INTRABIOTICS PHARMACEUTICALS INC /DE
Form 10-K/A
June 25, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K/A

(Amendment No. 1)

þ **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2002

OR

o **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 0-29993

IntraBiotics Pharmaceuticals, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**94-3200380**
(State or Other Jurisdiction of Incorporation or Organization)	*(IRS Employer Identification No.)*
2483 East Bayshore Road, Suite 100, Palo Alto, CA	**94303**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code:

(650) 526-6800

Securities registered under Section 12(b) of the Exchange Act:

None.

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value $.001 per share
(Title of Class)

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in PART III of this

Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No þ

The aggregate market value of the Common Stock, held by non-affiliates of the registrant, based on the closing price on June 28, 2002 as reported by the Nasdaq National Market was approximately $32,019,000. The determination of affiliate status for the purposes of this calculation is not necessarily a conclusive determination for other purposes. The calculation excludes approximately 12,987,000 shares held by directors, officers and stockholders whose ownership exceeds five percent of the Registrant s outstanding common stock as of June 28, 2002. Exclusion of these shares should not be construed to indicate that such person controls, is controlled by or is under common control with the Registrant. The number of shares outstanding of the registrant s Common Stock, par value $0.001 per share, as of March 14, 2003 was 39,231,351 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Part III Portions of the registrant s definitive proxy statement to be issued in conjunction with the registrant s annual stockholders meeting to be held on June 5, 2003 are incorporated by reference into this Form 10-K.

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Explanatory Note

This amendment does not reflect events occurring after the original filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2002 (the Form 10-K) or modify or update those disclosures as presented in the Form 10-K, except to reflect certain revisions and clarifications in Items 1, 2, 6, 7, 8 and 15 of this Amendment No. 1 to Form 10-K.

PART I

This report contains forward-looking statements. These forward-looking statements are based on our current expectations about our business and industry, and include, but are not limited to, statements and concerns about plans to: continue development of our current product candidate; conduct clinical trials with respect to product candidates; seek regulatory approvals; address certain markets; engage third party manufacturers to supply our commercial requirements; market, sell and distribute our products; and evaluate additional product candidates for subsequent clinical and commercial development. In some cases, these statements may be identified by terminology such as may , will , should , expects , plans , anticipates , believes , estimates , predicts , potential , or continue or the negative of such terms and other comparable These statements involve known and unknown risk and uncertainties that may cause our or our industry s results, levels of activity, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. Factors that may cause or contribute to such differences include, among others, those discussed under the captions Business , Risks Related to Our Business and Management s Discussion and Analysis of Financial Conditions and Results of Operations . Except as required by law, we undertake no obligation to update any forward-looking statement to reflect events after the date of this report.

Item 1. ***Business***

BUSINESS

IntraBiotics Pharmaceuticals, Inc. is a biopharmaceutical company focused on developing an antimicrobial drug, a drug capable of destroying microorganisms that cause disease. Our only drug candidate in development is iseganan hydrochloride, or HCl, oral solution for the prevention of ventilator-associated pneumonia, or VAP. Iseganan HCl is an antimicrobial drug that kills a wide variety of microorganisms, including bacteria and fungi, and is effective against many drug-resistant, disease-causing bacteria and yeast. VAP is a bacterial pneumonia that can develop in patients receiving mechanical (artificial) ventilation and is the most common infection occurring in mechanically-ventilated patients.

In 2002, we were primarily developing iseganan HCl for the prevention of ulcerative oral mucositis, a complication that develops in cancer patients receiving chemotherapy or radiation that results in painful ulcer-like sores in the mouth and throat. The top-line results of our 545-patient phase III clinical trial of iseganan HCl oral solution to treat patients undergoing radiotherapy to prevent or reduce ulcerative oral mucositis showed no significant difference between iseganan and placebo in the primary or secondary end-points. The top-line results of our 509-patient phase III clinical trial of iseganan HCl oral solution to treat patients undergoing aggressive chemotherapy to prevent or reduce ulcerative oral mucositis showed no significant difference between iseganan and placebo in the primary end-point. Iseganan appears to be safe when applied to the oral cavity. We are not pursuing further development of iseganan HCl to treat oral mucositis at this time.

Previously, we have completed two earlier stage trials of iseganan HCl for other indications: to prevent pneumonia in patients requiring breathing assistance from a mechanical ventilator and to treat respiratory infections in patients with cystic fibrosis. The data from each of these trials support the advancement to the next stage of human clinical testing for each of these two indications. In February 2003, we announced plans to begin working on a phase II/III clinical trial of iseganan HCl oral solution to prevent VAP. A phase II/ III clinical trial attempts to establish the safety and efficiency of a drug candidate in an expanded patient

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population. If we are able to obtain additional financing, we anticipate having the first patient enrolled before the end of the third quarter of 2003.

Since commencing operations in 1994, we have not generated any revenue from product sales, and we have funded our operations primarily through the private sale of equity securities, including a private placement of 5.9 million shares of common stock resulting in net proceeds of approximately $13.9 million in February 2002, a settlement of $3.6 million from a vendor in January 2002, funds received from a terminated collaboration agreement, the proceeds of equipment financing arrangements and our initial public offering of common stock in March 2000. We have incurred losses in each year since inception, and we expect to incur substantial losses for at least the next several years. We expect that losses may fluctuate, and that such fluctuations may be substantial. As of December 31, 2002, our accumulated deficit was approximately $200.3 million. We will need to raise additional funds in the future to continue our operations.

In April 2002, we acquired Apothogen, Inc. for 450,000 shares of our common stock. Concurrently with the closing of the acquisition, Ernest Mario, Ph.D. joined IntraBiotics as our Chairman and Chief Executive Officer. Dr. Mario also acquired 1.2 million shares of our common stock in a simultaneously completed private placement resulting in net proceeds to us of $5.0 million. In January 2003, Dr. Mario stepped down from the position of our Chief Executive Officer, while remaining the Chairman of the Board. Henry J. Fuchs, M.D., our President and Chief Operating Officer, was appointed the Chief Executive Officer at that time.

In October 2002, we announced a restructuring plan, which included a reduction in force. As a result of the restructuring, we planned to reduce our expenses from approximately $7.5 million per quarter to approximately $1.5 million per quarter. The restructuring plan was substantially completed by year-end and included a reduction of approximately 26 positions, or 70% of our workforce. In addition, we terminated some of our contracts, including our real estate leases, which we believe will not be necessary for our future operations. We have recorded charges related to the impairment of equipment and the acquired workforce totaling $1.6 million, which are included in our operating expenses for the year ended December 31, 2002.

In February 2003, we entered into agreements with certain investors providing for the issuance, in a private placement financing, subject to shareholder approval of newly created Series A convertible preferred stock, and warrants to purchase common stock, for an aggregate gross purchase price of $3.5 million. The primary purpose of completing the private placement is to provide funds to allow us to conduct and complete our clinical trial of iseganan HCl for the prevention of VAP. A special meeting of stockholders at which the approval and ratification of the private placement is solicited is scheduled to take place on April 3, 2003. If the stockholders approve the transaction, we anticipate completing the private placement during the second quarter 2003. On March 19, 2003, we received an alternative financing proposal from Mr. C. Robert Coates. We are currently evaluating Mr. Coates proposal.

Iseganan HCl Oral Solution for Prevention of Ventilator-Associated Pneumonia (VAP)

Iseganan HCl oral solution is a potential new drug for the prevention of VAP. Iseganan HCl is an antimicrobial drug whose properties may be well suited for use in preventing VAP. Iseganan HCl kills a wide spectrum of bacteria known to cause pneumonia and to date no evidence of resistance to iseganan has emerged in our early stage clinical trials. VAP is a common infection occurring among patients in the intensive care unit. Patients who require artificial ventilation are vulnerable to developing pneumonia as a consequence of the aspiration of bacteria-laden saliva. Prior clinical trials using a variety of other antibiotics have demonstrated that the incidence of VAP can be reduced through prophylactic decontamination of the oral cavity. We believe conventional antibiotics are not widely prescribed to prevent VAP because of concerns for the development of antibiotic resistance, and there are currently no approved therapeutics specifically for the prevention of VAP. As a consequence, patients who develop VAP incur extended stays in the intensive care unit and increased hospital charges. In the United States, over 400,000 patients are artificially ventilated each year for at least 48 hours and are vulnerable to developing VAP.

In 2001, a phase I and IIa trial of iseganan HCl oral solution in mechanically ventilated patients evaluating safety and antimicrobial activity was completed. In February 2003, we announced plans to begin work on our new phase II/III trial. Single doses of iseganan HCl were well tolerated in clinical studies in

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mechanically ventilated patients, and were shown to effect significant reductions in the level of bacteria in the oral cavity of cancer patients as well as patients who require artificial ventilation. Iseganan HCl reduced the levels of oral microbial flora by more than 100-fold compared to pre-treatment baseline levels after a single 9 mg oral-topical dose. The phase IIa study evaluating the safety and antimicrobial efficacy of iseganan HCl oral solution administered for up to five days demonstrated that iseganan HCl oral solution was well tolerated and provided a significant antimicrobial effect in ventilated patients. We believe, these results support further development of iseganan HCl oral solution for the prevention of VAP.

In the first quarter of 2003, we commenced preparations for a new phase II/III trial of iseganan HC1 oral solution for the prevention of VAP. As part of our preparation, we met with members of our Steering Committee and Data Monitoring Committee, which are comprised of doctors and statisticians who are experienced in the care of mechanically-ventilated patients and/or the design of clinical trials. We have entered into consulting agreements with the members of our Steering and Data Monitoring committees, pursuant to which they are compensated on an hourly basis for the time they spend providing us with input on the design, conduct, analysis and reporting of clinical trials.

