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SYNAPTIC PHARMACEUTICAL CORP
Form 10-Q
August 14, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

Mark One:

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

For the quarter ended June 30, 2002

OR

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

Commission File Number 0-27324

SYNAPTIC PHARMACEUTICAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware 22-2859704
(State or other jurisdiction (I.R.S. Employer Identification No.)
of incorporation or organization)

215 College Road 07652
Paramus, NJ (Zip Code)
(Address of principal executive offices)

(201) 261-1331
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

As of August 1, 2002, there were 10,977,790 shares of the registrant's Common Stock outstanding.

SYNAPTIC PHARMACEUTICAL CORPORATION

INDEX TO QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED

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JUNE 30, 2002

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PART I. FINANCIAL INFORMATION

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|--|--|
| Item 1. Financial Statements | |
| SYNAPTIC PHARMACEUTICAL CORPORATION | |
| BALANCE SHEETS | |
| (in thousands, except share information) | |

| | June 30, | December 31, |
|--------|----------|--------------|
| Assets | 2002 | 2001 |
| ----- | | |

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| | (Unaudited) | (Audited) |
|--|-------------|-----------|
| Current assets: | | |
| Cash and cash equivalents | \$ 30,495 | \$ 45,552 |
| Marketable securities--current maturities | 4,043 | 2,553 |
| License fee receivable | 1,688 | - |
| Deferred tax assets | - | 256 |
| Other current assets | 1,018 | 431 |
| ----- | | |
| Total current assets | 37,244 | 48,792 |
| Property and equipment, net | 4,376 | 4,268 |
| Marketable securities | - | 1,545 |
| Other assets | 219 | 228 |
| ----- | | |
| | \$ 41,839 | \$ 54,833 |
| ===== | | |
| Liabilities, Redeemable Convertible Preferred Stock and Stockholders' (Deficit) Equity | | |
| ----- | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,523 | \$ 1,441 |
| Accrued liabilities | 1,225 | 1,104 |
| Accrued compensation | 542 | 550 |
| Deferred revenue | 1,111 | 107 |
| ----- | | |
| Total current liabilities | 4,401 | 3,202 |
| Deferred rent obligation | 985 | 845 |
| Series B senior redeemable convertible preferred stock; authorized, issued and outstanding--11,056 sha liquidation preference--\$11,056 | 10,241 | 10,206 |
| Series C senior redeemable convertible preferred stock; authorized, issued and outstanding--29,944 sha liquidation preference--\$29,944 | 27,711 | 27,613 |
| Stockholders' (deficit) equity: | | |
| Series A preferred stock, \$.01 par value; authorized--1,000,000 shares | - | - |
| Common Stock, \$.01 par value; authorized--25,000,000 shares issued and outstanding--10,975,990 shares in 2002 and 10,953,353 shares in 2001 | 110 | 109 |
| Additional paid-in capital | 99,454 | 99,376 |
| Accumulated other comprehensive income--net unrealized gains on securities | 40 | 87 |
| Accumulated deficit | (101,103) | (86,605) |
| ----- | | |
| Total stockholders' (deficit) equity | (1,499) | 12,967 |
| ----- | | |
| | \$ 41,839 | \$ 54,833 |
| ===== | | |

See notes to financial statements.

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SYNAPTIC PHARMACEUTICAL CORPORATION STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except share and per share information)
(Unaudited)

