) | (143,166) |
| Total stockholders' equity | 53,919 | 76,146 |
| Total liabilities and stockholders' equity | 63,276 | 90,246 |

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | For the three months ended | | Period from |
|--|---|-----------|-------------|
| | March 31 | | August 13, |
| | 2006 | 2007 | 1996 |
| | | | (inception) |
| | | | to |
| | | | March 31, |
| | | | 2007 |
| | \$000, except per share and share amounts | | |
| Revenues: | | | |
| Collaboration and research and development revenue | 95 | 10 | 3,000 |
| Grant revenue | 56 | 42 | 3,519 |
| | 151 | 52 | 6,519 |
| Operating expenses: ⁽²⁾ | | | |
| Research and development | (8,004) | (3,977) | (125,952) |
| General and administrative | (3,915) | (2,632) | (38,585) |
| Other restructuring costs | — | (80) | (305) |
| Total operating expenses | (11,919) | (6,689) | (164,842) |
| Operating loss | (11,768) | (6,637) | (158,323) |
| Other income (expense): | | | |
| Costs associated with aborted 2004 IPO | — | — | (3,550) |
| Change in valuation of derivative | — | (40) | (255) |
| Change in valuation of warrants | — | 458 | 458 |
| Interest income | 127 | 828 | 9,435 |
| Interest expense | (68) | (51) | (3,967) |
| Total other income (expense) | 59 | 1,195 | 2,121 |
| Loss before taxes | (11,709) | (5,442) | (156,202) |
| Income tax benefit | 360 | 552 | 13,036 |
| Net loss | (11,349) | (4,890) | (143,166) |
| Dividends on Preferred Ordinary shares | (2,827) | — | (38,123) |
| Net loss applicable to ordinary shareholders | (14,176) | (4,890) | (181,289) |
| Net loss per share – basic and diluted | \$ (2.09) | \$ (0.27) | |

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Weighted average shares⁽¹⁾ 6,793,293 18,188,350

(1) Weighted average shares have been adjusted to reflect the equivalent Xcyte shares and equity structure.

(2) Amounts include stock-based compensation, consisting of stock-based compensation expense under SFAS 123R, the amortization of deferred stock-based compensation and the value of options issued to non-employees for services rendered, allocated as shown below:

| | For the three months ended March 31, | | Period from August 13, 1996 (inception) to March 31, |
|----------------------------|--------------------------------------|-------|--|
| | 2006 | 2007 | 2007 |
| | \$000 | \$000 | \$000 |
| Research and development | 4,546 | 290 | 8,386 |
| General and administrative | 2,425 | 253 | 4,310 |
| | 6,971 | 543 | 12,696 |

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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CYCLACEL PHARMACEUTICALS, INC.

(A Development Stage Company)

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

| | For the three months ended March 31, | | Period from August 13, 1996 (inception) to March 31, |
|----------------------|--------------------------------------|---------|--|
| | 2006 | 2007 | 2007 |
| | \$000 | \$000 | \$000 |
| Net loss | (11,349) | (4,890) | (143,166) |
| Currency translation | (1,853) | (34) | (2,576) |
| Comprehensive loss | (13,202) | (4,924) | (145,742) |

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | For the three months ended March 31, | | Period from August 13, 1996 (inception) to March 31, |
|---|--|---------|--|
| | 2006 | 2007 | 2007 |
| | \$000 | \$000 | \$000 |
| Cash flows from operating activities: | | | |
| Net loss | (11,349) | (4,890) | (143,166) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Amortization of investment premiums, net | — | (20) | (49) |
| Change in valuation of derivative | — | 40 | 255 |
| Change in valuation of warrants | — | (458) | (458) |
| Depreciation and amortization | 274 | 241 | 9,330 |
| Unrealized foreign exchange loss | — | 8 | 3,377 |
| Deferred revenue | — | — | (98) |
| Compensation for warrants issued to non employees | — | — | 1,215 |
| Shares issued for IP rights | — | — | 446 |
| Loss on disposal of property, plant and equipment | — | — | 27 |
| Stock based compensation | 6,971 | 543 | 12,697 |
| Provision for restructuring | — | 80 | 305 |
| Amortization of issuance costs of Preferred Ordinary "C" shares | — | — | 2,517 |
| Changes in operating assets and liabilities: | | | |
| Prepaid expenses and other current assets | (10) | (308) | (3,855) |
| Accounts payable and other current liabilities | 1,778 | (1,299) | (1,629) |
| Net cash used in operating activities | (2,336) | (6,063) | (119,086) |
| Investing activities: | | | |
| Purchase of property, plant and equipment | (46) | (142) | (6,811) |
| Proceeds from sale of property, plant and equipment | — | — | 26 |
| Short-term investments on deposit, net of maturities | 7,181 | 4,249 | (1,709) |
| Net cash provided by (used in) investing activities | 7,135 | 4,107 | (8,494) |
| Financing activities: | | | |
| Payment of capital lease obligations | (62) | (71) | (3,691) |
| Proceeds from issuance of ordinary and preferred ordinary shares, net of issuance costs | — | — | 90,858 |
| Proceeds from issuance of common stock and warrants, net of issuance costs | — | 33,358 | 75,984 |
| Payment of preferred stock dividend | — | (307) | (1,228) |
| Repayment of government loan | — | — | (455) |