Together with our Steering and Data Monitoring committees, we designed a phase II/III study to test the effectiveness of iseganan HC1 in preventing VAP. The phase II/III trial is designed to be a 500 patient, double blind, placebo controlled study, which is anticipated to enroll the first patient before the end of the third quarter of 2003 if we obtain financing to conduct the trial. Preliminary data from this trial would be expected in the second quarter of 2004. We cannot be certain that iseganan HCl oral solution will prove to be safe or effective in the prevention of VAP, or will receive regulatory approvals.

Iseganan HCl Solution for Inhalation for Treatment of Respiratory Infections

We believe iseganan HCl may be effective in treating respiratory infections in cystic fibrosis (CF) patients. Iseganan HCl has been formulated as a solution for inhalation by patients with CF. Since iseganan is a broad spectrum, rapidly acting antimicrobial agent with a low propensity to result in antimicrobial resistance, we believe iseganan HCl is well suited for this indication.

Two phase I studies of iseganan HCl solution for inhalation, administered as a single dose or up to five doses, have enabled us to establish the dose tolerance and further develop the formulation for this product candidate. These studies also demonstrated that iseganan HCl solution for inhalation was well tolerated when administered to patients with CF. However, we cannot be certain that after further study iseganan HCl solution for inhalation will prove to be safe or effective in treating respiratory infections, or will receive regulatory approvals. In addition, we are currently focusing our resources on the VAP program and are not expending significant resources on the program for respiratory infections in CF patients.

Ramoplanin Ointment for the Eradication of Nasal *Staphylococcus Aureus*

The commercialization and development rights for this formulation of ramoplanin were returned to Biosearch Italia S.p.A. in April 2002.

Our Preclinical Research Programs

Prior to our reduction in force, we were conducting research focused on discovering and developing compounds with novel chemical structures and mechanisms of antimicrobial activity against bacteria or fungi. We have filed patent applications on these compounds. In May 2002, we sold the two pre-clinical anti-infective programs to Micrologix Biotech Inc. for cash of $400,000 and 750,000 shares of Series A preferred stock of Micrologix.

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Strategic Relationships

Biosearch Italia S.p.A., Gerenzano, Italy

In May 1998, we entered into a license agreement with Biosearch Italia, under which we had exclusive rights in the U.S. and Canada to develop and commercialize products containing certain formulations of ramoplanin for the treatment or prevention of human disease.

In May 2001, we announced an amendment to this agreement. Under the new terms of the agreement, Biosearch Italia reimbursed us for ongoing clinical trial expenses during a three-month transition period, ending August 31, 2001. During this period, Biosearch Italia assumed responsibility for the clinical development of ramoplanin oral powder at its own expense. In exchange for our clinical development expenses and efforts to date, we will receive a royalty on future net sales of ramoplanin in North America, if it is successfully developed. Biosearch Italia waived all of our future milestone payments and obligations for the development of oral formulations of ramoplanin. Rights for the development and commercialization of topical formulations of ramoplanin, which were retained under certain conditions of the agreement, reverted back to Biosearch Italia in April 2002.

PolyPeptide Laboratories A/S, Hillerød, Denmark

In January 1997, we entered into both a Development Supply Agreement and a Purchase Supply Agreement with PolyPeptide Laboratories A/S, for the development of manufacturing processes for iseganan HCl and for the clinical and commercial manufacture and supply of iseganan HCl, as a bulk drug substance. Under these agreements, we made payments to PolyPeptide upon achievement of certain development milestones and upon receipt of materials to be used in clinical trials. As of December 31, 2002, these payments totaled $8.0 million.

In December 2002, we reached an agreement with PolyPeptide to terminate the Development Supply Agreement, the Purchase Supply Agreement, and a related purchase order agreement entered into by the parties in September 1998 for the purchase of 35kg of iseganan HCl. Under this termination agreement, we paid Polypeptide $4.7 million upon execution of the termination agreement, assigned letters of credit totaling $547,000 and will pay an additional $250,000 upon delivery and acceptance of lot I of drug substance (seven kg), which is expected sometime in the second quarter of 2003. As part of our cost cutting efforts, Polypeptide agreed to deliver completed lots of drug substance (lots H1-H4); to complete manufacture and deliver certain lots of drug substance (lots I1-I3), and to deliver partially completed lots of drug substance (lots J, K, and L). In addition, we agreed to have the completed drug substance and the partially completed lots stored at Polypeptide at a cost of $50,000 per year for five years.

The Regents of the University of California

In April 1994, we entered into a license agreement with The Regents of the University of California, under which we have exclusive rights to develop and commercialize Protegrin-based products, such as iseganan HCl. To date, we have paid a $50,000 licensing fee, $25,000 upon the filing of an Investigational New Drug application and $50,000 upon the initiation of a phase III trial.

We are also obligated to bear all patent costs and submit semi-annual progress reports to the Regents until the first commercial sale. Subsequent to this sale, we are obligated to provide quarterly royalty reports and make quarterly royalty payments to the Regents. The Regents have the right to inspect our royalty records at any time.

We may terminate the agreement upon prior written notice which shall be effective 90 days after the date of such notice. The Regents may provide a notice of default if any of the following occur: we fail to use diligent efforts to develop and commercialize Protegrin-based products, we are unable to meet certain targets for raising capital or expending resources for the development and commercialization of Protegrin-based products, or we cannot achieve the commercialization milestones stated in a development plan that we presented to the Regents. Upon receipt of the notice of default, we have 90 days to cure the default. If we do not cure the default, the agreement automatically terminates.

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The agreement is effective for the life of the Regents patent rights, unless all patent applications are abandoned or no patents are issued, or for 17 years from the first commercial sale of the licensed product, whichever comes first.

Manufacturing

We intend to use contract manufacturers to prepare our drugs instead of developing this capability internally. Until the fourth quarter of 2002, we contracted with PolyPeptide as a single source for supply of bulk drug substance of iseganan HCl for use in the clinical trials. PolyPeptide manufactured iseganan HCl on a pilot scale to our specifications. As of the end of 2002, we no longer have a supply agreement with PolyPeptide. We currently have sufficient quantities of iseganan HCl to complete the current clinical trial for the prevention of VAP. By using third-party manufacturers we can leverage their expertise and capital investment.

Intellectual Property

We own two U.S. patents covering iseganan HCl. Together, these patents contain claims to compositions of matter, pharmaceutical compositions and methods of use, including the treatment or prevention of oral mucositis. These patents expire no earlier than 2015. In addition, we are either the owner or exclusive licensee from The Regents of the University of California of seven other U.S. patents covering related antimicrobial peptides and/or their uses. We also have two pending U.S. applications directed to specific uses of iseganan HCl, including the treatment of VAP.

Applications covering iseganan HCl and the related antimicrobial peptides, as well as their uses, are either pending or have issued in major foreign jurisdictions. Australia has issued patents covering iseganan HCl and the related antimicrobial peptides, as well as their uses. Such patents expire no earlier than 2016. In addition, the Company has patent applications covering iseganan and the related antimicrobial peptides, as well as their uses, pending in Europe, Japan, Canada, Hong Kong and Israel. Currently, the most important patents to the Company are the issued patents covering iseganan HC1 and the pending patents covering the use of iseganan HC1 to prevent VAP.

We cannot guarantee that patents will be issued as a result of any patent application or that patents that have issued will be sufficient to protect our technology or products. We cannot predict the enforceability or scope of any issued patent or those that may issue in the future. Moreover, others may independently develop similar technologies or duplicate the technology we have developed. We also rely on trade secrets and proprietary know-how for protection of certain of our intellectual property. We cannot guarantee that our confidentiality agreements provide adequate protection or remedies in the event of unauthorized use or disclosure of our intellectual property. Third parties may assert infringement or other claims against us. Even if these claims are without merit, defending a lawsuit takes significant time, may be expensive and may divert management attention from other business concerns and if unsuccessful, we may be forced to license the intellectual property.

Marketing and Sales

We currently have no specific sales and marketing infrastructure for iseganan HCl oral solution for the prevention of VAP. We are evaluating opportunities to partner with other pharmaceutical companies to develop and commercialize our product candidate. We cannot guarantee that we will successfully develop or commercialize our product candidate, achieve significant market penetration, or generate any revenues from our product.

Competition

We are not aware of any products that compete with iseganan HCl for the prevention of VAP. However, pharmaceutical companies and biotechnology companies may develop products in the future that compete with iseganan HCl for the prevention of VAP. Many of these companies have substantially greater experience, financial and other resources than we do. In addition, they may have greater experience in developing drugs,

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obtaining regulatory approvals and manufacturing and marketing products. We believe the principal bases for competition for our drug candidate are potential effectiveness, price and reimbursement status, and ease of administration and side effect profile. We cannot give any assurances that we can effectively compete with these other pharmaceutical and biotechnology companies.

Government Regulation

Governmental authorities in the U.S. and other countries extensively regulate, among other things, the research, development, testing, manufacture, labeling, promotion, advertising, distribution, and marketing, of our products. The FDA regulates drugs, including antibiotics, under the Federal Food, Drug, and Cosmetic Act and its implementing regulations. Failure to comply with the applicable U.S. requirements may subject us to administrative or judicial sanctions, such as FDA refusal to approve pending new drug applications, warning letters, product recalls, product seizures, total or partial suspension of production or distribution, injunctions, and/or criminal prosecution.

The steps required before a drug may be marketed in the U.S. include:

submission to the FDA of an investigational new drug exemption for human clinical testing, which must become effective before human clinical trials may commence;

adequate and well-controlled clinical trials to establish the safety and efficacy of the drug for each indication;

submission to the FDA of a new drug application; and

FDA review and approval of the new drug application.

An investigational new drug application automatically becomes effective 30 days after receipt by the FDA, unless before that time the FDA raises concerns or questions about issues such as the conduct of the trials as outlined in the investigational new drug exemption. In such a case, the investigational new drug application sponsor and the FDA must resolve any outstanding FDA concerns or questions before clinical trials can proceed. We cannot be sure that submission of an investigational new drug application will result in the FDA allowing clinical trials to commence.

