ALFACELL CORP
Form 10-Q
December 21, 2009

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

FORM 10-Q

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

For the quarterly period ended: October 31, 2009

[ ] 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: 0-11088

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

Delaware	22-2369085
(State or other jurisdiction of organization)	(I.R.S. Employer Identification No.)

300 Atrium Drive, Somerset, NJ 08873
(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code): (732) 652-4525

NOT APPLICABLE
(Former name, former address, and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant has (1) 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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definitions of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. Large Accelerated Filer [ ] Accelerated Filer [ ] Non-accelerated Filer [ ] Smaller Reporting Company [X]

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

The number of shares of Common Stock, $.001 par value, outstanding as of December 16, 2009 was 47,313,880 shares.

ALFACELL CORPORATION
(A Development Stage Company)

FORM 10-Q

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

ALFACELL CORPORATION
(A Development Stage Company)

CONDENSED BALANCE SHEETS
October 31, 2009 and July 31, 2009

	October 31, 2009 (Unaudited)	July 31, 2009 (See Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,558,453	$ 129,194
Prepaid expenses	150,523	54,494
Total current assets	1,708,976	183,688
Property and equipment, net of accumulated depreciation and amortization of $385,133 at October 31, 2009 and $377,134 at July 31, 2009	100,019	108,018
Restricted cash	1,801,805	266,280
Total assets	$ 3,610,800	$ 557,986
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable	$ 758,092	$ 407,273
Accrued clinical trial expenses	430,081	459,911
Accrued professional service fees	367,465	350,486
Accrued compensation expense	186,437	207,245
Derivative liability	13,400,703	-
Current portion of obligations under capital lease	4,542	4,299
Convertible debt, less debt discount of $3,214,384	35,616	-
Other accrued expenses	631	2,890
Total current liabilities	15,183,567	1,432,104
Other liabilities:		
Accounts payable, net of current portion	444,223	444,223
Obligations under capital lease, net of current portion	11,411	12,641
Accrued retirement benefits	296,250	335,250
Accrued interest, related party	5,342	-
Deferred rent	281,648	284,134
Deferred revenue	5,200,000	5,200,000
Total other liabilities	6,238,874	6,276,248
Total liabilities	21,422,441	7,708,352
Commitments and contingencies		
Stockholders' deficiency:		
Preferred stock, $.001 par value. Authorized and unissued, 1,000,000 shares at October 31, 2009 and July 31, 2009	–	–
Common stock $.001 par value. Authorized 100,000,000 shares at October 31, 2009 and July 31, 2009; issued and outstanding 47,313,880 shares at October 31, 2009 and July 31, 2009	47,314	47,314
Capital in excess of par value	101,062,222	101,734,572

Deficit accumulated during development stage		(118,921,177)		(108,932,252)
Total stockholders' deficiency		(17,811,641)		(7,150,366)
Total liabilities and stockholders' deficiency	$	3,610,800	$	557,986

See accompanying notes to condensed financial statements.

ALFACELL CORPORATION
(A Development Stage Company)

CONDENSED STATEMENTS OF OPERATIONS

Three months ended October 31, 2009 and 2008,
and the Period from August 24, 1981
(Date of Inception) to October 31, 2009

(Unaudited)

	Three Months Ended October 31, 2009	Three Months Ended October 31, 2008	August 24, 1981 (Date of Inception) to October 31, 2009
Sales	$ 18,750	$ -	$ 572,239
Operating expenses:			
Cost of sales	-	-	336,495
Research and development	160,881	1,727,381	72,742,761
General and administrative	399,473	1,093,473	41,363,362
Total operating expenses	560,354	2,820,854	114,442,618
Loss from operations	(541,604)	(2,820,854)	(113,870,379)
Investment income	251	18,563	2,302,332
Other income	-	-	99,939
Interest expense:			
Related parties, net	(6,727)	-	(1,154,274)
Fair value adjustment – derivative liability	(9,439,084)	-	(9,439,084)
Others	(1,761)	(1,112)	(2,884,967)
Loss before state tax benefit	(9,988,925)	(2,803,403)	(124,946,433)
State tax benefit	-	-	6,025,256
Net loss	$ (9,988,925)	$ (2,803,403)	$ (118,921,177)
Loss per common share - basic and diluted	$ (0.21)	$ (0.06)	
Weighted average number of common shares outstanding – basic and diluted	47,313,880	47,310,510	

See accompanying notes to condensed financial statements.