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| | | | |
|---|---|---|-------|
| Government loan received | — | — | 414 |
| Loan received from Cyclacel Group Plc | — | — | 9,103 |
| Proceeds of committable loan notes issued from shareholders | — | — | 8,883 |

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| | For the three months ended March 31, | | Period from August 13, 1996 (inception) to March 31, 2007 |
|--|--|--------|---|
| | 2006 | 2007 | 2007 |
| | \$000 | \$000 | \$000 |
| Loans received from shareholders | — | — | 1,645 |
| Cash and cash equivalents assumed on stock purchase | 17,915 | — | 17,915 |
| Costs associated with stock purchase | (1,951) | — | (1,951) |
| Net cash provided by financing activities | 15,902 | 32,980 | 197,477 |
| Effect of exchange rate changes on cash and cash equivalents | (111) | (47) | 5,318 |
| Net increase in cash and cash equivalents | 20,701 | 31,024 | 69,897 |
| Cash and cash equivalents at beginning of period | 3,117 | 44,238 | — |
| Cash and cash equivalents at end of period | 23,707 | 75,215 | 75,215 |
| Supplemental disclosure of cash flows information: | | | |
| Cash received during the period for: | | | |
| Interest | 364 | 800 | 9,285 |
| Taxes | — | — | 10,739 |
| Cash paid during the period for: | | | |
| Interest | (119) | (45) | (868) |
| Schedule of non-cash transactions: | | | |
| Acquisitions of equipment purchased through capital leases | — | — | 3,470 |
| Issuance of Ordinary shares in connection with license agreements | — | — | 592 |
| Issuance of Ordinary shares on conversion of bridging loan | — | — | 1,638 |
| Issuance of Preferred Ordinary "C" shares on conversion of secured convertible loan notes and accrued interest | — | — | 8,893 |
| Issuance of Ordinary shares in lieu of cash bonus | — | — | 164 |

SEE NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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CYCLACEL PHARMACEUTICALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(Unaudited)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

The Company is a development-stage biopharmaceutical company dedicated to the discovery, development and eventual commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious disorders. As a development stage enterprise, substantially all efforts of the Company to date have been devoted to performing research and development, conducting clinical trials, developing and acquiring intellectual properties, raising capital and recruiting and training personnel. The Company was incorporated in the state of Delaware in 1996 and is headquartered in Berkeley Heights, New Jersey with research facilities located in the United Kingdom.

The accompanying unaudited condensed consolidated financial statements as of March 31, 2007 and for the three month periods ended March 31, 2006 and 2007 have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed interim financial statements have been prepared on the same basis as the annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position and results of operations of Cyclacel Pharmaceuticals, Inc. have been included. Operating results for the three month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited condensed financial statements should be read in conjunction with the Company's audited financial statements and footnotes related thereto for the year ended December 31, 2006 included in the Company's annual report on Form 10-K filed with the SEC on March 16, 2007.

2. Registered Direct Equity Offering

On February 16, 2007, the Company raised \$36 million in gross proceeds, before deducting placement agent fees and estimated offering expenses of \$2.6 million, in a "registered direct" offering through the sale of shares of its common stock and warrants. The Company entered into subscription agreements with these investors pursuant to which it has sold approximately 4.2 million units, each unit consisting of one share of common stock and a seven-year warrant to purchase 0.25 shares of common stock, at a purchase price of \$8.47125 per unit. The purchase price for the shares and the exercise price for the warrants was \$8.44 per share, the closing bid price for the Company's common stock on February 12, 2007. Investors in the financing paid \$0.125 per warrant. The Company has issued 4,249,668 shares of common stock and warrants to purchase 1,062,412 shares of common stock.