Clinical trials typically are conducted in three sequential phases, but the phases may overlap or be combined. Phase III trials usually further evaluate clinical efficacy and test further for safety by using the drug in its final form in an expanded patient population. We cannot assure you that phase I, phase II, or phase III testing will be completed successfully within any specified period of time, if at all. Furthermore, we, or the FDA may suspend clinical trials at any time on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk.

Assuming successful completion of the required clinical testing, the results of the pre-clinical studies and of the clinical trials, together with other detailed information, including information on the manufacture and composition of the drug, are submitted to the FDA in the form of a new drug application requesting approval to market the product for one or more indications. Before approving a new drug application, the FDA usually will inspect the facility or the facilities at which the drug is manufactured, and will not approve the product unless compliance with current good manufacturing practices is satisfactory. If the FDA determines the new drug application and the manufacturing facilities are acceptable, the FDA will issue an approval letter. If the FDA determines the new drug application submission or manufacturing facilities are not acceptable, the FDA will outline the deficiencies in the submission and often will request additional testing or information. Notwithstanding the submission of any requested additional information, the FDA ultimately may decide that the new drug application does not satisfy the regulatory criteria for approval. The testing and approval process requires substantial time, effort, and financial resources, and we cannot be sure that any approval will be granted on a timely basis, if at all. After approval, certain changes to the approved product, such as adding new indications, manufacturing changes, or additional labeling claims are subject to further FDA review and approval.

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If regulatory approval is obtained, we will be required to comply with a number of post-approval requirements. For example, as a condition of approval of the new drug application, the FDA may require post marketing testing and surveillance to monitor the drug s safety or efficacy. In addition, holders of an approved new drug application are required to report certain adverse reactions, if any, to the FDA, and to comply with certain requirements concerning advertising and promotional labeling for their products. Also, quality control and manufacturing procedures must continue to conform to current good manufacturing practices after approval, and the FDA periodically inspects manufacturing facilities to assess compliance with current good manufacturing practices. Accordingly, manufacturers must continue to expend time, money, and effort in the area of production and quality control to maintain compliance with current good manufacturing practices.

We use and will continue to use third-party manufacturers to produce our products in clinical and commercial quantities, and we cannot be sure that future FDA inspections will not identify compliance issues at the facilities of our contract manufacturers that may disrupt production or distribution, or require substantial resources to correct. In addition, discovery of problems with a product may result in restrictions on a product, manufacturer, or holder of an approved new drug application, including withdrawal of the product from the market. Also, new government requirements may be established that could delay or prevent regulatory approval of our products under development.

The FDA provides periods of marketing exclusivity for new drugs that are the subject of an approved new drug application. Iseganan HCl oral solution, if approved, may qualify for marketing exclusivity, which would prevent any competitors from seeking approval of a generic version until five years after approval of our product candidate. Even if a product is approved and granted exclusivity, it does not prevent the approval and marketing of competing products.

Outside the U.S., our ability to market our products will also be contingent upon receiving marketing authorizations from the appropriate regulatory authorities. The foreign regulatory approval process includes all the risks associated with FDA approval described above. The requirements governing conduct of clinical trials and marketing authorization vary widely from country to country.

Under European Union regulatory systems, marketing authorizations may be submitted either under a centralized or decentralized procedure. The centralized procedure provides for the grant of a single marketing authorization that is valid for all European Union member states. The decentralized procedure provides for mutual recognition of national approval decisions. Under this procedure, the holder of a national marketing authorization may submit an application to the remaining member states. Within 90 days of receiving the applications and assessment report, each member state must decide whether to recognize approval.

We plan to choose the appropriate route of European regulatory filing in an attempt to accomplish the most rapid regulatory approvals. However, the chosen regulatory strategy may not secure regulatory approvals or approvals of the chosen product indications. In addition, these approvals, if obtained, may take longer than anticipated. We cannot assure you that any of our product candidates will prove to be safe or effective, will receive regulatory approvals, or will be successfully commercialized.

Employees

As of March 15, 2003, we had eight full-time employees, three of whom are engaged in product development activities and five of whom were engaged in general and administrative activities. Our employees are not represented by a collective bargaining agreement. We believe that we have good relations with our employees.

Website Address

Our website address is www.intrabiotics.com. We make available free of charge through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to these reports as soon as reasonably practicable after filing**.**

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RISKS RELATED TO OUR BUSINESS

Our business faces significant risks and the risks described below may not be the only risks we face. Additional risks that we do not know of or that we currently believe are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition, or results of operations could be materially adversely affected and the trading price of our common stock could decline.

We expect to continue to incur future operating losses and may never achieve profitability.

We have never generated revenue from product sales and have incurred significant net losses in each year since inception. We incurred net losses of $45.6 million in 2000, $67.4 million in 2001 and $34.5 million in 2002. As of December 31, 2002, our accumulated deficit was approximately $200.3 million. We expect to continue to incur substantial additional losses for the foreseeable future, and we may never become profitable. To date, we have financed our operations primarily through the private sale of equity securities, funds received from a terminated collaboration agreement, the proceeds of equipment financing arrangements, and our initial public offering of common stock in March 2000. We have begun a new phase II/III trial of iseganan HCl oral solution for the prevention of ventilator-associated pneumonia (VAP) in the first quarter of 2003. We may also develop iseganan for other indications in the future or acquire or license other products.

We will receive product revenues only if we complete clinical trials with respect to one or more products, receive regulatory approvals and successfully commercialize such products. We do not know whether we will be successful in developing iseganan for our currently planned VAP indication or other indications, or in acquiring or licensing other products.

We must raise capital to continue our operations, and if we fail to obtain the capital necessary to fund our operations, we will be unable to develop our drug candidates and may have to cease operations.

At December 31, 2002, our cash and cash equivalents, including short-term investments, were $13.3 million, which included restricted cash of $250,000. During the fourth quarter of 2002, we entered into several settlement agreements to terminate some of our contracts, including our real estate leases, supply agreements with Polypeptide Laboratories A/S and debt agreement with Silicon Valley Bank, which resulted in aggregate cash payments of approximately $22.3 million. We believe that our existing cash, cash equivalents and investments will be sufficient to meet our current operating and capital requirements for at least the next fifteen months. However, we have based this estimate on assumptions that may prove to be wrong. For example, we are assuming that we will have iseganan HCl in active clinical development over the next twelve months without any significant staff or other resources expansion. In addition, in February 2003, we entered into agreements to sell to certain investors, in a private placement, Series A preferred stock and warrants to purchase common stock, subject to stockholder approval and ratification of the transaction. If we are able to secure stockholder approval, and the transaction is successfully completed, we will receive aggregate gross proceeds of approximately $3.5 million. We believe that this additional capital would be sufficient to meet our operating and capital needs for an additional three months. However, we cannot assure you that the stockholders will approve the transaction, or that our current estimates and assumptions will remain unchanged. To the extent we pursue the development of iseganan for other indications or acquire or license other products, we will need to raise additional capital to fund clinical development costs. For the years ended December 31, 2000, 2001 and 2002, net cash used for operating activities was $50.4 million, $53.6 million, and $26.3 million, respectively. Our future liquidity and capital requirements will depend on many factors, including timing, cost and progress of our VAP trial, our evaluation of, and decisions with respect to, our strategic alternatives, costs associated with, the regulatory approvals, securing in-licensing opportunities, purchasing additional products or drug candidates and conducting pre-clinical research and clinical development of those drug candidates.

We believe that additional financing will be required in the future to fund our operations, complete our VAP trial, conduct any other possible iseganan HCl trials or commercialize our current and any future product candidates. We do not know whether additional financing will be available when needed or on

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acceptable terms, if at all. If we are unable to raise additional financing, including our currently proposed private placement, when necessary, we may have to delay our product development efforts or any product acquisitions or be forced to cease operations. Any additional equity financing will be dilutive to existing stockholders, and debt financing, if available, may involve restrictive covenants. Collaborative arrangements may require us to relinquish our rights to certain of our technologies, drug candidates or marketing territories.

Our only late stage clinical candidate failed to meet the primary endpoint in our phase III clinical trials for the prevention of oral mucositis in cancer patients.

We had only one late stage lead product, iseganan HCl, which failed in the phase III trial conducted on patients with head and neck cancer receiving radiotherapy and the phase III trial conducted on patients with cancer receiving aggressive chemotherapy. Our other indications for iseganan are in an early stage of clinical development. We initiated work on a phase II/III trial for the prevention of VAP in the first quarter of 2003. If this trial fails to meet its primary endpoint, we may not be able to continue to operate as a going concern and maybe forced to cease operations.

We depend on the outcome of our clinical trial for the prevention of VAP and any future clinical trials for other indications for iseganan or for products that we may license or acquire, and if they are unsuccessful, we will not be able to commercialize those products and generate product revenue.

Before obtaining regulatory approvals for the commercial sale of any products, we must demonstrate through pre-clinical research and clinical trials that our drug candidates are safe and effective for use in humans. If we are unable to demonstrate the safety and efficacy of a drug candidate, we will be unable to obtain regulatory approval from the FDA and to commercialize the drug candidate, and we will be unable to generate product revenue from that candidate for that indication. Clinical trials are expensive and time-consuming to conduct, and the timing and outcome of these trials is uncertain. A number of new drugs have shown promising results in early clinical trials, but subsequently failed to establish sufficient safety and efficacy data to obtain necessary regulatory approvals. A number of companies have suffered significant setbacks in advanced clinical trials, even after promising results in earlier trials. For example, in May 2002, we announced that our phase III clinical trial of iseganan HCl oral solution to treat patients undergoing radiotherapy to prevent or reduce oral mucositis had failed to demonstrate any difference between iseganan and placebo in the primary or secondary endpoints, and in September 2002, we announced that our phase III clinical trial of iseganan HCl oral solution to treat patients undergoing aggressive chemotherapy to prevent or reduce oral mucositis had failed to demonstrate any difference between iseganan and placebo in the primary endpoint. We believe that iseganan does not provide clinical benefit for these patients. We have begun work on a phase II/III trial for prevention of VAP and are focusing our resources on this trial. If this trial fails to meet its primary endpoint, and we do not acquire or license any additional product candidates, we will not be able to commercialize any products or generate any revenue. In addition, as a result of our focus on the VAP trial and the delay in clinical development of any other drug candidates, our ability to generate product revenue will be delayed and we do not expect to generate product revenue in the near term.

