

PALATIN TECHNOLOGIES INC  
Form 10-Q  
February 08, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended December 31, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-15543

**PALATIN TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-4078884**

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

**4C Cedar Brook Drive  
Cranbury, New Jersey**

(Address of principal executive offices)

**08512**

(Zip code)

**(609) 495-2200**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

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

As of February 6, 2008, 85,204,169 shares of the registrant's common stock, par value \$.01 per share, were outstanding.

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**SIGNATURES**

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**PALATIN TECHNOLOGIES, INC.**  
**Consolidated Balance Sheets**  
(unaudited)

	December 31, 2007	June 30, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 20,405,499	\$ 31,447,615
Available-for-sale investments	2,362,084	2,323,642
Accounts receivable	367,739	607,841
Prepaid expenses and other current assets	456,458	1,008,464
Total current assets	23,591,780	35,387,562
Property and equipment, net	5,809,350	6,070,226
Restricted cash	475,000	475,000
Other assets	254,268	848,446
Total assets	\$ 30,130,398	\$ 42,781,234
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Capital lease obligations and notes payable, current portion	\$ 306,609	\$ 216,841
Accounts payable	583,192	1,120,894
Accrued expenses	2,393,544	2,420,837
Accrued compensation	467,104	941,300
Deferred revenue, current portion	1,916,669	4,864,833
Total current liabilities	5,667,118	9,564,705
Capital lease obligations and notes payable, net of current portion	238,350	275,126
Deferred rent, net of current portion	1,715,500	1,966,628
Deferred revenue, net of current portion	6,805,553	12,443,087
Total liabilities	14,426,521	24,249,546
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock of \$.01 par value - authorized 10,000,000 shares; Series A Convertible; issued and outstanding 4,997 shares as of December 31, 2007 and June 30, 2007	50	50
Common stock of \$.01 par value - authorized 150,000,000 shares; issued and outstanding 85,204,169 and 85,126,915 shares as of December 31, 2007 and June 30, 2007, respectively	852,042	851,269
Additional paid-in capital	207,039,292	205,875,438
Accumulated other comprehensive income	38,442	-

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Accumulated deficit	(192,225,949)	(188,195,069)
Total stockholders' equity	15,703,877	18,531,688
Total liabilities and stockholders' equity	\$ 30,130,398	\$ 42,781,234

The accompanying notes are an integral part of these consolidated financial statements.

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**PALATIN TECHNOLOGIES, INC.**  
**Consolidated Statements of Operations**  
(unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
<b>REVENUES:</b>				
Licenses, grants and contracts	\$ 742,835	\$ 3,743,109	\$ 9,720,566	\$ 8,678,211
<b>OPERATING EXPENSES:</b>				
Research and development	3,791,344	9,569,483	11,735,221	21,693,180
General and administrative	2,329,052	1,654,932	3,988,062	3,217,408
Total operating expenses	6,120,396	11,224,415	15,723,283	24,910,588
Loss from operations	(5,377,561)	(7,481,306)	(6,002,717)	(16,232,377)
<b>OTHER INCOME (EXPENSE):</b>				
Investment income	314,470	227,140	711,091	551,374
Interest expense	(12,469)	(13,122)	(30,698)	(23,188)
Total other income, net	302,001	214,018	680,393	528,186
Loss before income taxes	(5,075,560)	(7,267,288)	(5,322,324)	(15,704,191)
Income tax benefit	1,291,444	778,308	1,291,444	778,308
<b>NET LOSS</b>	<b>\$ (3,784,116)</b>	<b>\$ (6,488,980)</b>	<b>\$ (4,030,880)</b>	<b>\$ (14,925,883)</b>
Basic and diluted net loss per common share	\$ (0.04)	\$ (0.09)	\$ (0.05)	\$ (0.21)
Weighted average number of common shares outstanding used in computing basic and diluted net loss per common share	85,204,169	71,055,893	85,190,733	70,967,207

The accompanying notes are an integral part of these consolidated financial statements.