The Company has valued the warrants at \$6.3 million using a Black-Scholes pricing model with the following factors: risk free interest rate of 4.58%, volatility of 85%, dividend yield of 0% and a life of 6.88 years. Emerging Issues Task Force ("EITF") 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" requires freestanding contracts that are settled in a Company's own stock, including common stock warrants to be designated as an equity instrument, asset or liability. Under the provisions of EITF 00-19, a contract designated as an asset or a liability must be carried at fair value until exercised or expired, with any changes in fair value recorded in the results of operations. A contract designated as an equity instrument must be included within equity, and no fair value adjustments are required. The Company reviews the classification of its contracts at each balance sheet date.

Pursuant to EITF Issue No. 00-19, since the Company is unable to control all the events or actions necessary to settle the warrants in registered shares the warrants have been recorded as long-term liabilities at fair value. The fair value of

the outstanding warrants is evaluated at each reporting period with any resulting change in the fair value being reflected in the consolidated statements of operations. The change in fair value recognized in the financial statements during the first quarter of 2007 was \$458,000.

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In connection with the issuance of the common stock and warrants, the Company incurred placement agent fees, legal fees and other expenses of approximately \$2.6 million which have been charged to Additional Paid in Capital on the consolidated balance sheet.

3. STOCK BASED COMPENSATION

On January 1, 2006, the Company adopted Financial Accounting Standards Board Statement (“FASB”), Statement No. 123R, “Share-Based Payment” (“SFAS 123R”). SFAS 123R requires the Company to measure all share-based payment awards, including those with employees, granted, modified, repurchased or cancelled after, or that were unvested as of, January 1, 2006 at fair value. Under SFAS 123R, the fair value of stock options and other equity-based compensation must be recognized as expense in the statements of operations over the requisite service period of each award.

There are 1,615,795 shares of Cyclacel common stock reserved for issue under the equity incentive plans. A resolution to approve the amendment of the 2006 Equity Incentive Plan, (“2006 Plan”), to increase the number of shares of common stock issuable thereunder by an additional 1,384,205 shares, to an aggregate of 3,000,000 shares will be voted on by stockholders at the annual meeting of the Company in May 2007.

As of the date of this report, a total of 1,592,091 options have been granted pursuant to the equity incentive plans. In the first quarter of 2007, we granted 256,250 stock options to our non-executive directors under the 2006 Plan which vest ratably over the four years to March 8, 2011. The total fair value of all options granted under the 2006 Plan is \$6,704,000. In respect of these options, \$3,642,000 of compensation expense has not been recognized at March 31, 2007. A summary of activity for the options under our share option plans for the three months ended March 31, 2007 is as follows:

| | Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (in millions) |
|-------------------------------|-----------|--|--|---|
| Balance as of January 1, 2007 | 1,335,841 | \$ 6.72 | 9.44 | — |
| Granted | 256,250 | \$ 7.80 | 10.00 | — |
| Exercised | — | — | — | — |
| Expired | — | — | — | — |
| Cancelled/forfeited | — | — | — | — |
| Balance as of March 31, 2007 | 1,592,091 | \$ 5.62 | 9.32 | — |
| Unvested at March 31, 2007 | 828,528 | \$ 7.05 | 9.41 | — |

| | | | | |
|--|---------|---------|------|---|
| Vested and exercisable at March 31, 2007 | 763,563 | \$ 6.69 | 9.22 | — |
|--|---------|---------|------|---|

The fair value of the stock options granted during the quarter is calculated at each reporting date using the Black-Scholes option-pricing model prescribed by SFAS 123R using the following assumptions:

| | |
|---|--|
| | For the three months ended March 31, 2007 |
| Expected term | 4.25 years |
| Risk free interest rate | 4.56% |
| Volatility | 70% |
| Dividends | 0.00% |
| Resulting weighted average grant date fair value | \$ 4.48 |

The expected term assumption was estimated using past history of early exercise behavior and expectations about future behaviors.

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The expected volatility assumption was based on the historical volatility of our common stock since the merger with Xcyte Therapies, Inc. on March 27, 2006 together with an analysis of the historical volatilities of a peer group of similar biotechnology companies.

The weighted average risk-free interest rate represents interest rate for treasury constant maturities published by the Federal Reserve Board. If the term of available treasury constant maturity instruments is not equal to the expected term of an employee option, we use the weighted average of the two Federal Reserve securities closest to the expected term of the employee option.

Dividend yield has been assumed to be zero as (a) we have never declared or paid any dividends and (b) do not currently anticipate paying any cash dividends on our outstanding shares of common stock in the foreseeable future.