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|--|-------------------|--------------------------------------|-------------------|
| | 2002 | 2001 | 2002 | 2001 |
| Revenues: | | | | |
| Contract revenue | \$ 293 | \$ 290 | \$ 586 | \$ 577 |
| License revenue | 1,771 | 83 | 1,771 | 166 |
| Total revenues | 2,064 | 373 | 2,357 | 743 |
| Expenses: | | | | |
| Research and development | 6,802 | 4,087 | 13,235 | 8,100 |
| General and administrative | 2,164 | 1,757 | 4,376 | 3,547 |
| Total expenses | 8,966 | 5,844 | 17,611 | 11,647 |
| Loss from operations | (6,902) | (5,471) | (15,254) | (10,904) |
| Other income, net: | | | | |
| Interest income | 245 | 356 | 457 | 778 |
| Other | 121 | 123 | 241 | 254 |
| Other income, net | 366 | 479 | 698 | 1,032 |
| Net loss before benefit from income taxes | (6,536) | (4,992) | (14,556) | (9,872) |
| Income tax benefit | - | - | 58 | - |
| Net loss | (6,536) | (4,992) | (14,498) | (9,872) |
| Accretion to redemption value of mandatorily redeemable convertible preferred stock | (67) | - | (133) | - |
| Net loss applicable to common stockholders | \$ (6,603) | \$ (4,992) | \$ (14,631) | \$ (9,872) |
| Comprehensive loss: | | | | |
| Net loss | \$ (6,536) | \$ (4,992) | \$ (14,498) | \$ (9,872) |
| Unrealized (losses) gains arising during period | (9) | (70) | (47) | 259 |
| Comprehensive loss | \$ (6,545) | \$ (5,062) | \$ (14,545) | \$ (9,613) |
| Basic and diluted net loss per share | \$ (0.60) | \$ (0.46) | \$ (1.33) | \$ (0.90) |
| Shares used in computation of net loss per share | 10,975,408 | 10,938,949 | 10,971,170 | 10,938,331 |

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See notes to financial statements.

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SYNAPTIC PHARMACEUTICAL CORPORATION
STATEMENTS OF CASH FLOWS

(in thousands)
(Unaudited)

For the six months ended June 30, 2002 and 2001

| | 2002 | 2001 |
|--|-------------|------------|
| ----- | | |
| Operating activities: | | |
| Net loss | \$ (14,498) | \$ (9,872) |
| Adjustments to reconcile net loss to net cash (used in) operating activities: | | |
| Depreciation | 560 | 693 |
| Amortization of premiums on securities | 8 | 201 |
| Deferred rent, net | 149 | 50 |
| Non-cash stock compensation | 105 | - |
| Changes in operating assets and liabilities: | | |
| Increase in license fee receivable | (1,688) | - |
| Increase in other current assets | (331) | (41) |
| Increase in accounts payable, accrued liabilities and accrued compensation | 195 | 696 |
| Increase in deferred revenue | 1,004 | 417 |
| ----- | | |
| Net cash (used in) operating activities | (14,496) | (7,856) |
| Investing activities: | | |
| Purchases of property and equipment | (668) | (318) |
| Proceeds from sale or maturity of investments | - | 18,090 |
| Purchase of investments | - | (2,000) |
| Proceeds from sale of equipment | - | 16 |
| ----- | | |
| Net cash (used in) provided by investing activities | (668) | 15,788 |
| Financing activities: | | |
| Issuance of common stock | 107 | 21 |
| ----- | | |
| Net cash provided by financing activities | 107 | 21 |
| ----- | | |
| Net (decrease) increase in cash and cash equivalents | (15,057) | 7,953 |
| Cash and cash equivalents at beginning of period | 45,552 | 2,037 |
| ----- | | |
| Cash and cash equivalents at end of period | \$ 30,495 | \$ 9,990 |
| ===== | | |

See notes to financial statements.

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SYNAPTIC PHARMACEUTICAL CORPORATION
NOTES TO FINANCIAL STATEMENTS

June 30, 2002

Note 1 -- Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with the instructions to Form 10-Q and may not include all information and footnotes required for a presentation in accordance with accounting principles generally accepted in the United States. In the opinion of the management of Synaptic Pharmaceutical Corporation (the "company"), these financial statements include all normal and recurring adjustments necessary for a fair presentation of the financial position and the results of operations and cash flows of the company for the interim periods presented. For more complete financial information, these financial statements should be read in conjunction with the audited financial statements for the fiscal year ended December 31, 2001, and notes thereto included in the company's 2001 Annual Report on Form 10-K. The results of operations for the fiscal quarter ended June 30, 2002, are not necessarily indicative of the results of operations to be expected for the full year.