If our collaborative partners assisting in our clinical trials fail to appropriately manage our clinical trial, the trial could be delayed or could fail.

We rely on contract research organizations to assist us in managing and monitoring our clinical trial. The FDA may inspect some of our clinical investigational sites, our collaborative partner s records and our facility and files to determine if the clinical trial is conducted according to good clinical practices. If the FDA determines that the trial is not in compliance with good clinical practices, we may be required to repeat the clinical trial. If our contract research organizations fail to perform under our agreements with them, we may face delays in completing our clinical trial or failure of our clinical program.

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If we fail to obtain FDA approvals for any future products that we develop, acquire or license, we will be unable to commercialize our drug candidates.

We do not have a drug candidate approved for sale in the U.S. or any foreign market. We must obtain approval from the FDA in order to sell our drug candidate in the U.S. and from foreign regulatory authorities in order to sell our drug candidate in other countries. We must successfully complete pivotal clinical trials and demonstrate manufacturing capability before we can file with the FDA for approval to sell our products. The FDA could require us to repeat clinical trials as part of the regulatory review process. Delays in obtaining or failure to obtain regulatory approvals may:

delay or prevent the successful commercialization of our drug candidate;

diminish our competitive advantage; and

defer or decrease our receipt of revenues or royalties.

The regulatory review and approval process is lengthy, expensive and uncertain. Extensive pre-clinical and clinical data and supporting information must be submitted to the FDA for each indication to establish safety and effectiveness in order to secure FDA approval. We have limited experience in obtaining such approvals, and cannot be certain when, if ever, we will receive these regulatory approvals.

In addition to initial regulatory approval, our drug candidate will be subject to extensive and rigorous ongoing domestic and foreign government regulation. Any approvals, once obtained, may be withdrawn if compliance with regulatory requirements is not maintained or safety problems are identified. Failure to comply with these requirements may subject us to stringent penalties.

Development and commercialization of competitive products could reduce or prevent sales of any future products that we develop, acquire or license.

We may be unable to compete successfully if other companies develop and commercialize competitive products that are less expensive, more effective, have fewer side effects or are easier to administer than drug candidates which we develop, acquire or license. If we are unable to compete successfully with any future drug candidate, physicians may not recommend and patients may not buy our drug, which would cause our product revenue to decline.

Many of our competitors and related private and public research and academic institutions have substantially greater experience, financial resources and larger research and development staffs than we do. In addition, many of these competitors, either alone or together with their collaborative partners, have significantly greater experience than we do in developing drugs, obtaining regulatory approvals and manufacturing and marketing products. We also compete with these organizations and other companies for in-licensing opportunities for future drug candidates, and for attracting scientific and management personnel.

If we are unable to adequately protect our intellectual property, we may be unable to sell our products or to compete effectively.

We rely on a combination of patents, trade secrets and contractual provisions to protect our intellectual property. If we fail to adequately protect our intellectual property, other companies or individuals may prevent us from selling our products or may develop competing products based on our technology. Our success depends in part on our ability to:

obtain patents;

protect trade secrets;

operate without infringing upon the proprietary rights of others; and

prevent others from infringing on our proprietary rights.

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We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary rights are covered by valid and enforceable patents or are effectively maintained as trade secrets.

We expect to protect our proprietary position by filing U.S. and foreign patent applications related to our proprietary technology, inventions and improvements that are important to the development of our business. For example, we own or have rights to nine patents and seven pending patent applications in the U.S. However, the patent position of biopharmaceutical companies involves complex legal and factual questions. We cannot predict the enforceability or scope of any issued patents or those that may issue in the future. Patents, if issued, may be challenged, invalidated or circumvented. Consequently, if any patents that we own or license from third parties do not provide sufficient protection, our competitive position would be weakened. Furthermore, others may independently develop similar technologies or duplicate any technology that we have developed. In addition, we may not be issued patents for our pending patent applications, those we may file in the future, or those we may license from third parties.

In addition to patents, we rely on trade secrets and proprietary know-how. Our contract manufacturers perform the manufacturing processes covered by these trade secrets. Accordingly, our contract manufacturers and we must maintain confidentiality. We have confidentiality and proprietary information agreements with our contract manufacturers and with our employees. These agreements may not provide meaningful protection or adequate remedies for our technology in the event of unauthorized use or disclosure of confidential and proprietary information.

We may be subject to intellectual property litigation that could be costly and time-consuming.

The biotechnology and pharmaceutical industries have been characterized by extensive litigation regarding patents and other intellectual property rights. Although we are not currently a party to any lawsuits, third parties may assert infringement or other intellectual property claims against us. We may have to pay substantial damages, including treble damages; for past infringement if it is ultimately determined that our products infringe a third party s proprietary rights. The defense and prosecution of intellectual property suits, U.S. Patent and Trademark Office interference proceedings and related legal and administrative proceedings in the U.S and internationally are costly and time-consuming to pursue and their outcome is uncertain. If we become involved in any of these proceedings, we will incur substantial expense and the efforts of our technical and management personnel will be significantly diverted. An adverse determination may result in the invalidation of our patents, subject us to significant liabilities or require us to seek licenses that may not be available from third parties on satisfactory terms, or at all. Our stock price could decline based on any public announcements related to litigation or interference proceedings initiated or threatened against us.

If physicians and patients do not accept our products, we may be unable to generate significant revenue, if any.

Any future drug candidate that we develop, acquire or license may not gain market acceptance among physicians, patients and the medical community. If any future drug candidate fails to achieve market acceptance, we may be unable to successfully market and sell the product, which would limit our ability to generate revenue. The degree of market acceptance of any drug candidate depends on a number of factors, including:

demonstration of clinical efficacy and safety;

cost-effectiveness;

convenience and ease of administration;

potential advantage over alternative treatment methods; and

marketing and distribution support.

Physicians will not recommend our products until such time as clinical data or other factors demonstrate the safety and efficacy of our drugs as compared to other treatments. In practice, competitors may be more

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effective in marketing their drugs. Even if the clinical safety and efficacy of our product is established, physicians may elect not to recommend its use. For example, physicians may be reluctant to prescribe widespread use of our product because of concern about developing bacterial strains that are resistant to our drugs, or because of the cost of our drug.

The failure to recruit and retain key personnel may delay our ability to execute our business plan.

We are highly dependent on our management and technical staff. Competition for personnel is intense. If we lose the services of any of our senior management or technical staff, we may be unable to successfully complete our planned clinical trial for VAP. We do not maintain key person life insurance and do not have employment agreements with our management and technical staff. In October 2002 we announced a restructuring, including a reduction in force of approximately 70% of our workforce. In order to pursue any future product development, marketing and commercialization, we will need to hire additional qualified scientific personnel to perform research and development and personnel with expertise in clinical testing, government regulation, manufacturing, marketing and finance. We may not be able to attract and retain personnel on acceptable terms given the competition for such personnel among biotechnology, pharmaceutical and other companies.

In addition, we rely on consultants to assist us in formulating our research and clinical development strategy. All of our consultants are employed by other entities. They may have commitments to, or relationships with, other entities that may limit their availability to us. The loss of the services of these personnel may delay our research and development efforts.

Directors, executive officers, principal stockholders and affiliated entities own a portion of our capital stock and may be able to exert control over our activities.

Our directors, executive officers, principal stockholders and affiliated entities beneficially own, in the aggregate, approximately 36% of our outstanding common stock. These stockholders, if acting together, may be able to significantly influence any matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions.

Antitakeover provisions in our charter documents and under Delaware law may make an acquisition of us more difficult.

Provisions of our certificate of incorporation and bylaws could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

These provisions:

- provide for a classified board of directors of which approximately one third of the directors will be elected each year;
- allow the authorized number of directors to be changed only by resolution of the board of directors;
- require that stockholder actions must be effected at a duly called stockholder meeting and prohibit stockholder action by written consent;
- establish advance notice requirements for nominations to the board of directors or for proposals that can be acted on at stockholder meetings; and
- limit who may call stockholder meetings.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit large stockholders from consummating a merger with, or acquisition of us. These provisions may prevent a merger or acquisition that would be attractive to stockholders and could limit the price that investors would be willing to pay in the future for our common stock.

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If we are unable to maintain our Nasdaq National Market listing, the liquidity of our common stock would be seriously impaired and we would become subject to various statutory requirements, which would likely harm our business.

On November 12, 2002, we received a letter from Nasdaq advising us that our common stock had not met Nasdaq s minimum bid price requirement for 30 consecutive trading days and that, if we were unable to demonstrate compliance with this requirement during the 90 calendar days ending February 10, 2003, our common stock may be subject to delisting from the Nasdaq National Market. On March 19, 2003, we received an additional letter from Nasdaq advising us that our grace period for regaining compliance has been extended in accordance with Nasdaq s new rules, until May 12, 2003. The Nasdaq National Market also requires maintenance of minimum stockholders equity of $10 million. Without raising additional equity capital, it is likely that our stockholders equity will fall below the $10 million minimum during 2003. If we are unable to meet the Nasdaq National Market requirements, at the discretion of Nasdaq, our common stock may be transferred to the Nasdaq SmallCap Market. Transferring to the Nasdaq SmallCap Market would provide us with an additional grace period to satisfy the minimum requirement bid price requirement provided that we meet the Nasdaq SmallCap Market s other listing requirements, including the maintenance of stockholder s equity of at least $5 million; however, we would nevertheless be subject to certain adverse consequences described below. In addition, in such event we would still be required to satisfy various listing maintenance standards for our common stock to be quoted on the Nasdaq SmallCap Market, including the minimum bid price requirement after expiration of any grace periods. If we fail to meet such standards, our common stock would likely be delisted from the Nasdaq SmallCap Market and trade on the over-the-counter bulletin board, commonly referred to as the pink sheets. Such alternatives are generally considered as less efficient markets and would seriously impair the liquidity of our common stock and limit our potential to raise future capital through the sale of our common stock, which could materially harm our business.