ALFACELL CORPORATION
(A Development Stage Company)

CONDENSED STATEMENT OF STOCKHOLDERS' DEFICIENCY

Period from July 31, 2009 to October 31, 2009

(Unaudited)

	Common Stock				
	Number of Shares	Amount	Capital In Excess of par Value	Deficit Accumulated During Development Stage	Total Stockholders' Deficiency
Balance at July 31, 2009	47,313,880	$ 47,314	$ 101,734,572	$ (108,932,252)	$ (7,150,366)
Stock-based compensation	—	—	74,885	—	74,885
Derivative liability	—	—	(747,235)	—	(747,235)
Net loss	—	—	—	(9,988,925)	(9,988,925)
Balance at October 31, 2009	47,313,880	$ 47,314	$ 101,062,222	$ (118,921,177)	$ (17,811,641)

See accompanying notes to condensed financial statements.

ALFACELL CORPORATION

(A Development Stage Company)

CONDENSED STATEMENTS OF CASH FLOWS

Three months ended October 31, 2009 and 2008,
and the Period from August 24, 1981
(Date of Inception) to October 31, 2009

(Unaudited)

	Three Months Ended October 31, 2009	Three Months Ended October 31, 2008	August 24, 1981 (Date of Inception) to October 31, 2009
Cash flows from operating activities:			
Net loss	$ (9,988,925)	$ (2,803,403)	$ (118,921,177)
Adjustments to reconcile net loss to net cash used in operating activities:			
Gain on sale of marketable securities	-	-	(25,963)
Depreciation and amortization	7,999	9,337	1,753,593
Loss on disposal of property and equipment	-	-	18,926
Loss on lease termination	-	-	30,964
Stock-based compensation expense	74,885	633,274	13,938,817
Amortization of deferred rent	(2,486)	14,222	183,684
Amortization of debt discount	35,616	-	629,835
Fair value of derivative liability	9,403,468	-	9,403,468
Amortization of deferred compensation	-	-	11,442,000
Changes in assets and liabilities:			
Increase in prepaid expenses	(96,029)	(63,492)	(210,390)
Decrease in loan receivable-related party	-	-	96,051
Increase in restricted cash	(1,535,525)	-	(1,801,805)
Increase in interest payable-related party	5,342	-	749,881
Increase (decrease) in accounts payable	350,819	(118,411)	1,708,950
Increase in accrued payroll and expenses, related parties	-	-	2,348,145
(Decrease) increase in accrued retirement benefits	(65,442)	-	452,250
(Decrease) increase in accrued expenses	(9,476)	(386,464)	1,547,497
Increase in deferred revenue	-	-	5,200,000
Net cash used in operating activities	(1,819,754)	(2,714,937)	(71,455,274)
Cash flows from investing activities:			
Purchase of marketable equity securities	-	-	(290,420)
Purchase of short-term investments	-	-	(1,993,644)
Proceeds from sale of marketable equity securities	-	-	316,383
Proceeds from sale of short-term investments	-	-	1,993,644
Capital expenditures	-	-	(1,605,066)
Patent costs	-	-	(97,841)
Net cash used in investing activities	-	-	(1,676,944)

(continued)

See accompanying notes to condensed financial statements.