Note 2 - Senior Redeemable Convertible Preferred Stock

On August 3, 2001, the company sold to investors (the "purchasers"), 9,438 shares of Series B Preferred Stock in a private placement for \$9,438,000. On September 26, 2001, the company sold 1,618 shares of Series B Preferred Stock and 29,944 shares of Series C Preferred Stock for \$31,562,000. Net proceeds, after giving effect to placement fees and offering expenses, were approximately \$37,745,000. The purchasers were granted certain subscription and registration rights in connection with their acquisition of the Preferred Stock.

The Series B and Series C Convertible Preferred Stock (the "Preferred Stock") are two series of senior redeemable convertible preferred stock having identical terms, except that the Series B Preferred Stock has an initial conversion price of \$4.3358 and the Series C Preferred Stock has an initial conversion price of \$5.9713. Each share of Preferred stock may be converted at any time at the option of the holder thereof into a number of shares of common stock determined by dividing \$1,000 by the conversion price, as appropriately adjusted for any stock splits, stock dividends, combinations or similar events. All shares of Preferred Stock shall automatically be converted into common stock upon the vote to so convert of holders of a majority of the Preferred Stock then outstanding, voting together as a separate class. The Preferred Stock is currently convertible into an aggregate of 7,564,584 shares of common stock.

Holders of Preferred Stock are entitled to receive dividends on a pari passu basis, if and when dividends are declared on the common stock, in an amount equal to the dividends that would have been payable had their shares been converted to common stock immediately prior to the record date for the dividend.

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Upon any liquidation of the company, each holder of Preferred Stock is entitled to receive \$1,000, plus declared but unpaid dividends, if any, for each share held, prior to the holders of any common stock or junior preferred stock receiving any assets of the company available for distribution.

Holders of Preferred Stock, voting together as a separate class, are entitled to elect two members of the board of directors, as long as 60% of the Preferred Stock issued and outstanding as of September 26, 2001 remains outstanding.

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The holders of the Preferred Stock are entitled to vote together with the holders of the common stock on all matters presented to our stockholders for consideration, except that as long as the holders of the Preferred Stock are entitled to vote as a separate class to elect members of the board of directors, they will not be entitled to vote for the remaining directors. Each share of Preferred Stock has a number of votes equal to the number of shares of common stock into which it may then be converted.

The company may redeem all outstanding shares of Preferred Stock at any time after August 3, 2003, provided that the company can redeem these shares prior to August 3, 2009, only if the market price of the common stock is at least 200% of the conversion price then in effect for any 20 consecutive trading days ending within 10 trading days of the redemption date. The company must redeem all outstanding shares of Preferred Stock in two annual installments beginning on August 3, 2009. On any redemption, the redemption price will be \$1,000 per share, as appropriately adjusted for any stock splits, stock dividends, combinations or similar events, plus declared but unpaid dividends.

During 2001, the company recorded an adjustment to net loss applicable to common stockholders of \$4,226,000 relating to the beneficial conversion feature inherent in the issuances of the Series B Preferred Stock. This amount was determined based upon the excess of the fair value of the company's common stock into which the Series B Preferred Stock was immediately convertible less the initial conversion price of \$4.3358 per share in accordance with Emerging Issues Task Force No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios." For the six-month period ended June 30, 2002, the company recorded an adjustment to net loss applicable to common stockholders of approximately \$133,000 representing the accretion of the Series B Preferred Stock and Series C Preferred Stock to their respective redemption values.

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

Overview

Synaptic is a drug discovery company using G protein-coupled receptors as the basis for developing new drugs for the treatment of a variety of human disorders.

We currently collaborate with Grunenthal GmbH ("Grunenthal") and Kissei Pharmaceutical Co., Ltd. ("Kissei"). In connection with our collaborative arrangement with Grunenthal, we have licensed some of our technology and patent rights to them. We have also granted licenses to some of our technology and patent rights to other pharmaceutical companies.

Since our inception, we have financed our operations primarily through the sale of our stock, through contract and license revenue under license agreements, and through interest income and capital gains resulting from the investment of the proceeds of our financing activities pending use of these funds for operational activities. We have also received funds through government grants under the Small Business Innovative Research ("SBIR") program of the National Institutes of Health and through the sale of our New Jersey state tax net operating loss ("NOL") carryforwards.