While we are planning to effect a reverse stock split in the effort to regain compliance, we cannot assure you that we will be able to secure stockholder approval of the proposed stock split or, if effected, the stock split will be sufficient to maintain our stock price on a sustainable basis. In addition, as we expend our capital resources on our clinical trial, we may have difficulty complying with other Nasdaq listing requirements, such as the minimum stockholders equity requirement for example.

If we are delisted from the Nasdaq National Market, we will face a variety of legal and other consequences that will likely negatively affect our business including, without limitation, the following:

- we may lose our exemption from the provisions of Section 2115 of the California Corporations Code, which imposes aspects of California corporate law on certain non-California corporations operating within California. As a result, (i) our board of directors would no longer be classified and our stockholders would elect all of our directors at each annual meeting, (ii) our stockholders would be entitled to cumulative voting, and (iii) we would be subject to more stringent stockholder approval requirements and more stockholder-favorable dissenters rights in connection with certain strategic transactions;

- the state securities law exemptions available to us would be more limited and, as a result, future issuances of our securities may require time-consuming and costly registration statements and qualifications;

- due to the application of different securities law exemptions and provisions, we may be required to amend our stock option and stock purchase plans and comply with time-consuming and costly administrative procedures;

- the coverage of IntraBiotics by securities analysts may decrease or cease entirely; and

- we may lose current or potential investors.

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Our stock price may be volatile, and the value of your investment may decline.

The market prices for securities of biotechnology companies in general have been highly volatile and our stock may be subject to volatility. During 2002, our closing stock price ranged from a low of $0.27 to a high of $4.80. The following factors, in addition to the other risk factors described in this section, may have a significant impact on the market price of our common stock:

announcements regarding strategic alternatives, including a merger or sale of the company or acquisition or license of products or product candidates;

publicity regarding actual or perceived adverse events in our clinical trial or relating to products under development by us or our competitors;

announcements of technological innovations or new commercial products by our competitors or us;

developments concerning proprietary rights;

regulatory developments in the United States or foreign countries;

litigation;

significant short selling in our common stock;

economic and other external factors; and

period-to-period fluctuations in our financial results and changes in analysts recommendations.

Item 2. ***Properties***

We are currently leasing one facility on 2483 East Bayshore Road, Suite 100, in Palo Alto, California. The facility provides approximately 3,600 square feet of office space. The lease expires in June 2004. We believe that our facility is adequate and suitable for at least our current and near-term future needs.

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PART II

Item 6. ***Selected Financial Data***

The following selected financial data should be read in conjunction with our financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included in Items 7 and 8 of this report. The financial data for periods prior to the financial statements presented in Item 8 of this Form 10-K/A are derived from audited financial statements not included in this Form 10-K/A.

	Year Ended December 31,				
	2002	2001	2000	1999	1998
	(In thousands, except per share amounts)				
Statement of Operations Data:					
Revenues:					
Contract revenue	$	$	$	$ 7,863	$ 5,357
License fee and milestone revenue					1,000
Total revenues				7,863	6,357
Operating expenses:					
Research and development	23,053	38,034	39,152	26,102	21,997
General and administrative	8,617	9,202	11,560	6,082	2,533
Impairment of acquired workforce	1,365				
Restructuring and other charges	6,118	21,956			
Arbitration settlement	(3,600)				
Total operating expenses	35,553	69,192	50,712	32,184	24,530
Operating loss	(35,553)	(69,192)	(50,712)	(24,321)	(18,173)
Interest income	703	2,843	5,699	1,372	963
Interest expense	(459)	(1,110)	(563)	(166)	(172)
Other income	856	93			
Net loss	$(34,453)	$(67,366)	$(45,576)	$(23,115)	$(17,382)
Basic and diluted net loss per share	$ (0.94)	$ (2.29)	$ (2.02)	$ (21.62)	$ (20.89)
Shares used to compute basic and diluted net loss per share	36,763	29,432	22,512	1,069	832

	As of December 31				
	2002	2001	2000	1999	1998
	(In thousands)				
Balance Sheet Data:					
Cash, cash equivalents, restricted cash deposits and short-term investments	$ 13,315	$ 35,470	$ 86,065	$ 31,429	$ 29,869
Working capital	15,191	29,629	86,142	25,743	21,279

Total assets	16,226	42,465	108,288	35,958	32,099
Long term obligations, less current portion		5,000	8,309	1,725	867
Accumulated deficit	(200,269)	(165,816)	(98,450)	(52,874)	(29,759)
Total stockholders equity	15,480	26,212	89,955	27,914	22,498

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Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis of our financial condition and results of operations should be read together with our financial statements and related notes appearing elsewhere in this Form 10-K. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. The actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth under Risks Related To Our Business . All forward-looking statements included in this document are based on information available to us on the date of this document and we assume no obligation to update any forward looking statements contained in this Form 10-K.

Overview

IntraBiotics Pharmaceuticals, Inc. is a biopharmaceutical company focused on developing iseganan HCl oral solution for the prevention of ventilator-associated pneumonia (VAP).

In 2002, we focused our resources mainly on developing iseganan HCl for the prevention of ulcerative oral mucositis. The top-line results of our 545-patient phase III clinical trial of iseganan HCl oral solution to treat patients undergoing radiotherapy to prevent or reduce ulcerative oral mucositis showed no significant difference between iseganan and placebo in the primary or secondary end-points. The top-line results of our 509-patient phase III clinical trial of iseganan HCl oral solution to treat patients undergoing aggressive chemotherapy to prevent or reduce ulcerative oral mucositis showed no significant difference between iseganan and placebo in the primary end-point. Iseganan appears to be safe when applied to the oral cavity. We are not pursuing further development of iseganan HCl to treat oral mucositis.

Previously, we completed two earlier stage trials for other indications of iseganan HCl to prevent pneumonia in patients requiring breathing assistance from a mechanical ventilator and to treat respiratory infections in patients with cystic fibrosis. We believe the data from each of these trials support the advancement to the next stage of human clinical testing for each of these two indications. In February 2003, we announced plans to launch a 500 patient phase II/III clinical study of iseganan HCl for the prevention of VAP. We recently concluded a productive meeting with the FDA to discuss the development of iseganan for VAP and anticipate enrolling the first patient before the end of the third quarter 2003 if we obtain additional financing.

Since commencing operations in 1994, we have not generated any revenue from product sales, and we have funded our operations primarily through the private sale of equity securities, funds received from a terminated collaboration agreement, the proceeds of equipment financing arrangements and our initial public offering of common stock in March 2000. During the quarter ended March 31, 2002, we completed a private placement of 5.9 million shares of common stock resulting in net proceeds of $13.9 million, and during the quarter ended June 30, 2002, we completed a private placement of 1.2 million shares of common stock to Ernest Mario, Ph.D. resulting in proceeds of $5.0 million. In addition, during the quarter ended June 30, 2002, we sold two pre-clinical anti-infective programs to Micrologix Biotech Inc., a Canadian company, for cash and 750,000 shares of Series A preferred shares of Micrologix, and recognized other income of $775,000. During the quarter ended September 30, 2002, we also recognized $200,000 of other income in connection with the redemption of 400,000 shares of Series A preferred shares of Micrologix, which was triggered by a milestone set forth in our agreement with Micrologix. We have incurred losses in each year since inception, and we expect to incur substantial losses for at least the next several years. We expect that losses may fluctuate, and that such fluctuations may be substantial. As of December 31, 2002, our accumulated deficit was approximately $200.3 million. We will need to raise additional funds in the future to continue our operations.

In April 2002, we acquired Apothogen, Inc., a privately held pharmaceutical in-licensing company based in North Carolina. We issued 450,000 shares of its common stock in exchange for all of Apothogen s outstanding capital stock. The total purchase price of $2.0 million was determined based on the average closing price of our common stock on the two days prior to the closing date, the closing date and two days after the closing date. We acquired Apothogen to obtain its workforce, including the services of Dr. Ernest Mario,

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in order to obtain additional seasoned executives who could bring expertise in the commercialization of products, including product launch, and other strategic relationships.

We allocated the purchase price based on the relative fair value of the net tangible and intangible assets acquired. Net tangible assets were valued at $300,000 and consisted primarily of cash, other current assets and fixed assets. The amount of the purchase price in excess of the net tangible assets acquired of $1.7 million was allocated to acquired workforce, which was to be amortized over three years. The acquired workforce, net of amortization, of $1.4 million was deemed to be impaired after the negative results of the phase III trial of iseganan HC1 for the prevention of oral mucositis in cancer patients receiving chemotherapy were announced. The acquired workforce was comprised of sales and marketing management, and given there would be no drug approval in the near future, the acquired workforce was deemed impaired, and therefore written down to zero in December 2002.

Concurrent with the closing of the acquisition, Dr. Ernest Mario, the former Chairman and Chief Executive Officer of Apothogen, joined us as Chairman and Chief Executive Officer and purchased $5.0 million of newly issued shares of our common stock in a private placement at a purchase price per share of $4.01.

In October 2002, we announced a restructuring plan, which included a significant reduction in force. As a result of the restructuring, we planned to reduce our expenses from approximately $7.5 million per quarter to approximately $1.5 million per quarter. The restructuring plan was substantially completed by year-end and included a reduction of approximately 26 positions, or 70% of our workforce. In addition, we terminated some of our contracts including our real estate leases, which we believe are not necessary for our future operations. We have recorded charges related to the impairment of equipment and acquired workforce totaling $1.6 million, which are included in operating expenses for the year ended December 31, 2002.