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**PALATIN TECHNOLOGIES, INC.**  
**Consolidated Statements of Cash Flows**  
(unaudited)

	Six Months Ended December 31,	
	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (4,030,880)	\$ (14,925,883)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	691,257	707,600
Stock-based compensation	1,054,398	713,958
Changes in operating assets and liabilities:		
Accounts receivable	240,102	(78,678)
Prepaid expenses and other	1,146,184	772,700
Accounts payable	(537,702)	(637,894)
Accrued expenses and other	(752,617)	695,225
Deferred revenues	(8,585,698)	(2,074,610)
Net cash used in operating activities	(10,774,956)	(14,827,582)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(231,593)	(434,903)
Net cash used in investing activities	(231,593)	(434,903)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payments on capital lease obligations and notes payable	(145,796)	(88,768)
Proceeds from issuances of common stock and warrants	110,229	691,966
Net cash provided by (used in) financing activities	(35,567)	603,198
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(11,042,116)</b>	<b>(14,659,287)</b>
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>31,447,615</b>	<b>28,333,211</b>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$ 20,405,499</b>	<b>\$ 13,673,924</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Equipment acquired under financing agreements	\$ 198,788	\$ 212,848
Cash paid for interest	\$ 30,698	\$ 23,188

The accompanying notes are an integral part of these financial statements.

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**PALATIN TECHNOLOGIES, INC.**  
**Notes to Consolidated Financial Statements**  
(unaudited)

**(1) ORGANIZATION**

*Nature of Business* Palatin Technologies, Inc. ( Palatin or the Company ) is a biopharmaceutical company primarily focused on discovering and developing targeted, receptor-specific small molecule and peptide therapeutics, including melanocortin ( MC )-based therapeutics. Therapeutics affecting the activity of the MC family of receptors may have the potential to treat a variety of conditions and diseases, including sexual dysfunction, obesity and related disorders, cachexia, skin pigmentation disorders and inflammation-related diseases. The Company is exploring other receptor-specific therapeutics, including congestive heart failure therapeutics.

Bremelanotide, an MC receptor agonist, is a patented, nasally administered MC-based peptide in clinical development for the treatment of male and female sexual dysfunction. In 2004, the Company entered into a collaborative development and marketing agreement with King Pharmaceuticals, Inc. ( King ) to jointly develop and commercialize bremelanotide. In September 2007, the Company received notice from King terminating the collaborative development and marketing agreement between the Company and King, in accordance with its terms, effective December 5, 2007. Upon this termination, Palatin has retained all rights to bremelanotide. See Note 4 regarding the agreement with King.

The Company has a licensing and research collaboration agreement with AstraZeneca AB ( AstraZeneca ) to discover, develop and commercialize small molecule compounds that target MC receptors for the treatment of obesity, diabetes and related metabolic syndrome. The Company is also conducting research on peptidomimetic compounds for the treatment of other disorders, including congestive heart failure. Certain compounds under investigation result from utilization of the Company s MIDAS(TM) technology, a proprietary platform technology to design and synthesize compounds that mimic the activity of peptides.

NeuroSpec is the Company s radiolabeled monoclonal antibody product for imaging and diagnosing infection and the subject of a strategic collaboration agreement with the Mallinckrodt division of Covidien Ltd. ( Mallinckrodt ). In July 2004, the Company received approval from the U.S. Food and Drug Administration ( FDA ) to market NeuroSpec for imaging and diagnosing equivocal appendicitis. In December 2005, the Company and Mallinckrodt voluntarily suspended the sales, marketing and distribution of NeuroSpec following the occurrence of certain serious adverse events involving patients who received NeuroSpec. Significant development activities pertaining to NeuroSpec are currently suspended while the Company and Mallinckrodt evaluate future development and marketing alternatives.

Key elements of the Company s business strategy include entering into alliances and partnerships with pharmaceutical companies to facilitate the development, manufacture, marketing, sale and distribution of the Company s product candidates under development, expansion of the Company s pipeline through the utilization of its MC expertise and patented drug discovery platform, opportunistic acquisition of synergistic products and technologies and partial funding of the Company s development and discovery programs with the cash flow from collaboration agreements.

*Business Risk and Liquidity* The Company has incurred negative cash flows from operations since its inception, and has expended, and expects to continue to expend in the future, substantial funds to complete its planned product development efforts. As shown in the accompanying consolidated financial statements, the Company has an accumulated deficit as of December 31, 2007 and incurred a net loss for the three and six months ended December 31, 2007. The Company anticipates incurring additional losses in the future as a result of spending on its development programs. To achieve profitability, the Company, alone or with others, must successfully develop and commercialize its technologies and proposed products, conduct successful pre-clinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture and market such technologies and proposed products. The time required to reach profitability is highly uncertain, and there can be no assurance that the Company will be able to achieve profitability on a sustained basis, if at all.