ALFACELL CORPORATION
(A Development Stage Company)

CONDENSED STATEMENTS OF CASH FLOWS, Continued

Three months ended October 31, 2009 and 2008
and the Period from August 24, 1981
(Date of Inception) to October 31, 2009

(Unaudited)

	Three Months Ended October 31, 2009	Three Months Ended October 31, 2008	August 24, 1981 (Date of Inception) to October 31, 2009
Cash flows from financing activities:			
Proceeds from short-term borrowings	$ -	$ -	$ 874,500
Payment of short-term borrowings	-	-	(653,500)
Increase in loans payable - related party, net	-	-	2,628,868
Proceeds from bank debt and other long-term debt, net of costs	-	-	3,667,460
Reduction of bank debt and long-term debt	-	-	(2,966,568)
Payment of capital lease obligations	(987)	(793)	(7,825)
Proceeds from issuance of common stock, net	-	-	53,102,893
Proceeds from exercise of stock options and warrants, net	-	13,220	14,080,850
Proceeds from issuance of convertible debentures, related party	3,250,000	-	3,547,000
Proceeds from issuance of convertible debentures, unrelated party	-	-	416,993
Net cash provided by financing activities	3,249,013	12,427	74,690,671
Net increase (decrease) in cash and cash equivalents	1,429,259	(2,702,510)	1,558,453
Cash and cash equivalents at beginning of period	129,194	4,661,656	-
Cash and cash equivalents at end of period	$ 1,558,453	$ 1,959,146	$ 1,558,453
Supplemental disclosure of cash flow information – interest paid	$ 1,761	$ 1,112	$ 1,725,021
Noncash financing activities:			
Issuance of convertible subordinated debenture for loan payable to officer	$ -	$ -	$ 2,725,000
Issuance of common stock upon the conversion of convertible subordinated debentures, related party	$ -	$ -	$ 3,242,000
Conversion of short-term borrowings to common stock	$ -	$ -	$ 226,000
Conversion of accrued interest, payroll and expenses by related parties to stock options	$ -	$ -	$ 3,194,969
Repurchase of stock options from related party	$ -	$ -	$ (198,417)
Conversion of accrued interest to stock options	$ -	$ -	$ 142,441
Conversion of accounts payable to common stock	$ -	$ -	$ 506,725

(continued)

See accompanying notes to condensed financial statements.

ALFACELL CORPORATION
(A Development Stage Company)

CONDENSED STATEMENTS OF CASH FLOWS, Continued

Three months ended October 31, 2009 and 2008
and the Period from August 24, 1981
(Date of Inception) to October 31, 2009

(Unaudited)

	Three Months Ended October 31, 2009	Three Months Ended October 31, 2008	August 24, 1981 (Date of Inception) to October 31, 2009
Conversion of notes payable, bank and accrued interest to long-term debt	$ -	$ -	$ 1,699,072
Conversion of loans and interest payable, related party and accrued payroll and expenses, related parties to long-term accrued payroll and other, related party	$ -	$ -	$ 1,863,514
Issuance of common stock upon the conversion of convertible subordinated debentures, other	$ -	$ -	$ 1,584,364
Issuance of common stock for services rendered	$ -	$ -	$ 2,460
Lease incentive allowance	$ -	$ -	$ 67,000
Issuance of warrants with notes payable	$ -	$ -	$ 594,219
Derivative liability – warrant reclassification	$ 747,235	$ -	$ 747,235
Acquisition of equipment through capital lease obligation	$ -	$ -	$ 23,778

See accompanying notes to condensed financial statements.

ALFACELL CORPORATION
(A Development Stage Company)

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited condensed financial statements of Alfacell Corporation ("Alfacell" or the "Company") have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not contain all of the information and notes required by U.S. GAAP for complete financial statements. In the opinion of the management, the accompanying unaudited condensed interim financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the Company's financial position as of October 31, 2009, the results of its operations for the three months ended October 31, 2009 and 2008, and the period from August 24, 1981 (date of inception) to October 31, 2009, the changes in stockholders' deficiency for the three months ended October 31, 2009, and its cash flows for the three months ended October 31, 2009 and 2008, and the period from August 24, 1981 (date of inception) to October 31, 2009. The results of operations for the three months ended October 31, 2009 are not necessarily indicative of operating results for fiscal year 2010 or future interim periods. The July 31, 2009 balance sheet presented herein has been derived from the audited financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2009, filed with the Securities and Exchange Commission.