To date, our expenditures have been for research and development related expenses, general and administrative related expenses, fixed asset purchases and various patent related expenditures incurred in protecting our technologies. Historically, we have not been profitable, and at June 30, 2002 we had an accumulated deficit of \$101,103,000. We incurred net losses applicable to common stockholders of \$26,118,000, \$13,859,000 and \$15,121,000 for the fiscal years ended 2001, 2000 and 1999, respectively. We expect to continue to incur operating losses for a number of years, and we will not become profitable unless and until we receive royalty revenue or revenue from sales of drugs developed with the use of our technology or patent rights.

Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States that require us to make estimates and assumptions. We believe that of our significant accounting policies, the following may involve a higher degree of judgment and complexity:

Revenue

Revenues that we receive, or may receive, are derived from either multi-element revenue arrangements or from research services that we perform. Historically, virtually all revenue that has been recorded has been under

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multi-element revenue arrangements. Generally, revenue is realized or realizable and earned when all of the following criteria are met: (1) an arrangement exists, (2) services have been rendered, (3) prices of services are fixed or determinable and (4) collectibility is reasonably assured. As the structures of our arrangements are unique and may contain several different revenue components, each is reviewed on a case-by-case basis in order to determine the appropriate amount and term over which to recognize revenues.

Under these multi-element revenue arrangements, we may receive one or more of the following types of revenue: license revenue, research funding revenue, milestone revenue, royalty revenue and revenue derived from sales of drugs.

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License revenue represents non-refundable payments for a license to one or more of our patents and/or a license to our technology. Payments for licenses are recognized as they are received or, if earlier, when they become guaranteed, provided they are independent of any continuing research activity on the related project. Otherwise, they are recognized pro-rata during the term of the related research agreement in accordance with Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements."

Research funding revenue includes payment to support a specified number of Synaptic's scientists. Such revenue is recognized ratably over the period in which the research is performed.

Milestone revenue represents non-refundable payments for the achievement of a specified milestone under either an existing arrangement or under a license that has been granted to one or more of our patents and/or our technology. Such payments typically coincide with the achievement of a substantial element in a multi-element arrangement or measure substantive stages of progress toward completion under a long-term contract. The recognition of such payments as revenue is determined based upon the nature of the underlying arrangement. Milestone payments received under contracts where the company is performing related ongoing research, and which are deemed to have multi-element financial arrangements, will be recognized as revenue over the remaining life of the contract. Milestone payments received under license agreements are recognized as revenue as they are received or, if earlier, when they become guaranteed, provided they are independent of any research activity.

Royalty revenue represents payments that may be received from the sales of drugs that may be developed using the technology or the patent rights that have been licensed. We are entitled to receive royalty payments under most of our license agreements. To date, we have not received royalty payments and we do not expect to receive such payments for a number of years, if at all.

Revenue derived from the sales of drugs would be recognized if the company markets drugs. The company may develop drugs on its own or in partnership with others. As part of the agreement with Grunenthal, we have development and marketing rights in certain geographical areas with respect to any drugs that are jointly identified under the agreement. Accordingly, we may receive revenue from sales of drugs in our designated geographical areas if we market them independently, or we may receive royalty payments if we license our marketing rights to a third party. To date, we have not received revenue from the sales of drugs and we do not expect to receive such revenues for a number of years, if at all.

Income Taxes

We account for income taxes using the liability method. Under this method,

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deferred income tax assets and liabilities reflect tax carryforwards and the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes, as determined under currently enacted tax rates. Deferred tax assets are recorded if future realization is more likely than not.

Deferred taxes are recorded primarily for Federal and state net operating loss carryforwards, research and development credit carryforwards and depreciation and amortization, which are reported in different periods for Federal income tax purposes than for financial reporting purposes. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized.