The Company believes that its cash, cash equivalents and available-for-sale investments as of December 31, 2007, together with expected receipts from collaboration and license agreements and other income, are adequate to fund operations for at least the next twelve months. The nature and timing of the Company s development activities are highly dependent on its financing activities. Management plans to continue to refine its operations, control expenses, evaluate alternative methods to conduct its business, and seek available and attractive sources of financing and sharing of development costs through strategic collaboration agreements or other resources. Should appropriate sources of financing not be available, management would delay certain clinical trials and research activities until such time as appropriate financing was available. There can be no assurance that the Company s

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financing efforts will be successful. If adequate funds are not available, the Company's financial condition will be materially and adversely affected, due to the Company's expected negative cash flows from operations.

*Concentrations* Concentrations in the Company's assets and operations subject it to certain related risks. Financial instruments that potentially subject the Company to concentrations of credit risk primarily consist of cash and cash equivalents, available-for-sale investments and accounts receivable. The Company's cash and cash equivalents are primarily invested in one money market fund sponsored by a large financial institution. The Company's accounts receivable balance as of December 31, 2007 consists of amounts due from its collaboration partners, and is comprised of \$317,300 due from AstraZeneca and \$50,439 due from Mallinckrodt.

Revenues from collaboration partners as a percentage of total revenues were as follows (see Note 4 regarding the agreement with King):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
AstraZeneca	99%	-%	15%	-%
Mallinckrodt	1%	2%	1%	2%
King	-%	98%	84%	98%

## (2) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnote disclosures required to be presented for complete financial statements. In the opinion of management, these consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary to present fairly the Company's financial position as of December 31, 2007, and its results of operations and its cash flows for the three and six months ended December 31, 2007 and 2006. The results of operations for the three- and six-month periods ended December 31, 2007 may not necessarily be indicative of the results of operations expected for the full year, except that the Company expects to incur a significant loss for the fiscal year ending June 30, 2008.

The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K, filed with the Securities and Exchange Commission (SEC), which includes consolidated financial statements as of June 30, 2007 and 2006 and for each of the fiscal years in the three-year period ended June 30, 2007.

## (3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Principles of Consolidation* The consolidated financial statements include the accounts of Palatin and its wholly-owned inactive subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

*Use of Estimates* The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Cash and Cash Equivalents* Cash and cash equivalents include cash on hand, cash in banks and all highly liquid investments with a purchased maturity of three months or less. Restricted cash secures letters of credit for security deposits on leases.

*Investments* The Company classifies its investments as available-for-sale investments and all such investments are recorded at fair value based on quoted market prices. Unrealized holding gains and losses, net of the related tax effect, if any, are generally excluded from earnings and are reported in accumulated other comprehensive income/loss until realized. Interest and dividends on securities classified as available-for-sale are included in investment income. Gains and losses are recorded in the statement of operations when realized or when unrealized holding losses are determined to be other than temporary, on a specific-identification basis.

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*Fair Value of Financial Instruments* The Company's financial instruments consist primarily of cash and cash equivalents, available-for-sale investments, accounts receivable, accounts payable, capital lease obligations and notes payable. Management believes that the carrying value of these assets and liabilities are representative of their

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respective fair values based on quoted market prices for investments and the short-term nature of the other instruments.

*Property and Equipment* Property and equipment consists of office and laboratory equipment, office furniture and leasehold improvements and includes assets acquired under capital leases. Property and equipment are recorded at cost. Depreciation is recognized using the straight-line method over the estimated useful lives of the related assets, generally five years for laboratory equipment, seven years for office furniture and equipment and the lesser of the term of the lease or the useful life for leasehold improvements. Amortization of assets acquired under capital leases is included in depreciation. Maintenance and repairs are expensed as incurred while expenditures that extend the useful life of an asset are capitalized.

*Impairment of Long-Lived Assets* The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of a long-lived asset, management evaluates whether the estimated future undiscounted net cash flows from the asset are less than its carrying amount. If impairment is indicated, the long-lived asset would be written down to fair value. Fair value is determined by an evaluation of available price information at which assets could be bought or sold including quoted market prices, if available, or the present value of the estimated future cash flows based on reasonable and supportable assumptions.