In February 2003, we entered into agreements with certain investors providing for the issuance, in a private placement financing, subject to shareholder approval, of newly created Series A convertible preferred stock, and warrants to purchase common stock, for an aggregate gross purchase price of $3.5 million. The primary purpose of completing the private placement is to provide funds to allow us to conduct and complete our clinical trial of iseganan HCl for the prevention of VAP. A special meeting of stockholders at which the approval and ratification of the private placement is solicited is scheduled to take place on April 3, 2003. If the stockholders approve the transaction, we anticipate completing the private placement during the second quarter 2003. On March 19, 2003, we received an alternative financing proposal from Mr. C. Robert Coates. We are currently evaluating Mr. Coates proposal.

Critical Accounting Policies

Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses, and related disclosures. On an on-going basis, we evaluate these estimates, including those related to clinical trial accruals, restructuring accruals and stock based compensation. Estimates are based on historical experience, information received from third parties and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Impairment of Long-Lived Assets

Long-lived assets and certain identifiable intangible assets to be held and used are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted cash flows resulting

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from the use of the assets and their eventual disposition. In the event that such cash flows are insufficient to recover the carrying amount of the assets, the assets are written down to the estimated fair value. Long-lived assets to be disposed of are reported at the lower of the carrying amount or the estimated fair value less costs to sell.

Clinical Trial Accruals

The Company s accrued costs for clinical trial activities are based upon estimates of the services received and related expenses incurred that have yet to be invoiced by the contract research organizations, laboratories and consultants, or the clinical trial service providers, that perform the activities. Related contracts vary significantly in length, and may be for a fixed amount, a variable amount based on actual costs incurred, capped at a certain limit or for a combination of these elements. Activity levels are monitored through close communication with the service provider, including detailed invoice and task completion review, analysis of expenses against budgeted amounts, and pre-approval of any changes in the scope of the services to be performed. Each significant clinical trial service provider provides an estimate of costs incurred but not invoiced at the end of each quarter for each individual trial. The estimates are reviewed and discussed with the service provider as necessary, and included in research and development expenses for the related quarter. These estimates could differ significantly from the actual amount subsequently invoiced. No adjustments for material changes in estimates have been recognized in any period presented.

Restructuring charges

Our restructuring charges include our estimate of the costs for terminated employees in accordance with EITF 94-3 and related interpretations. We continue to monitor the actual costs and expected remaining obligations in connection with our restructuring plan, and revise the estimates accordingly. Severance estimates were determined based on our assessment of remaining payroll and employee benefits for the employees involved.

Results of Operations

Comparison of Years Ended December 31, 2002 and 2001

Revenues

IntraBiotics had no product sales or contract revenue for the years ended December 31, 2002 and 2001. We do not anticipate any product revenue in the near future.

Expenses

Research and Development

Research and development expenses decreased to $23.1 million for the year ended December 31, 2002 compared to $38.0 million for the same period in 2001. The decrease primarily consists of decreases of $5.1 million in salaries and benefits, $6.7 million of outside services related to clinical trials and $2.1 million of license fees. During 2001, we commenced a research and technology licensing agreement with New Chemical Entities, Inc. (now Albany Molecular Research, Inc. (AMRI)) and with Diversa Corporation. In conjunction with the May 2001 restructuring, we terminated or restructured research and licensing collaborations with AMRI, Biosearch Italia, S.p.A., Cetek Corporation and Diversa Corporation. The total research and development expenses incurred in 2001 in conjunction with these collaborations were $4.5 million of which $1.75 million was charged to research and development and $2.75 million was charged to restructuring. In addition, we issued 700,000 warrants to Diversa Corporation, valued at $560,000, which was also charged to restructuring. Research and development expenses include salaries for research and development personnel, clinical trial expenses from clinical trial service providers, drug substance, consulting expenses, building and equipment costs, supplies, collaboration expenses, administrative expenses and allocations of corporate costs. In 2002, approximately 58% of research and development expenses were related to clinical trial activities performed by the clinical trial service providers compared to 50% in 2001. The clinical trial expenses in 2002 and 2001 primarily relate to phase III clinical studies of iseganan HCl oral solution for the reduction in

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incidence and severity of ulcerative oral mucositis. Due to the significant number of risks and uncertainties associated with developing drugs (See the Risks Related to our Business beginning on page 8), clinical studies vary significantly in length and can span as many as seven to ten years. Any estimation of the length and completion dates of particular clinical studies are therefore highly speculative. Included in research and development expenses are non-cash stock compensation charges of $656,000 and $1.5 million in 2002 and 2001, respectively.

During 2002, we completed two phase III clinical studies. We are no longer developing iseganan HCl oral solution for the reduction in incidence and severity of ulcerative oral mucositis. Subsequent to our October 2002 restructuring, we terminated our supply agreement with PolyPeptide Laboratories for iseganan HCl manufacturing. As a result of this termination agreement, during the quarter ended December 31, 2002, we have expensed $4.8 million related to the delivery of lots H, J, K and L, and recorded a prepaid for drug substance of $2.4 million as of December 31, 2002, which will be expensed upon delivery of lots I1-I3.

In February 2003, we commenced preparations for a new phase II/III clinical trial of iseganan HCl oral solution for the prevention of VAP. Enrollment in the trial is expected to begin in the middle of 2003, and preliminary data from this trial are expected in the second quarter of 2004. The aggregate costs incurred for the development of iseganan HCl for the prevention of VAP during 2000, 2001, 2002 and the first quarter of 2003, were approximately $2.9 million.

Drug development in the United States is a process that includes several steps defined by the FDA. The process begins with the filing of an IND application that, if successful, allows clinical study of the potential new drug. Clinical development typically involves three phases of study: phase I, II and III. The most significant costs associated with clinical development are the phase III trials as they tend to be the longest and largest studies conducted during the drug development process. After completion of clinical trials, a new drug application, or NDA, may be filed with the FDA. In responding to an NDA, the FDA may grant marketing approval, request additional information or deny the application if it determines that the application does not provide an adequate basis for approval. The successful development of our drug candidates is highly uncertain. A product s completion date and completion costs are difficult to predict. The lengthy process of seeking regulatory approvals, and the subsequent compliance with applicable statutes and regulations, require the expenditure of substantial resources. Any failure by us to obtain, or any delay in obtaining, regulatory approvals could have a material adverse effect on our results of operations. A discussion of the risks and uncertainties associated with completing our projects on schedule, or at all, and certain consequences of failing to do so are set forth in the risk factors entitled *If we fail to obtain FDA approvals for any future products that we develop, acquire or license, we will be unable to commercialize our drug candidates* and *We expect to continue to incur future operating losses and may never achieve profitability* as well as in other risk factors.

Research and development expenses may increase in the future if we are able to advance new and existing product candidates into later stages of clinical development. For example, we anticipate that the initiation of our phase II/ III clinical trial for VAP will result in increased research and development expenses, compared to expenses incurred when no clinical trial is in progress. The commencement and completion of our clinical trials may be delayed by many factors, including: slower than expected rate of patient enrollment; our inability to adequately obtain data about patients after their treatment in our clinical trials; additional regulatory requests; inability to manufacture sufficient quantities of materials used for clinical trials or unforeseen safety issues. As a result, our research and development expenses may also fluctuate. Our future capital requirements will depend on many factors, including the timing, cost, extent and results of clinical trials, payments associated with manufacturing scale-up, the costs and timing of regulatory approvals, costs associated with researching drug candidates, securing in-licensing opportunities and conducting pre-clinical research.

General and Administrative

General and administrative expenses decreased to $8.6 million for the year ended December 31, 2002, compared to $9.2 million for the same period in 2001. The decrease was primarily attributed to the restructuring implemented in May 2001 with a large percentage attributable to costs related to the reduction in headcount for all of 2002. This decrease was partially offset due to the acquisition of Apothogen in April

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2002, as general and administrative headcount was increased as a result of the acquisition. General and administrative expenses include salaries for administrative personnel, outside contractors, travel costs, legal fees, building and equipment costs, supplies and other general administrative expenses. Included in general and administrative expenses are non-cash stock compensation charges of $1.7 million and $1.4 million in 2002 and 2001, respectively. In addition, approximately $344,000 was incurred in conjunction with the termination of our property leases at 1245 and 1255 Terra Bella Avenue, Mountain View, California during the fourth quarter of 2002.

During November 2001, we entered into an agreement to modify the vesting of the former CEO s unvested stock options so that a portion of his unvested options would vest upon his departure in January 2002, and the remaining options would continue to vest over a consulting period. In connection with this modification, compensation expense of $413,000, including the amortization of $408,000 of previously recorded deferred stock compensation associated with the awards, was recorded in general and administrative expense in the year ended December 31, 2001. In connection with this modification, compensation expense of $155,000, including the amortization expense of $112,000 of previously recorded deferred stock compensation associated with the awards, was recorded in general and administrative expense in the year ended December 31, 2002. We expect to continue to record consulting expense through July 31, 2003 related to the periodic revaluation of these stock options as they vest in accordance with EITF 96-18. In addition, in 2003, we will amortize the remaining deferred stock compensation originally recorded in connection with these options, of approximately $57,000.

Restructuring and Other Charges

In October 2002 we announced a restructuring plan as a result of the failure of two phase III clinical trials. This plan reduced headcount by 26 employees, or 70% of the workforce. We recorded restructuring charges of $848,000 for severance costs of which, $784,000 was paid as of December 31, 2002. No other charges were incurred as a result of the restructuring plan. At December 31, 2002, there were no remaining employees working who were affected by the restructuring plan. The remaining accrued severance as of December 31, 2002 of $64,000 remains in the liability account and was paid in January 2003 to employees who left the company in December 2002. As of December 31, 2002, we had 11 full-time employees.