At December 31, 2001, we had approximately \$29,625,000 of Federal and state net operating loss carryforwards and approximately \$1,610,000 research and development credit carryforwards. We

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have a history of operating losses and expect these losses to increase as a result of our strategy of increasing our internal drug development efforts. These losses would remain available to us on a carryforward basis to offset any future earnings; however, deferred tax assets attributable to these net operating losses have been fully offset by a valuation allowance in the financial statements, as their future realization is uncertain.

Research and Development

We perform research for ourselves and for our current collaborators, Kissei and Grunenthal. As this research progresses, we designate some projects for preclinical and clinical development. Until a lead compound is chosen for development, all costs associated with that compound are considered to be research expense. Costs incurred during the research phase are not separately identifiable by project. At this preliminary or investigational stage, research is performed within a broad family of receptors with the objective of identifying lead compounds. Once a lead compound enters the preclinical development stage, costs are accumulated for each project associated with that compound. Currently, the only project for which a lead compound has been chosen is the company's depression program. The lead compound in this program was selected during the second quarter of 2000. Costs incurred on the depression program for the six-month and inception-to-date periods ended June 30, 2002 approximated \$4,009,000 and \$6,559,000, respectively. Total research costs for the six-month period ended June 30, 2002 amounted to \$13,235,000.

In general, from the time a lead compound is chosen until that compound reaches the market, many years may elapse. During this time, the compound must undergo clinical trials that include Phase I, Phase II and Phase III trials, the results of which are subject to review and approval by the U.S. Food & Drug Administration and other regulatory agencies. Successful completion of each trial carries its own set of risks and may cost many millions of dollars. At this stage of Phase I clinical development of the depression program, completion costs and dates cannot be estimated.

Net Loss Applicable to Common Stockholders

During the third quarter of 2001, we sold shares of two series of senior redeemable convertible preferred stock the Series B Convertible Preferred Stock and Series C Convertible Preferred Stock, in a private equity placement. In

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connection with these issuances, we recorded an adjustment to net loss applicable to common stockholders for the year ended December 31, 2001 of approximately \$4,226,000 relating to the beneficial conversion feature inherent in the issuances of the Series B Convertible Preferred Stock. This amount was determined based upon the excess of the fair value of the company's common stock into which the Series B Convertible Preferred Stock was immediately convertible less the initial conversion price of \$4.3358 per share in accordance with Emerging Issues Task Force No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios." For the six-month period ended June 30, 2002, we recorded an adjustment to net loss applicable to common stockholders of approximately \$133,000 representing the accretion of the Series B and Series C Convertible Preferred Stock to their respective redemption values.

Results of Operations

Comparison of the Three Months Ended June 30, 2002 and 2001

Revenues. We recognized revenue of \$2,064,000 and \$373,000 for the three months ended June 30, 2002 and 2001, respectively. The increase in revenue of \$1,691,000 resulted primarily from an

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increase in license revenue resulting from the grant of licenses for certain of the company's patent rights to two separate pharmaceutical companies.

Research and Development Expenses. We incurred research and development expenses of \$6,802,000, and \$4,087,000 for the three months ended June 30, 2002 and 2001, respectively. The increase of \$2,715,000, or 66%, was attributable primarily to increases in: clinical and preclinical testing costs, supplies, and research salaries and fringe benefit expenses resulting from a net increase in headcount.

General and Administrative Expenses. We incurred general and administrative expenses of \$2,164,000 and \$1,757,000 for the three months ended June 30, 2002 and 2001, respectively. The increase of \$407,000, or 23%, was attributable primarily to increases in patent and legal expenses and accrued severance costs in accordance with the terms of the separation agreement entered into with our president and chief executive officer.

Other Income, Net. We recorded other income of \$366,000 and \$479,000 for the three months ended June 30, 2002 and 2001, respectively. The decrease of \$113,000 was primarily due a decrease in interest income related to lower cash, cash equivalent and marketable securities balances during 2002 as a result of the utilization of these resources to fund the company's operations and an overall reduction in interest rates.