*Deferred Rent* The Company's operating leases provide for rent increases over the terms of the leases. Deferred rent consists of the difference between periodic rent payments and the amount recognized as rent expense on a straight-line basis, as well as tenant allowances for leasehold improvements. Rent expense is being recognized ratably over the life of the leases.

*Revenue Recognition* Revenue from corporate collaborations and licensing agreements consists of up-front fees, research and development funding, and milestone payments. Non-refundable up-front fees are deferred and amortized to revenue over the related performance period. The Company estimates the performance period as the period in which it performs certain development activities under the applicable agreement. Estimated reimbursements for research and development activities and government grants are recorded in the period that the Company performs the related activities under the terms of the applicable agreements. Revenue resulting from the achievement of milestone events stipulated in the applicable agreements is recognized when the milestone is achieved, provided that such milestone is substantive in nature. See Note 4 regarding the agreement with King.

*Research and Development Costs* The costs of research and development activities are charged to expense as incurred, including the cost of equipment for which there is no alternative future use.

*Stock Options* The Company accounts for options granted to employees in accordance with Statement of Financial Accounting Standards (SFAS) 123(R), Share-Based Payment. SFAS 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services and requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements, measured by the fair value of the equity or liability instruments issued, adjusted for estimated forfeitures.

The Company accounts for options granted to consultants in accordance with Emerging Issues Task Force (EITF) Issue 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, and SFAS 123(R).

The Company determines the fair value of options utilizing the Black-Scholes option-pricing model. Compensation costs for share-based awards with pro rata vesting are allocated to periods on the straight-line basis.

*Income Taxes* The Company and its subsidiary file consolidated federal and separate-company state income tax returns. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences or operating loss and tax credit carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

In accordance with SFAS 109, Accounting for Income Taxes, the Company has recorded a valuation allowance against its deferred tax assets. The valuation allowance is based on management's estimates and analysis, which includes consideration of tax laws that may limit the Company's ability to utilize its net operating loss carryforwards.

During the three months ended December 31, 2007 and 2006, the Company sold New Jersey state net operating loss carryforwards, which resulted in the recognition of \$1,291,444 and \$778,308, respectively, in tax benefits.



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*Net Loss per Common Share* Basic earnings per share ( EPS ) is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution from the exercise or conversion of securities into common stock, including stock options and warrants, restricted stock units and shares of Series A Convertible Preferred Stock. As of December 31, 2007 and 2006, common shares issuable upon conversion of Series A Convertible Preferred Stock, the vesting of restricted stock units and the exercise of outstanding options and warrants amounted to an aggregate of 16,149,527 and 16,962,992 shares, respectively, and were not included in the computation of Diluted EPS because to do so would have been anti-dilutive for the periods presented.

*New Accounting Pronouncements* In December 2007, the Financial Accounting Standards Board ( FASB ) issued EITF Issue 07-1, Accounting for Collaborative Arrangements, which applies to collaborative arrangements that are conducted by the participants without the creation of a separate legal entity for the arrangements and clarifies, among other things, how to determine whether a collaborative agreement is within the scope of this issue. EITF Issue 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of EITF Issue 07-1 to have a material impact on its results of operations and financial position.

In June 2007, the FASB issued EITF Issue 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities, which applies to companies involved in research and development activities that make non-refundable advance payments for goods that will be used or for services that will be performed in future research and development activities. EITF Issue 07-3 is effective for financial statements issued for fiscal years beginning after December 15, 2007. The Company does not expect the adoption of EITF Issue 07-3 to have a material impact on its results of operations and financial position.

**(4) AGREEMENT WITH KING**

In September 2007, the Company received notice from King terminating the collaborative development and marketing agreement between the Company and King, in accordance with its terms, effective December 5, 2007. As of September 30, 2007, the Company had no further obligation to perform any services for King. The notice followed communication with representatives of the FDA, which raised serious concerns about the benefits and risks of the progression of bremelanotide into Phase 3 clinical studies for erectile dysfunction. Upon termination, Palatin regained sole ownership of all rights to bremelanotide without any obligation for future payments to King, other than any amounts payable for the reimbursement of bremelanotide costs incurred by King prior to termination. King has no obligation for future payments to Palatin, other than any amounts payable for the reimbursement of bremelanotide costs incurred by Palatin prior to termination.

In connection with the termination of the agreement, the Company recognized \$0 and \$6,499,796, respectively, of deferred up-front license fees received from King for the three- and six-month period ended December 31, 2007, together with \$0 and \$815,561, respectively, of associated deferred costs for the same periods, which prior to termination were being recognized as revenues and amortized as research and development costs over the estimated period of the Company's performance under the agreement.