There were no stock option exercises for the period ended March 31, 2007. No income tax benefits would have been recorded if there had been stock option exercises. SFAS 123R prohibits recognition of tax benefits for exercised stock options until such benefits are realized. As the Company presently has tax loss carry forwards from prior periods and expects to incur tax losses in 2007, the Company would not be able to benefit from the deduction for exercised stock options in the current reporting period.

Cash used to settle equity instruments granted under share-based payment arrangements amounted to \$Nil during all periods presented.

4. COMMITMENTS AND CONTINGENCIES

In 2005, the Company recorded an accrued restructuring liability associated with abandoning the facility in Bothell, Washington. The lease term on this space expires December 2010. The restructuring liability was computed as the present value of the difference between the remaining lease payments due less the estimate of net sublease income and expenses. The accrual balance was adjusted in 2006 to reflect a change in estimate due to continued deterioration in the local real estate market. As of March 31, 2007 the accrued restructuring liability was \$2.2 million. This represents the Company's best estimate of the fair value of the liability. Subsequent changes in the liability due to accretion, or changes in estimates of sublease assumptions, etc. will be recognized as adjustments to restructuring charges in future periods.

The Company records payments of rent related to the Bothell facility as a reduction in the amount of the accrued restructuring liability. Accretion expense is recognized due to the passage of time, which is also reflected as a restructuring charge. Based on our current projections of estimated sublease income and a discount rate of 7.8%, the Company expects to record additional accretion expense of approximately \$269,000 over the remaining term of the lease.

In connection with the abandonment of the Seattle and Bothell facilities and the related sale of assets in late 2005 the Company has been subjected to a State sales tax audit by the Department of Revenue of the State of Washington. In this connection the Company accrued \$270,000 in the year ended December 31, 2006 as a State tax assessment. There has been no change in the Company's assessment of the liability and the \$270,000 remains included in the accompanying balance sheet as a component of accrued liabilities.

5. MERGER

On March 27, 2006, Xcyte Therapies, Inc., or Xcyte, completed the Stock Purchase Agreement with Cyclacel Group plc whereby Xcyte acquired all of Cyclacel Limited's, ("Limited"), outstanding shares of common stock from Cyclacel Group plc. Xcyte changed its name to Cyclacel Pharmaceuticals, Inc., or Cyclacel, and Cyclacel was listed on the Nasdaq Global Market under the ticker symbol CYCC. The transaction was considered a "reverse merger" and was accounted for as a purchase by Cyclacel under accounting principles generally accepted in the United States. Accordingly, the purchase price was allocated among the fair values of the assets and liabilities of Xcyte, while the historical results of Limited are reflected in the results of the combined company. The 1,967,966 shares of Xcyte common stock outstanding, the 2,046,813 preferred stock outstanding and the outstanding Xcyte options, were considered as the basis for determining the consideration in the reverse merger transaction.

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Merger Purchase Price

The consolidated financial statements reflect the merger of Limited with Xcyte as a reverse acquisition wherein Limited is deemed to be the acquiring entity from an accounting perspective. Under the purchase method of accounting, Xcyte's outstanding shares of common and preferred stock were valued using the average closing price on Nasdaq for the two days prior to through the two days subsequent to the announcement of the transaction date of December 15, 2005 of \$4.38 (as adjusted for a reverse stock split) and \$3.72 per share for common stock and preferred stock, respectively. There were 1,967,967 shares of common stock and 2,046,813 shares of preferred stock outstanding as of March 27, 2006. The fair values of the Xcyte outstanding stock options were determined using the Black-Scholes option pricing model with the following assumptions: stock price of \$4.38 (as adjusted for the reverse stock split), volatility of 0.97; risk-free interest rate of 4.0%; and an expected life of three months.

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The purchase price is summarized as follows (in thousands):

| | |
|---|-----------|
| Fair value of Xcyte outstanding common stock | \$ 8,620 |
| Fair value of Xcyte outstanding preferred stock | 7,618 |
| Fair value of Xcyte outstanding stock options | 17 |
| Merger costs | 1,951 |
| Total purchase price | \$ 18,206 |

Merger Purchase Price Allocation

The purchase price allocation is as follows (in thousands):

| | |
|-------------------------------|-----------|
| Current assets | \$ 21,267 |
| Property, plant and equipment | 108 |
| Other assets | 259 |
| Current liabilities | (4,400) |
| Non-current liabilities | (1,777) |
| Goodwill | 2,749 |