Certain footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The condensed financial statements in this report should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2009.

The Company evaluated all events or transactions that occurred after October 31, 2009 through the date the financial statements were issued on December 21, 2009.

The Company is a development stage company as defined in the Accounting Standards Codification ("ASC"), "Development Stage Entities." The Company is devoting substantially all of its present efforts to establishing its business. Its planned principal operations have not commenced and, accordingly, no significant revenue has been derived therefrom.

The Company is continuing to develop its drug product candidates which require substantial capital for research, product development, and market development activities. The Company has not yet initiated marketing of a commercial drug product. Future product development will require clinical testing, regulatory approval, and substantial additional investment prior to commercialization. The future success of the Company is dependent on its ability to make progress in the development of its drug product candidates and, ultimately, upon its ability to attain future profitable operations through the successful manufacturing and marketing of those drug product candidates. There can be no assurance that the Company will be able to obtain the necessary financing or regulatory approvals to be able to successfully develop, manufacture, and market its products, or attain successful future operations. Accordingly, the Company's future success is uncertain.

2. LIQUIDITY

The Company has reported net losses of approximately $9,989,000, $4,539,000, $12,321,000 and $8,755,000 for the three months ended October 31, 2009 and the fiscal years ended July 31, 2009, 2008 and 2007, respectively. As of October 31, 2009, the Company had a working capital deficit of $13,475,000 and cash and cash equivalents of $1,558,000. The loss from date of inception, August 24, 1981 to October 31, 2009, amounts to approximately $118,921,000.

The Company expects that its cash balances and the $1.6 million restricted cash intended to be used for future clinical trials as of October 31, 2009, will be sufficient to support its activities into the fourth quarter of its fiscal year 2010, based on its reduced level of operations. The Company's long-term continued operations will depend on its ability to raise additional funds through various potential sources such as equity and debt financing, convertible debentures, collaborative agreements, strategic alliances, sale of tax benefits, revenues from the commercial sale and named-patient basis sale of ONCONASE®, licensing of its proprietary RNase technology and its ability to realize revenues from its technology and its drug candidates via out-licensing agreements with other companies. The Company may pursue available strategic alternatives which focus on, but not limited to, strategic partnership transactions. Such additional funds and various alternatives may not become available as the Company may need them or be available on terms acceptable to the Company, if at all. Insufficient funds could require the Company to delay, scale back, or eliminate one or more of its research and development programs or to out-license to third parties drug product candidates or technologies that the Company would otherwise seek to develop and commercialize without relinquishing its rights thereto. Unless and until the Company's operations generate significant revenues and cash flow, the Company will attempt to continue to fund operations from cash on hand and through the sources of capital described above. There can be no assurance that the Company will be able to raise the capital it needs on terms which are acceptable, if at all.

The audit report of the Company's independent registered public accounting firm on the Company's fiscal year ended July 31, 2009 financial statements expressed that there was substantial doubt about the Company's ability to continue as a going concern. Continued operations are dependent on the Company's ability to raise additional capital from various sources such as those described above. Such capital raising opportunities may not be available or may not be available on reasonable terms. The Company's financial statements do not include any adjustments that may result from the outcome of this uncertainty.