**(5) COMPREHENSIVE LOSS**

Comprehensive loss consists of the following:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
Net loss	\$ (3,784,116)	\$ (6,488,980)	\$ (4,030,880)	\$ (14,925,883)
Unrealized gain (loss) on investments	22,628	(5,010)	38,442	2,543
Comprehensive loss	\$ (3,761,488)	\$ (6,493,990)	\$ (3,992,438)	\$ (14,923,340)

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**(6) INVESTMENTS**

The following is a summary of available-for-sale investments, which consist of mutual funds that invest primarily in debt instruments:

	December 31, 2007	June 30, 2007
Cost	\$ 2,323,642	\$ 2,323,642
Unrealized gain on investments	38,442	-
Fair value	\$ 2,362,084	\$ 2,323,642

**(7) COMMITMENTS AND CONTINGENCIES**

As discussed in the Company's annual report on Form 10-K for the fiscal year ended June 30, 2007, Competitive Technologies, Inc. (CTI) initiated arbitration proceedings with the Company for breach of the terms of its license agreement for patent rights related to certain compounds and methods of treatment for sexual dysfunction and for other actions asserted to arise out of the license agreement, and also initiated litigation against the Company by filing a suit in Connecticut Superior Court for breach of the settlement agreement of an earlier arbitration between CTI and the Company. In January 2008, the Company entered into a settlement agreement and release with CTI, resolving all outstanding disputes between the Company and CTI. See Note 9, Subsequent Event, regarding the CTI settlement.

**(8) STOCKHOLDERS EQUITY**

On September 25, 2007, the Company issued grants of restricted stock units under the Company's 2005 Stock Plan totaling in the aggregate 1,573,915 shares of common stock as retention bonuses to its employees, other than the executive officers, that were not affected by a contemporaneous reduction in workforce. The shares approved for grant initially exceeded the number of authorized shares available for grant under the 2005 Stock Plan by 109,984. As a result, for accounting purposes the 109,984 shares were not considered granted until the date that sufficient authorized shares became available, which was on December 7, 2007, the date that the Company received stockholder approval to increase the number of authorized shares available for grant under the 2005 Stock Plan by 5,000,000 shares. These restricted stock units will vest on September 30, 2008, provided that the employee remains continuously employed by the Company through such date or earlier if the employee is involuntarily terminated by reason of a position elimination or change in control. The Company is amortizing the fair value of the restricted stock units, initially totaling approximately \$725,000, on a straight-line basis through September 30, 2008.

**(9) SUBSEQUENT EVENT**

On January 21, 2008, the Company entered into a settlement agreement and release with CTI, resolving all outstanding disputes between the Company and CTI. The arbitration proceeding and the Connecticut Superior Court proceeding have been dismissed with prejudice. The existing license agreement between CTI and the Company has been terminated. CTI retains all rights to a peptide called variously MT-II or PT-14, which peptide was developed at the University of Arizona, and the Company expressly relinquished all claims to any contractual or intellectual property rights to that peptide or any patents licensed under the terminated license agreement. The Company retains all rights to bremelanotide, and CTI expressly relinquished all claims to any contractual or intellectual property rights to bremelanotide, including any claim that making, using or selling bremelanotide infringes any patents licensed under the terminated license agreement. The settlement agreement and release also includes mutual covenants not to sue and releases of all claims by either party against the other based on, arising out of or in any way involving the subject matter of the license agreement, the arbitration or the Connecticut Superior Court proceeding. As part of the settlement, the Company remitted a one-time payment to CTI of \$800,000 that was accrued and charged to general and administrative expense as of December 31, 2007.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements filed as part of this report.

Statements in this quarterly report on Form 10-Q, as well as oral statements that may be made by us or by our officers, directors, or employees acting on our behalf, that are not historical facts constitute forward-looking statements, which are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934 (the Exchange Act). The forward-looking statements in this quarterly report on Form 10-Q do not constitute guarantees of future performance. Investors are cautioned that statements that are not strictly historical statements contained in this quarterly report on Form 10-Q including, without limitation, current or future financial performance, management's plans and objectives for future operations, clinical trials and results, product plans and performance, management's assessment of market factors, as well as statements regarding our strategy and plans and our strategic partners, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that could cause our actual results to be materially different from historical results or from any results expressed or implied by such forward-looking statements. Our future operating results are subject to risks and uncertainties and are dependent upon many factors, including, without limitation, the risks identified in this report, in our annual report on Form 10-K for the year ended June 30, 2007 and in our other Securities and Exchange Commission (SEC) filings.