In May 2001, we implemented a restructuring plan intended to conserve capital and focus resources on the development of iseganan HCl. As a result of this restructuring plan, we recorded restructuring charges of $10.1 million and asset write down charges of $11.8 million for a total of approximately $22.0 in the second quarter of 2001. The $10.1 million restructuring charge was for costs incurred in work force reduction of $2.9 million, the termination of collaboration agreements of $4.1 million and facilities consolidation $3.2 million.

For the year ended December 31, 2001, we paid $8.9 million of the restructuring charges in cash, primarily in severance costs to approximately 90 employees, rent payments on vacant buildings, and termination fees on collaboration agreements, and also expensed $560,000 for warrants issued as part of a collaboration agreement termination.

The May 2001 restructuring included a reduction in force of approximately 90 positions in research and administration, or 71% of our previous workforce of 127 employees. All of the terminated employees left in 2001. The estimated costs for terminated employees were reduced by $236,000 in the fourth quarter of 2001, as no remaining severance amounts were payable. In the quarter ended March 30, 2002 we received a refund for workers comp insurance of approximately $75,000 related to employees terminated as a result of the May 2001 reduction in force, which was recorded as an adjustment to reflect a revised estimate of the restructuring charges.

The May 2001 restructuring also included the termination of certain research and development collaborations and the consolidation of operations into one existing facility in Mountain View, California. The estimated costs associated with terminated collaboration agreements were increased by $483,000 in the fourth quarter of 2001 and $166,000 in 2002. There are no remaining amounts payable for such agreements and costs at December 31, 2002.

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We vacated three facilities in Mountain View, California as a part of the May 2001 restructuring plan, comprising 142,000 square feet. One of the vacated facilities was subleased during 2001, and the landlord took another back, with no continuing obligation to us. In the fourth quarter of 2001, an adjustment was made to increase restructuring charges associated with facilities consolidation by $1.9 million for additional costs related the third vacated facility. In November 2002, we reached agreements with the landlords of this building and the facility, which we had subleased, to terminate the leases. The additional expense recorded during in 2002 was $5.2 million and included cash payments, the issuance of common stock and the write-off of a deferred rent balance. At December 31, 2002, we had no further lease obligations and hence, there are no accrued restructuring charges related to these facilities.

Additionally as a part of the May 2001 restructure plan, we wrote down to estimated fair value $11.8 million of leasehold improvements, laboratory equipment, computers and other assets that were no longer being used. In the fourth quarter of 2001, we received proceeds from the disposition of certain leasehold improvements and other assets previously written down, in excess of the amounts originally estimated, and as a result recognized a gain of $2.2 million in the fourth quarter of 2001 in restructuring and other charges in the statement of operations.

Arbitration Settlement

The arbitration between us and the contract vendor relating to a drug dispensing error in iseganan HCI oral solution phase III clinical trials was resolved amicably in January 2002. We received $3.6 million in the settlement.

Interest Income and Expense

Interest income decreased to $703,000 for the year ended December 31, 2002 from $2.8 million for the same period in 2001. The decrease in interest income resulted from the decrease in average cash and investment balances as well as a decline in interest rates.

Interest expense decreased to $459,000 for the year ended December 31, 2002 from $1.1 million for the same period in 2001. The decrease was primarily attributed to a repayment of our line of credit and bank loan in October 2002, as well as a reduction in the interest rate on our line of credit.

Other Income

In May 2002, the we completed the sale of two pre-clinical anti-infective programs to Micrologix Biotech Inc., a Canadian company, for cash and 750,000 shares of Series A preferred shares of Micrologix, and recognized other income of $775,000. The Series A preferred shares are redeemable at $1 per share or convertible into common stock at the election of Micrologix upon the occurrence of certain time and achievement milestones as follows: (1) shares converted into common stock with a value of $400,000 upon the four month anniversary of the effective date of the agreement; (2) shares will convert into common stock with a value of $100,000 upon commencement of certain toxicology studies; and (3) shares will convert into common stock with a value of $250,000 upon filing for marketing approval for certain new drugs in various countries. During the quarter ended September 30, 2002, $200,000 of other income was recognized in connection with the redemption of 400,000 shares of Series A preferred shares of Micrologix, which was triggered by the first milestone set forth above.

Comparison of Years Ended December 31, 2001 and 2000

Revenues

IntraBiotics had no product sales or contract revenue for the years ended December 31, 2001 and 2000.

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Expenses

Research and Development

Research and development expenses decreased to $38.0 million for the year ended December 31, 2001 compared to $39.2 million for the same period in 2000. As we have advanced our product candidate into later stage clinical trials, our related expenses generally have increased. The decrease in clinical trial costs in 2001 is a result of a significant reduction in our research expenditures in an effort to focus our resources on our iseganan HCl development program, especially following the restructuring implemented in May 2001. In the second half of 2001, research and development expenses were $12.5 million (relating to the iseganan HCl for the prevention of oral mucositis program) compared to $25.5 million in the first half of 2001. These costs include salaries for research and development personnel, contractor and clinical trial site fees, building and equipment costs, supplies, administrative expenses and allocations of corporate costs. In 2001 approximately 50% of research and development expenses were for various contractor and clinical trial site fees. Included in research and development expenses are non-cash stock compensation charges of $1.5 million and $1.8 million in 2001 and 2000, respectively.

See Research and Development in the Comparison of Years Ended December 31, 2002 and 2001 portion of the MD&A for a detailed discussion of 2001 activities.

General and Administrative

General and administrative expenses decreased to $9.2 million for the year ended December 31, 2001, compared to $11.6 million for the same period in 2000. The decrease was primarily attributed to the restructuring in May 2001 with a large percentage attributable to costs related to headcount. In the second half of 2001, general and administrative expenses were $2.3 million compared to $6.9 million in the first half of 2001. These costs include salaries for administrative personnel, outside contractors, legal fees, accounting fees, building and equipment costs, supplies and other general administrative expenses. Included in general and administrative expenses are non-cash stock compensation charges of $1.4 million and $1.4 million in 2001 and 2000, respectively.

See General and administrative in the Comparison of Years Ended December 31, 2002 and 2001 portion of the MD&A for a detailed discussion of 2001 activities.

Restructuring and other charges

See Restructuring and other charges in the Comparison of Years Ended December 31, 2002 and 2001 portion of the MD&A. There were no restructuring charges in the year 2000.

Interest Income and Expense

Interest income decreased to $2.8 million for the year ended December 31, 2001 from $5.7 million for the same period in 2000. The decrease in interest income resulted from the decrease in average cash and investment balances.

Interest expense increased to $1.1 million for the year ended December 31, 2001 from $563,000 for the same period in 2000. The increase was primarily attributed to an increase in the average debt outstanding in 2001 compared to 2000.

Income Taxes

Since inception, we have incurred operating losses and accordingly have not recorded a provision for income taxes for any of the periods presented. As of December 31, 2002, we had net operating loss carryforwards for federal and state income tax purposes of approximately $180.0 million and $40.0 million, respectively. We also had federal and state research and development tax credits of approximately $1.9 million and $1.8 million, respectively. If not utilized, the net operating losses and credits will expire in the years 2004 through 2022. Utilization of net operating losses and credits may be subject to a substantial annual limitation

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due to ownership change limitations provided by the Internal Revenue Code of 1986, as amended. The annual limitation may result in the expiration of our net operating losses and credit carryforwards before they can be used. Please read Note 10 of the Notes to the Financial Statements included in Item 8 of this Form 10-K for further information.

Liquidity and Capital Resources

In February 2003, we entered into agreements with certain investors providing for the issuance, in a private placement financing, subject to shareholder approval, of newly created Series A convertible preferred stock, and warrants to purchase common stock, for an aggregate gross purchase price of $3.5 million. The primary purpose of completing the private placement is to provide funds to allow us to conduct and complete our clinical trial of iseganan HCl for the prevention of VAP. A special meeting of stockholders at which the approval and ratification of the private placement is solicited is scheduled to take place on April 3, 2003. If the stockholders approve the transaction, we anticipate completing the private placement during the second quarter 2003. On March 19, 2003, we received an alternative financing proposal from Mr. C. Robert Coates. We are currently evaluating Mr. Coates proposal.

During the quarter ended March 31, 2002, we sold 5.9 million shares of common stock in a private placement resulting in net cash proceeds of approximately $13.9 million. Also during the quarter ended March 31, 2002, we received cash of $3.6 million in settlement of our arbitration with a contract vendor relating to a drug dispensing error in iseganan HCl oral solution phase III clinical trials. During the quarter ended June 30, 2002, we completed a private placement of 1.2 million shares of common stock to Ernest Mario, Ph.D. resulting in net proceeds of $5.0 million. In the initial public offering, which was completed in March 2000 we sold 7.5 million shares of common stock at a price of $15.00 per share. Net proceeds from the initial public offering were approximately $103.3 million. Prior to our initial public offering, we had financed our operations primarily through private placements of preferred stock and warrants, funds received from our prior collaboration with Pharmacia & Upjohn S.p.A. and the proceeds of equipment financings. Through December 31, 1999, we had raised aggregate net proceeds from the sale of preferred stock and warrants of $79.6 million. Prior to termination of the Pharmacia & Upjohn S.p.A. agreement, we received an aggregate of $21.4 million in cash payments under this agreement, of which $1.7 million of unused development funding was returned to Pharmacia & Upjohn S.p.A. in 2000.

Cash, cash equivalents, restricted cash and short-term investments were $13.3 million at December 31, 2002, compared to $35.5 million at December 31, 2001. On December 31, 2002, we had restricted cash of $250,000 compared to $7.5 million at December 31, 2001. The $250,000 of restricted cash consists of a certificate of deposit guaranteeing a standby letter of credit for product supplies. The reduction in restricted cash is due to the release of funds in connection with debt and lease terminations.