Net loss applicable to common stockholders. Our net loss applicable to common stockholders was \$6,603,000 (\$0.60 per share), and \$4,992,000 (\$0.46 per share) for the three months ended June 30, 2002 and 2001, respectively. The increase in net loss per share of \$0.14 resulted primarily from higher expenses partially offset by higher revenues during the second quarter of 2002 as described above.

Comparison of the Six Months Ended June 30, 2002 and 2001

Revenues. We recognized revenue of \$2,357,000 and \$743,000 for the six months ended June 30, 2002 and 2001, respectively. The increase in revenue of

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\$1,614,000 resulted primarily from an increase in license revenue resulting from the grant of licenses for certain patent rights to two separate pharmaceutical companies.

Research and Development Expenses. We incurred research and development expenses of \$13,235,000, and \$8,100,000 for the six months ended June 30, 2002 and 2001, respectively. The increase of \$5,135,000, or 63%, was attributable primarily to increases in: clinical and preclinical testing costs, supplies, and research salaries and fringe benefit expenses resulting from a net increase in headcount.

General and Administrative Expenses. We incurred general and administrative expenses of \$4,376,000 and \$3,547,000 for the six months ended June 30, 2002 and 2001, respectively. The increase of \$829,000, or 23%, was attributable primarily to increases in patent expenses, recruiter fees and accrued severance costs in accordance with the terms of the separation agreement entered into with our president and chief executive officer.

Other Income, Net. We recorded other income of \$698,000 and \$1,032,000 for the six months ended June 30, 2002 and 2001, respectively. The decrease of \$334,000 was primarily due a decrease in interest income related to lower cash, cash equivalent and marketable securities balances during 2002 as

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a result of the utilization of these resources to fund the company's operations and an overall reduction in interest rates.

Income tax benefit. During the six months ended June 30, 2002, we recorded a \$58,000 income tax benefit related to the sale of a portion of our New Jersey state net operating loss carryforwards.

Net loss applicable to common stockholders. Our net loss applicable to common stockholders was \$14,631,000 (\$1.33 per share), and \$9,872,000 (\$0.90 per share) for the six months ended June 30, 2002 and 2001, respectively. The increase in net loss per share of \$0.43 resulted primarily from higher expenses partially offset by higher revenues during the first quarter of 2002 as described above.

Operating Trends. Our revenues may vary from period to period depending on numerous factors, including the timing of revenue earned under license agreements and revenue that may be earned under future collaborative and/or license agreements. During 2001 and for the six-month period ended June 30, 2002, we recognized revenue under our research and licensing agreement with Kissei Pharmaceutical Co., Ltd. and will continue to recognize additional revenues under this agreement during the remainder of 2002. Also during the second quarter of 2002 we recognized revenue relating to the licensing of certain of the company's patent rights to Procter and Gamble Pharmaceuticals and Ranbaxy Laboratories Limited. Under the terms of some of our license agreements, revenues may be recognized if specified milestones are achieved. We continue to assess the opportunity for obtaining additional funding under new collaborative and/or license agreements. We continue to monitor our spending level in order to ensure that we have enough cash to last at least through the second quarter of 2003.

Since late 2000, we have been pursuing a new business strategy of increasing our internal drug development efforts. This new strategy requires us to hire additional employees with drug development expertise and to incur additional preclinical expenses as well as expenses associated with clinical trials.

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Legal expenses are expected to continue to be a significant expense as a result of a suit filed by the company. See "Legal Proceedings" in PART II, Item 1.

Other income, net is expected to decrease during 2002 because of less favorable short-term interest rates. This decrease will, however, be somewhat mitigated by an increase in rental income that we expect to recognize under our existing sublease agreements.

We are pursuing further sales of our state tax NOL carryforwards and our state research and development credits under the State of New Jersey's Technology Business Tax Certificate Transfer Program (the "Program"). No assurance can be given, however, as to the amount of NOL carryforwards that may be sold under the Program in any one year. External factors that may have an effect on future NOL sales include limitations imposed by State law and availability of buyers and related demand.

Property and equipment spending may vary from period to period depending on numerous factors, including the level of drug development efforts, the number of collaborations in which we are involved at any given time, and replacement due to normal wear and obsolescence. Equipment spending in 2002 is expected to increase from that of 2001.