We expect to incur losses in the future as a result of spending on our planned development programs and losses may fluctuate significantly from quarter to quarter.

**Critical Accounting Policies and Estimates**

Our significant accounting policies are described in the notes to our consolidated financial statements included in this report and in our annual report on Form 10-K for the year ended June 30, 2007, and have not changed as of December 31, 2007. We believe that our accounting policies and estimates relating to revenue recognition, accrued expenses and stock-based compensation are the most critical.

**Overview**

We are a biopharmaceutical company focused on discovering and developing targeted, receptor-specific small molecule and peptide therapeutics. Our proprietary drug development pipeline is based primarily on melanocortin (MC)-based therapeutics, and we believe we are a leader in this area of pharmaceutical research and development. Therapeutics affecting the activity of the MC family of receptors may have the potential to treat a variety of conditions and diseases, including sexual dysfunction, obesity and related disorders, cachexia, skin pigmentation disorders and inflammation-related diseases. We are exploring other receptor-specific therapeutics, including congestive heart failure therapeutics.

Bremelanotide is our nasally administered MC-based peptide in clinical development for two distinct indications, the treatment of male erectile dysfunction (ED) and the treatment of female sexual dysfunction (FSD). In 2004, we entered into a collaborative development and marketing agreement with King Pharmaceuticals, Inc. (King) to jointly develop and commercialize bremelanotide. Pursuant to the agreement, we and King shared all collaboration development costs based on an agreed percentage. In September 2007, we received notice from King terminating the agreement in accordance with its terms effective December 5, 2007. As of September 30, 2007, we had no further obligation to perform any services for King. Termination followed comments by the U.S. Food and Drug Administration (FDA) raising serious concerns about the acceptable benefit/risk ratio to support the progression of bremelanotide into Phase 3 studies for ED as a first-line therapy in the general population. As a result of termination, we solely own all rights to bremelanotide.

In January 2007, we entered into an exclusive global licensing and research collaboration agreement with AstraZeneca AB (AstraZeneca), a major international pharmaceutical and healthcare business, to discover, develop and commercialize small molecule compounds that target MC receptors for the treatment of obesity, diabetes and related metabolic syndrome. The collaboration is based on Palatin's MC receptor obesity program and includes access to compound libraries, core technologies and expertise in MC receptor drug discovery and development. We and AstraZeneca are in the process of identifying clinical candidate MC therapeutic small molecules for the treatment of obesity and related disorders.

We have developed a library of novel natriuretic (promoting sodium excretion) receptor compounds, and identified a lead clinical candidate for which we submitted an Investigational New Drug application with the FDA, and initiated Phase 1 clinical trials for the treatment of congestive heart failure (CHF). We are also conducting



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research to identify additional clinical candidate compounds for the treatment of both chronic CHF and acutely decompensated (rapidly deteriorated) CHF.

We are evaluating future development and marketing activities involving NeutroSpec, our radiolabeled monoclonal antibody product for imaging and diagnosing infection, with the Mallinckrodt division of Covidien Ltd. (Mallinckrodt), with whom we have a strategic collaboration agreement. In July 2004, the Company received approval from the FDA to market NeutroSpec for imaging and diagnosing equivocal appendicitis. In December 2005, we and Mallinckrodt voluntarily suspended the sales, marketing and distribution of NeutroSpec following certain serious adverse events involving patients who received NeutroSpec.

Key elements of our business strategy include: entering into alliances and partnerships with pharmaceutical companies to facilitate the development, manufacture, marketing, sale and distribution of product candidates we are developing; expanding our pipeline through the utilization of our MC expertise and patented drug discovery platform; acquiring synergistic products and technologies; and partially funding our development and discovery programs with the cash flow from our collaboration agreements.

We incorporated in Delaware in 1986 and commenced operations in the biopharmaceutical area in 1996. Our corporate offices and research and development facility are located at 4C Cedar Brook Drive, Cranbury, New Jersey 08512 and our telephone number is (609) 495-2200. We maintain an Internet site at <http://www.palatin.com>, where among other things, we make available free of charge on and through this website our Forms 3, 4 and 5, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) and Section 16 of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our website and the information contained therein or connected thereto shall not be deemed to be incorporated into this quarterly report on Form 10-Q.