3. LOSS PER COMMON SHARE

The following table sets forth the computation of basic and diluted net loss per common share:

	Three Months Ended October 31, 2009	Three Months Ended October 31, 2008
Numerator:		
Net loss	$ (9,988,925)	$ (2,803,403)
Denominator:		
Weighted average number of common shares outstanding	47,313,880	47,310,510
Loss per common share - basic and diluted	$ (0.21)	$ (0.06)
Potentially dilutive securities:		
Warrants	51,408,821	13,810,261
Stock options	4,064,767	5,176,150
Total potentially dilutive securities	55,473,588	18,986,411

As the Company has incurred a net loss for all periods presented, basic and diluted per common share amounts are the same, since the inclusion of all potentially dilutive securities would be anti-dilutive.

4. STOCK-BASED COMPENSATION

In December 2004, the Financial Accounting Standards Board ("FASB") issued amended guidance on accounting for "Stock Compensation". The amended guidance requires all share-based payments, including stock option grants to employees, to be recognized as an operating expense in the statement of operations. The expense is recognized over the requisite service period based on fair values measured on the date of grant. The Company adopted the amended guidance on Stock Compensation effective August 1, 2005 using the modified prospective method and, accordingly, prior period amounts have not been restated. Under the modified prospective method, the fair value of all new stock options issued after July 31, 2005 and the unamortized fair value of unvested outstanding stock options at August 1, 2005 are recognized as expense as services are rendered.

Shares, warrants and options have been issued to non-employees for services. The fair value of such securities is recorded as an expense and additional paid-in capital in stockholders' equity over the applicable service periods using variable accounting through the vesting date based on the fair value of the securities at the end of each period or the vesting date.

The Company recorded the following stock-based compensation expense based on the fair value of stock options:

	Three Months Ended October 31,			
	2009		2008	
Research and development	$	20,673	$	241,216
General and administrative		54,212		392,058
Total stock-based compensation expense	$	74,885	$	633,274
Basic and diluted loss per common share	$	(0.00)	$	(0.01)

The fair value of the stock options at the grant dates was estimated using the Black-Scholes option pricing model based on the weighted-average assumptions as noted in the following table. The risk-free interest rate for periods approximating the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The expected stock price volatility is based on the historical volatility of the Company's stock price. For post July 31, 2005 grants, the expected term until exercise is derived using the "simplified" method as allowed under the provisions of SAB 107 and SAB 110 and represents the period of time that options granted are expected to be outstanding. The "simplified" method was used since the Company does not have sufficient historical data to provide a basis to estimate a justifiable expected term. There were no stock options granted during the three months ended October 31, 2008.

	Three Months Ended October 31,		
	2009		2008
Expected dividend yield		0%	-
Risk-free interest rate		2.64%	-
Expected stock price volatility		111.39%	-
Expected term (years)		5.89	-
Weighted average grant date fair value	$	0.28	-

The following table summarizes the stock option activity for the period August 1, 2009 to October 31, 2009:

	Stock Options Outstanding		Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value
Balance August 1, 2009	4,771,650	$	2.64	3.84	$	12,230
Granted	511,667		0.34	9.86		-
Exercised	-		-			
Expired	(1,210,550)		2.67			
Forfeited	(8,000)		1.29			
Balance October 31, 2009	4,064,767	$	2.34	5.43	$	2,300
Exercisable as of October 31, 2009	2,360,767	$	3.02	3.05	$	1,400

As of October 31, 2009, there was approximately $912,000 of total unrecognized compensation expense related to unvested options granted that is expected to be recognized over a weighted average period of 3.24 years.

5. RESTRICTED CASH

Lease security deposit held by a bank as collateral for a standby letter of credit in favor of the Company. The cash held by the bank is restricted as to use for the term of the standby letter of credit.	$ 201,805
Escrow agreement held by bank which can be disbursed only to satisfy obligations of the Company owed to clinical research organizations, hospitals, doctors and other vendors and service providers associated with the clinical trials which the Company intends to conduct for its ONCONASE® product. The escrow agreement shall terminate on the earlier of the date that all funds have been disbursed from the escrow account and April 19, 2011, at which time any remaining funds will be disbursed to the Company.	1,600,000
Total	$1,801,805