Net of restricted cash, our cash, cash equivalents and short-term investments on December 31, 2002 were $13.1 million compared to $28.0 million at December 31, 2001.

Net cash used for operating activities was $26.3 million for the year ended December 31, 2002, $53.6 million for the year ended December 31, 2001 and $50.4 million for the year ended December 31, 2000. The decrease from 2001 to 2002 was a result of decreased net losses, primarily due to the $22.0 million of restructuring expense recorded in May 2001, the effect of May 2001 restructuring in reducing overall headcount for 2002 and the completion of two of the phase III trials during 2002. The increase from 2000 to 2001 was primarily due to increased research and development activity and the cost of the restructuring plan implemented in May 2001.

Net cash provided by (used in) investing activities was $(1.6) million for the year ended December 31, 2002, $44.7 million for the year ended December 31, 2001 and $(42.7) million for the year ended December 31, 2000. The decrease in the cash used by investing activities in 2002 from the cash provided by investing activities in 2001 is reflected in the maturities of short-term investments of $51.8 million in 2001. The increase in cash provided by investing activities in 2001 from a use of cash in 2000 was also due to the maturities of short-term investments used to fund our operations in 2001.

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Net cash provided by (used in) financing activities was $10.1 million for the year ended December 31, 2002, $(2.1) million for the year ended December 31, 2001 and $113.5 million for the year ended December 31, 2000. The cash provided by financing activities in 2002 was due to the issuance of 7.1 million shares of common stock in private placements and the issuance of 300,000 shares of common stock upon exercise of options for a total of $19.5 million, offset by $9.4 million paid to Silicon Valley Bank (SVB) during the fourth quarter of 2002, for principal and interest payments to retire our corporate debt. The cash used in financing activities in 2001 was primarily due to payments on financing obligations partially offset by proceeds from financing obligations. The cash provided by financing activities for the year ended December 31, 2000 was due to the issuance of common stock, including net proceeds of $103.3 million from the initial public offering, and proceeds of $10.8 million from equipment lease financing arrangements, partially offset by payments on these obligations.

In August 2001, we refinanced all of the existing financing obligations by entering into a new line of credit of $2.5 million and term loan agreement of $7.5 million with SVB. The interest rate varied according to the prime rate. On October 10, 2002, we repaid to SVB, the $2.5 million line of credit and the remaining $5.5 million balance of the $7.5 million term loan at which time the restriction on the $2.5 million certificate of deposit was released. At December 31, 2002, the Company had no obligations to SVB.

At December 31, 2002, we had no lease commitments on facilities. In February 2003, we entered into an agreement to lease a facility under an operating lease agreement, which expires in June 2004. Under the terms of this lease we are committed to pay approximately $84,000 in 2003 and $43,000 in 2004.

The following are future contractual commitments at December 31, 2002, (in thousands):

	Payments Due by Period				
Contractual Commitment	**Total**	**1 year**	**2-3 years**	**4-5 years**	**Thereafter**
Consultant payments	$220	$220	$	$	$
Polypeptide Labs	540	340	100	100	
Total contractual commitments	$760	$560	$100	$100	$

The $540,000 commitment to Polypeptide Labs represents, in year one, the payment of $250,000 for drug substance, $40,000 for a completion report, and $50,000 fee for storage of drug substance and for future years the remaining $200,000 represents storage fees for our drug substance.

We have an obligation to pay ongoing consulting payments to Mr. Ken Kelley, a former officer, through September 30, 2003. The aggregate payments for the duration of the agreement total $550,000, with the remaining $220,000 as of December 31, 2002 to be paid in 2003.

We expect to continue to incur substantial operating losses. We believe that existing capital resources will be sufficient to fund our operations for at least the next 15 months. In addition, in February 2003, we entered into agreements to sell to certain investors, in a private placement, Series A preferred stock and warrants to purchase common stock, subject to stockholder approval and ratification of the transaction. If we are able to secure stockholder approval, and the transaction is successfully completed, we will receive aggregate gross proceeds of approximately $3.5 million. We believe that this additional capital would be sufficient to meet our operating and capital needs for an additional three months. However, we cannot assure you that the stockholders will approve the transaction, or that our current estimates and assumptions will remain unchanged. This forecast is a forward-looking statement that involves risks and uncertainties, and actual results could vary. Our future capital requirements will depend on many factors, including:

The timing, delay, cost, extent and results of clinical trials;

Future opportunities for raising capital;

Payments to third parties for manufacturing scale up;

The costs and timing of regulatory approvals;

The costs of establishing sales, marketing and distribution capabilities; and

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The progress of our development activities.

Until we can generate sufficient cash from our operations, which we do not expect for the foreseeable future, we expect to finance future cash needs through private and public financings, including equity financings. We cannot be certain that additional funding will be available when needed or on favorable terms. If additional funding is not available, we may need to delay or curtail our development and clinical trial activities to a significant extent.

Recent Accounting Pronouncements

In August 2002, the Financial Accounting Standards Board issued Statement No. 146 (SFAS 146), *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 supersedes Emerging Issues Task Force Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs To Exit an Activity (Including Certain Costs Associated with a Restructuring)* and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, as opposed to when management is committed to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. This Statement is effective for exit or disposal activities initiated after December 31, 2002. The provisions of SFAS No. 146 are required to be applied prospectively after the adoption date to newly initiated exit activities, and may affect the timing of recognizing future restructuring costs, as well as the amounts recognized. The adoption of the statement on January 1, 2003 will not impact the Company s financial statements through December 31, 2002.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* . FIN 45 requires that a liability be recorded in the guarantor s balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued. FIN 45 is effective on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for financial statements for interim and annual periods ending after December 31, 2002. This interpretation does not currently have any impact on our financial position, results of operations or disclosure.

In December 2002, the FASB issued Statement No. 148 (SFAS 148), *Accounting for Stock-Based Compensation, Transition and Disclosure.* SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, SFAS No. 148 requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of SFAS No. 148 are effective for the Company s fiscal year 2002. We have elected to follow the intrinsic value method of accounting as prescribed by APB 25 to account for employee and director stock options. See Stock-based compensation in Note 2 of our Notes to Consolidated Financial Statements for disclosures required by SFAS 148.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51.* FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. We do not believe there will be material effect upon our financial condition or results of operations from the adoption of the provisions of FIN 46.

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Item 8. ***Financial Statements and Supplementary Data***

INTRABIOTICS PHARMACEUTICALS, INC.

INDEX TO FINANCIAL STATEMENTS

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REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders of

IntraBiotics Pharmaceuticals, Inc.

We have audited the accompanying balance sheets of IntraBiotics Pharmaceuticals, Inc. as of December 31, 2002 and 2001, and the related statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of IntraBiotics Pharmaceuticals, Inc. as of December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

/s/ ERNST & YOUNG LLP

Palo Alto, California
January 31, 2003

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INTRABIOTICS PHARMACEUTICALS, INC.

BALANCE SHEETS

(In thousands, except share and per share amounts)

	December 31,	
	2002	**2001**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,170	$ 27,982
Restricted cash deposits	250	7,488
Short-term investments	2,895	
Prepaid drug substance	2,375	1,900
Prepaid expenses	247	3,512
Total current assets	15,937	40,882
Property and equipment, net	112	1,540
Other assets	177	43
Total assets	$ 16,226	$ 42,465
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 345	$ 515
Accrued clinical costs		1,663
Accrued employee liabilities	135	610
Accrued restructuring charges	64	2,861
Deferred rent		618
Other accrued liabilities	202	611
Current financing obligations		4,375
Total current liabilities	746	11,253
Long-term financing obligations		5,000
Commitments		
Stockholders equity:		
Preferred stock, $0.001 par value:		
5,000,000 convertible shares authorized at December 31, 2002 and 2001; no shares outstanding at December 31, 2002 and 2001		
Common stock, $0.001 par value:		
50,000,000 shares authorized at December 31, 2002 and 2001; 39,225,824 and 29,798,203 shares issued and outstanding at December 31, 2002 and 2001, repectively	39	30
Additional paid-in capital	216,430	196,575
Deferred stock compensation	(720)	(4,577)
Accumulated deficit	(200,269)	(165,816)
Total stockholders equity	15,480	26,212
Total liabilities and stockholders equity	$ 16,226	$ 42,465

See accompanying notes.

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INTRABIOTICS PHARMACEUTICALS, INC.

STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

	Year Ended December 31,		
	2002	**2001**	**2000**
Operating expenses:			
Research and development	$ 23,053	$ 38,034	$ 39,152
General and administrative	8,617	9,202	11,560
Impairment of acquired workforce	1,365		
Restructuring and other charges	6,118	21,956	
Arbitration settlement	(3,600)		
Total operating expenses	35,553	69,192	50,712
Operating loss	(35,553)	(69,192)	(50,712)
Interest income	703	2,843	5,699
Interest expense	(459)	(1,110)	(563)
Other income	856	93	
Net loss	$(34,453)	$(67,366)	$(45,576)
Basic and diluted net loss per share	$ (0.94)	$ (2.29)	$ (2.02)
Shares used to compute basic and diluted net loss per share	36,763	29,432	22,512

See accompanying notes.

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INTRABIOTICS PHARMACEUTICALS, INC.

STATEMENT OF STOCKHOLDERS EQUITY

(In thousands, except share amounts)

	Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Deferred Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity
Balances at December 31, 1999	$ 79,609	$ 1	$ 13,828	$ (12,650)	$	$ (52,874)	$ 27,914
Conversion of preferred stock to 19,742 shares of common stock at the initial public offering	(79,609)	20	79,589				
Initial public offering of 7,500 shares of common stock for cash (net of issuance costs of $9,221)		7	103,272				103,279
Issuance of 532 shares of common stock upon exercise of options for cash		1	549				550
Issuance of 34 shares of common stock upon net exercise of warrants							