**Results of Operations**

*Three and Six Months Ended December 31, 2007 Compared to the Three and Six Months Ended December 31, 2006.*

**Licenses, Grants and Contracts** For the three and six months ended December 31, 2007, we recognized \$0.7 million and \$9.7 million, respectively, in licenses, grants and contracts revenue consisting of (i) \$0 and \$8.2 million, respectively, related to bremelanotide pursuant to our collaboration agreement with King, (ii) \$0.7 million and \$1.4 million, respectively, related to our license agreement with AstraZeneca, and (iii) \$0 and \$0.1 million related to NeutroSpec pursuant to our collaboration agreement with Mallinckrodt. For the three and six months ended December 31, 2006, we recognized \$3.7 million and \$8.7 million, respectively, in licenses, grants and contracts revenue consisting of (i) \$3.6 million and \$8.5 million, respectively, related to bremelanotide pursuant to our collaboration agreement with King, and (ii) \$0.1 million and \$0.2 million related to NeutroSpec pursuant to our collaboration agreement with Mallinckrodt.

The fluctuation in revenue related to King primarily reflects the recognition in September 2007 of the remaining deferred license revenue pursuant to King's up-front payment, based on the termination of our collaboration agreement with King. License and contract revenue from AstraZeneca for the three and six months ended December 31, 2007 consists of \$0.3 million and \$0.6 million, respectively, of revenue related to our research services performed during said periods and \$0.4 million and \$0.8 million, respectively, of license revenue related to AstraZeneca's \$10.0 million up-front license fee received at the inception of the agreement. Contract revenue from Mallinckrodt reflects Mallinckrodt's share of the costs incurred in certain NeutroSpec development activities. Future contract revenue from AstraZeneca and Mallinckrodt, in the form of reimbursement of shared development costs or the recognition of deferred license fees, will fluctuate based on development activities in our obesity and NeutroSpec programs. We may also earn contract revenue based on the attainment of certain development milestones.

**Research and Development** Research and development expenses decreased to \$3.8 million for the three months ended December 31, 2007 from \$9.6 million for the three months ended December 31, 2006. Research and development expenses decreased to \$11.7 million for the six months ended December 31, 2007 from \$21.7 million for the six months ended December 31, 2006.

Research and development expenses related to bremelanotide decreased to \$0.2 million and \$2.7 million, respectively, for the three and six months ended December 31, 2007 compared to \$5.4 million and \$13.3 million, respectively, for the same periods in 2006. These amounts include both third-party costs incurred by us and partially reimbursed by King and our share of costs for development activities performed by King. Research and development expenses related to bremelanotide decreased in the periods as a result of (i) the completion of certain Phase 2B trials on both men and women, and (ii) the delay in the initiation of Phase 3 clinical trials for ED. Similar to the recognition of license revenue explained above, the six months ended December 31, 2007 includes the

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recognition in September 2007 of \$0.8 million of deferred costs recorded based on the termination of our collaboration agreement with King. Upon the completion of further discussions with the FDA and external consultants, we will determine the next steps related to the further development of bremelanotide for ED and FSD.

Research and development expenses related to our obesity, CHF and other pre-clinical programs were \$0.7 million and \$1.7 million, respectively, for the three and six months ended December 31, 2007 compared to \$0.8 million and \$1.5 million, respectively, for the three and six months ended December 31, 2006. Spending to date has been primarily related to the identification and optimization of lead compounds. We expect to spend approximately \$2 million to \$3 million of direct costs during fiscal 2008 on laboratory research and the commencement of clinical trials on an identified compound. The amount of such spending and the nature of future development activities are dependent on a number of factors, including primarily the success of our discovery programs, pre-clinical studies, our ability to progress a compound into human clinical trials and discussions with AstraZeneca and other potential development partners.

The historical amounts of project spending above exclude general research and development spending, which decreased to \$2.9 million for the three months ended December 31, 2007 compared to \$3.4 million for the three months ended December 31, 2006. The decrease is primarily related to the reduction in workforce initiated in September 2007. For the six months ended December 31, 2007, general research and development spending increased to \$7.4 million compared to \$6.9 million for six months ended December 31, 2006, primarily due to severance costs recognized in September 2007.