6. CONVERTIBLE NOTES AND WARRANTS

On October 19, 2009, the Company completed a sale of 65 units (the “Units”) in a private placement (the “Offering”) to certain investors pursuant to a securities purchase agreement (the “Securities Purchase Agreement”) entered into on October 19, 2009. Each Unit consists of (i) $50,000 principal amount of 5% Senior Secured Convertible Promissory Notes (collectively, the “Notes”) convertible into shares of the Company’s common stock, par value $.001 per share (“Common Stock”), (ii) Series A Common Stock Purchase Warrants (the “Series A Warrants”) to purchase in the aggregate that number of shares of Common Stock initially issuable upon conversion of the aggregate amount of Notes issued as part of the Unit, at an exercise price of $0.15 per share with a three year term and (iii) Series B Common Stock Purchase Warrants (the “Series B Warrants”, together with the Series A Warrants, the “Warrants”) to purchase in the aggregate that number of shares of Common Stock initially issuable upon conversion of the aggregate amount of Notes issued as part of the Unit, at an exercise price of $0.25 per share with a five year term. The closing of the Offering occurred on October 19, 2009 (the “Closing”) and the Company received an aggregate of $3,250,000 in gross proceeds.

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The Notes mature on the earlier of (i) October 19, 2012; (ii) the closing of a public or private offering of the Company's debt or equity securities subsequent to the date of issuance resulting in gross proceeds of at least $8,125,000 other than a transaction involving a stockholder who holds 5% or more of the Company's outstanding capital stock as of the date of issuance; or (iii) on the demand of the holder of the Note upon the Company's consummation of a merger, sale of substantially all of its assets, or the acquisition by any entity, person or group of 50% or more of the voting power of the Company. Interest accrues on the principal amount outstanding under the Notes at 5% per annum, and is due upon maturity. Upon an event of default under the Notes, the interest rate shall increase to 7%, provided that if the Company is unable to obtain stockholder approval by April 1, 2010 to amend its certificate of incorporation to increase its authorized capital stock, the interest rate shall increase to 15% and such failure will be an Event of Default under the Notes. The Notes are convertible into Common Stock at the option of the holder of the Note at a price of $0.15 per share at any time prior to the date on which the Company makes payment in full of all amounts outstanding under the Note. The Notes are not prepayable for a period of one year following the issuance thereof. The Notes are secured by a senior security interest and lien on all of the Company's right, title and interest to all of the assets owned by the Company as of the Closing or thereafter acquired pursuant to the terms of a security agreement (the "Security Agreement") entered into by the Company with each of the investors. The Warrants are exercisable immediately following the Closing.

Pursuant to the terms of the Securities Purchase Agreement, certain investors party thereto are permitted to appoint a designee to the Company's Board of Directors (the "Board") within a reasonable period of time following the Closing. In addition, as a condition to Closing, each member of the Board other than David Sidransky, Chairman of the Board, and Charles Muniz, President, Chief Executive Officer and Chief Financial Officer, agreed to resign from the Board upon the request of Dr. Sidransky made at any time following the Closing and December 31, 2009.

In connection with the Offering, the Company entered into an investor rights agreement (the "Investor Rights Agreement") with each of the investors. The Investor Rights Agreement provides that the Company will file a "resale" registration statement (the "Initial Registration Statement") covering all of the shares issuable upon conversion of the Notes (the "Note Shares") and the shares issuable upon exercise of the Warrants (the "Warrant Shares", together with the Note Shares, the "Securities"), up to the maximum number of shares able to be registered pursuant to applicable Securities and Exchange Commission ("SEC") regulations, within 120 days of the Closing. If any Securities are unable to be included on the Initial Registration Statement, the Company has agreed to file subsequent registration statements until all the Securities have been registered. Under the terms of the Investor Rights Agreement, the Company is obligated to maintain the effectiveness of the "resale" registration statement until all securities therein are sold or otherwise can be sold pursuant to Rule 144, without any restrictions. A cash penalty at 1% per month will be triggered in the event the Company fails to file or obtain the effectiveness of a registration statement prior to the deadlines set forth in the Investor Rights Agreement or if the Company ceases to be current in filing its periodic reports with the SEC. The aggregate penalty accrued with respect to each investor may not exceed 6% of the original purchase price paid by that investor, or 12% if the only effectiveness failure is the Company's failure to be current in its periodic reports with the SEC.