At June 30, 2002, we held marketable securities with an estimated fair value of \$4,043,000. Our primary interest rate exposure results from changes in short-term interest rates. We do not purchase financial instruments for trading or speculative purposes. All of the marketable securities we hold are classified as available-for-sale securities. The following table provides information about marketable securities that we held at June 30, 2002:

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| Principal Amount and Weighted Average Stated Rate by Expected Maturity | | | | Estimated Fair Value |
|---|---------|---------|---------|-------------------------|
| (000's) | 2002 | 2003 | Total | (000's) |
| Principal | \$2,500 | \$1,500 | \$4,000 | \$4,043 |
| WeightedAvgStatedRtes | 6.50% | 6.20% | 6.39% | -- |

The stated rates of interest expressed in the above table may not approximate the actual yield of the securities that Synaptic currently holds since we have purchased some marketable securities at other than face value. Additionally, the securities represented in the above table may be called or redeemed, at the option of the issuer, prior to their expected due dates. If early redemptions occur, we may reinvest the proceeds realized on such calls or redemptions in marketable securities with stated rates of interest or yields that are lower than those of current holdings, affecting both future cash interest streams and future earnings.

In addition to investments in marketable securities, we place some of our cash in money market funds in order to keep cash available to fund operations and to hold cash pending investments in marketable securities. Fluctuations in short term interest rates will affect the yield on monies invested in such money market funds. Such fluctuations can have an impact on future cash interest streams and future earnings, but the impact of such fluctuations are not expected to be material.

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We do not believe that inflation has had a material impact on our results of operations.

Liquidity and Capital Resources

At June 30, 2002 and December 31, 2001, cash, cash equivalents and marketable securities aggregated \$34,538,000 and \$49,650,000, respectively. This decrease was primarily the result of the utilization of these resources to fund our operations. We intend to utilize our cash primarily for research, preclinical and clinical development costs, for patent related expenditures, for general corporate purposes, for leasehold improvements to our facilities and for the purchase of property and equipment. We expect to continue to incur operating losses for a number of years. We believe that cash, cash equivalents and marketable securities on hand, and cash that we expect to receive through existing license arrangements and interest payments on investments, will be sufficient to fund operations, as well as to support our share of certain development costs under the Grunenthal Agreement, if any, at least through the second quarter of 2003.

To date, we have met our cash requirements through the sale of our stock, through contract and license revenue, through interest income and gains resulting from our investments, through SBIR grants and through sales of portions of our state research and development credits and state NOL carryforwards.

As of December 31, 2001, we had NOL carryforwards of approximately \$76,000,000 for Federal income tax purposes that will expire principally in the years 2002 through 2021. In addition, we had Federal research and development credit carryforwards of approximately \$1,610,000 that will expire principally in 2002 through 2018. Also at December 31, 2001, we had NOL carryforwards of approximately \$61,000,000 for state income tax purposes and state research and development credit carryforwards of \$311,000. For financial reporting purposes, a valuation allowance has been recognized to offset the deferred tax assets related to these carryforwards.

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We lease laboratory and office facilities under an agreement expiring on December 31, 2015. The minimum annual payment under the lease is currently \$1,835,000. The lease provides for fixed escalations in rent payments in the years 2005 and 2010.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and qualitative disclosures about market risk (i.e., interest rate risk) are included in Item 2 of this Report.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On June 5, 2000, we filed suit in the United States District Court for the District of New Jersey against M.D.S. Panlabs, Inc., a Washington corporation, and Panlabs Taiwan Ltd., a Taiwanese corporation (collectively, "Panlabs"). The suit alleges that Panlabs has infringed several issued U.S. Patents owned by Synaptic that relate to cloned human receptors and their use in binding assays. The suit also alleges that Panlabs has been importing, selling and offering to sell products of our patented binding assay processes to pharmaceutical companies and others in the United States, particularly in New Jersey.