In connection with the Offering, the Company also entered into an escrow agreement (the "Escrow Agreement") whereby certain investors placed $1,600,000 of the proceeds paid for their Units in an escrow account pursuant to the terms of the Securities Purchase Agreement. Such amounts can be disbursed from the escrow account only to satisfy obligations of the Company owed to clinical research organizations, hospitals, doctors and other vendors and service providers associated with the clinical trials which the Company intends to conduct for its ONCONASE® product. The Escrow Agreement shall terminate on the earlier of the date that all funds have been disbursed from the escrow account and April 19, 2011, at which time any remaining funds will be disbursed to the Company.

Charles Muniz, the Company's President, Chief Executive Officer and Chief Financial Officer, subscribed for 20 Units, certain trusts and individuals related to James O. McCash, a beneficial owner of more than five percent of the Company's voting securities, subscribed for an aggregate of 20 Units, Europa International Inc., a beneficial owner of more than five percent of the Company's voting securities, subscribed for 15 Units and Unilab LP, an affiliate of US Pharmacia, an affiliate of the Company's distributor for ONCONASE® in Eastern Europe and a current stockholder, subscribed for 10 units. These investors are party to the Securities Purchase Agreement, the Investor Rights Agreement, the Security Agreement and the Escrow Agreement. The Company's entry into an employment agreement with Mr. Muniz upon terms reasonably acceptable to the investors in the Offering was a condition to the Closing.

The Company concluded that it should account for the warrants and conversion options embedded in the Notes in accordance with ASC Topic 815, "Derivatives and Hedging". Accordingly, the Company determined that the warrants and the conversion options embedded in the Notes should be accounted for as free standing derivatives that will be measured at fair value and classified as liabilities at the closing of the Offering. Each subsequent reporting period, the Company will mark to market the warrants and conversion feature of Notes with any change in fair value recorded through the statement of operations. This accounting treatment is due to the fact that the settlement terms of the warrants and conversion feature of the Notes do not allow them to qualify for equity presentation. Accordingly, on October 19, 2009, in connection with the closing of the Offering, the convertible feature of the Notes were recorded as a derivative liability of approximately $6.1 million and the Series A and Series B warrants were recorded as a derivative liability of approximately $6.1 million each, respectively.

At the closing for the Offering, the fair value of the conversion feature, approximately $6.1 million, exceeded the proceeds of $3.25 million. The difference of approximately $2.9 million was charged to expense as the change in the fair market value of the conversion liability. Accordingly, the Company recorded an initial discount of $3.25 million equal to the face value of the Notes, which will be amortized over the three-year term, using the straight-line method.

At October 31, 2009, the Company accounted for the conversion feature using the fair value method, with the resultant gain recognition recorded in the statement of operations. At October 31, 2009, the fair value of the conversion feature liability was approximately $4.3 million, comprised of the $6.1 million recorded at the closing for the Offering and $1.8 million gain recorded to mark to market the liability at October 31, 2009. The conversion feature was valued at October 19, 2009 and October 31, 2009 using the Black-Scholes valuation model and the following assumptions:

	October 19, 2009	October 31, 2009
Volatility	126%	126.2%
Risk-free interest rate	1.50%	1.43%
Remaining contractual life (years)	3.0	2.97

At the closing, the Company recorded the Series A and Series B warrants as liabilities at their fair values of approximately $6.1 million each, based upon the Black-Scholes valuation model. The warrants will be accounted for using mark-to-market accounting and charged to the statement of operations in a manner similar to the conversion feature at each reporting date.