On December 14, 2001, we filed a suit in the United States District Court for the District of New Jersey against Euroscreen, S.A., a Belgian corporation ("Euroscreen"). The suit alleges that Euroscreen has infringed numerous issued U.S. Patents owned by us, which relate to cloned human receptors and their use in binding assays. The suit alleges that Euroscreen has been importing, selling and offering to sell products of our patented binding assay processes to pharmaceutical companies and others in the United States, particularly in New Jersey, and that Euroscreen has conspired with Panlabs to infringe our patents.

The suits seek injunctions against the infringing activities of Euroscreen and Panlabs, damages, the destruction of data obtained by the infringement of patents and other relief.

We believe that our complaint against Panlabs and Euroscreen is well founded and necessary to protect the value of our intellectual property assets.

An adverse resolution of the above matters would not have a material

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adverse effect on our business.

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Item 4. Submission of Matters to a Vote of Security Holders

On May 9, 2002, the Company held its annual meeting of stockholders for the following purposes: (i) to elect two Preferred Directors and three Class III Common Directors to the Board of Directors (Proposal No. 1); to amend the Company's 1996 Director Plan in order to increase the number of shares of common stock available for award under such Plan and to increase the amount of each award (Proposal No. 2); and (iii) to ratify the appointment by the Board of Directors of Ernst & Young LLP as the independent auditors of the Company for the fiscal year ending December 31, 2002 (Proposal No. 3).

The preferred stockholders elected the persons named below, the Company's nominees for director, as Preferred Directors of the Company, casting votes for such nominees or withholding votes as indicated:

| | VOTES FOR | VOTES WITHHELD |
|------------------|-----------|----------------|
| Stewart J. Hen | 7,564,584 | 0 |
| Jonathan S. Leff | 7,564,584 | 0 |

The common stockholders elected the persons named below, the Company's nominees for director, as Class III Common Directors of the Company, casting votes for such nominees or withholding votes as indicated:

| | VOTES FOR | VOTES WITHHELD |
|----------------------|-----------|----------------|
| Zola P. Horowitz | 8,647,077 | 12,520 |
| Patrick J. McDonald | 8,648,627 | 10,970 |
| Kathleen P. Mullinix | 8,650,287 | 9,310 |

The stockholders, voting together as a single class, approved Proposal No. 2 as follows:

| VOTES FOR | VOTES AGAINST | VOTES ABSTAINED | BROKER NON-VOTES |
|-----------|---------------|-----------------|------------------|
|-----------|---------------|-----------------|------------------|

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14,111,295 2,101,891 10,995 N/A

The stockholders, voting together as a single class, approved Proposal No. 3 as follows:

| VOTES FOR | VOTES AGAINST | VOTES ABSTAINED | BROKER NON-VOTES |
|------------|---------------|-----------------|------------------|
| 16,178,196 | 44,402 | 1,583 | N/A |

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

None

Safe Harbor Statement

This Report on Form 10-Q contains "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Such statements include, but are not limited to, those relating to future cash and spending plans, amounts of future research funding, and any other statements regarding future growth, future cash needs, future operations, business plans and financial results, and any other statements which are not historical facts. When used in this document, the words "expects," "may," "believes," and similar expressions are intended to be among the words that identify forward-looking statements. Such statements involve

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risks and uncertainties, including, but not limited to, those risks and uncertainties detailed in the company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001 (the "2001 Form 10-K"), including in Item 1 of the 2001 Form 10-K under the captions "Patents, Proprietary Technology and Trade Secrets," "Competition" and "Government Regulation" as well as in the section entitled "Risk Factors" or detailed from time to time in filings the company makes with the SEC. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated. Although the company believes that the expectations reflected in the forward-looking statements contained herein are reasonable, it can give no assurance that such expectations will prove to be correct.

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SIGNATURE PAGE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SYNAPTIC PHARMACEUTICAL CORPORATION

Date: August 14, 2002

By: /s/ Kathleen P. Mullinix

Name: Kathleen P. Mullinix
Title: President and Chief Executive Officer

By: /s/ Edmund M. Caviasco

Name: Edmund M. Caviasco
Title: Controller (Principal Accounting Officer)