Cumulative spending from inception to December 31, 2007 on our bremelanotide, NeutroSpec and MIDAS programs amounts to approximately \$117.7 million, \$58.2 million and \$34.5 million, respectively. Due to risk factors described in our periodic filings with the SEC, including the difficulty in currently estimating the costs and timing of future Phase 1 clinical trials and large-scale Phase 2 and Phase 3 clinical trials for any product under development, we cannot predict with reasonable certainty when, if ever, a program will advance to the next stage of development or be successfully completed, or when, if ever, significant related net cash inflows will be generated.

*General and Administrative* General and administrative expenses increased to \$2.3 million and \$4.0 million, respectively for the three and six months ended December 31, 2007 as compared to \$1.7 million and \$3.2 million, respectively, for the three and six months ended December 31, 2006. The increase in expenses for the three and six months ended December 31, 2007 primarily reflects the \$0.8 million litigation settlement agreement and release resolving all outstanding disputes with Competitive Technologies, Inc. ( CTI ).

*Income Tax Benefit* Income tax benefits of \$1.3 million in the three and six months ended December 31, 2007 and \$0.8 million in the three and six months ended December 31, 2006 relate to the sale of New Jersey state net operating loss carryforwards. The amount of such losses and tax credits that we are able to sell depends on annual pools and allocations established by the state of New Jersey.

### **Liquidity and Capital Resources**

Since inception, we have incurred net operating losses, primarily related to spending on our research and development programs. We have financed our net operating losses primarily through equity financings and amounts received under collaborative agreements.

We will need regulatory approval to market and sell our products. Our product candidates are at various stages of development and will require significant further research, development and testing and some may never be successfully developed or commercialized. We may experience uncertainties, delays, difficulties and expenses commonly experienced by early stage biopharmaceutical companies, which may include unanticipated problems and additional costs relating to:

the development and testing of products in animals and humans;

product approval or clearance;

regulatory compliance;

good manufacturing practices;

intellectual property rights;

product introduction; and

marketing, sales and competition.

Failure to obtain timely regulatory approval for our product candidates and indications would impact our ability to increase revenues and could make it more difficult to attract investment capital for funding our operations. Any of these possibilities could materially and adversely affect our operations.

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During the six months ended December 31, 2007, we used \$10.8 million of cash for our operating activities, compared to \$14.8 million used in the six months ended December 31, 2006. Lower net cash outflows from operations in the 2007 period resulted primarily from lower operating expenses. Our periodic accounts receivable balances will continue to be highly dependent on the timing of such receipts and the division of development responsibilities between us and our collaboration partners.

During the six months ended December 31, 2007, net cash used in investing activities amounted to \$0.2 million for the acquisition of capital equipment compared to \$0.4 million used during the six months ended December 31, 2006.

We have incurred cumulative negative cash flows from operations since our inception, and have expended, and expect to continue to expend in the future, substantial funds to complete our planned product development efforts. We believe that our cash, cash equivalents and available-for-sale investments as of December 31, 2007, together with expected receipts from collaboration and license agreements and other income, will be adequate to fund the Company's operations for at least the next twelve months. No assurance can be given that we will earn future milestone payments that are contingent on specified events or that we will not consume a significant amount of our available resources before that time. We plan to continue to monitor the progress of our development programs and the timing and amount of related expenditures and potential milestone receipts, refine our operations, control expenses, evaluate alternative methods to conduct our business and seek additional financing and sharing of development costs through strategic collaboration agreements or other resources.

We are actively searching for certain products and technologies to license or acquire, now or in the future, and expect to continue to do so. If we are successful in identifying a product or technology for acquisition, we may require substantial funds for such an acquisition and subsequent development or commercialization. We do not know whether any acquisition will be consummated in the future or whether we will be able to obtain additional funding if such an acquisition is identified.

Our license agreement related to NeutroSpec requires royalty payments by us based on commercial net sales and payments of up to \$2.25 million contingent on the achievement of specified cumulative net margins on sales by Mallinckrodt. No contingent amounts will be payable related to NeutroSpec unless sales and marketing of NeutroSpec recommence. We do not reasonably expect to make any such contingent payments during the next twelve months.

We anticipate incurring additional losses over at least the next few years. To achieve profitability, we, alone or with others, must successfully develop and commercialize our technologies and proposed products, conduct pre-clinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture and market such technologies and proposed products. The time required to reach profitability is highly uncertain, and we do not know whether we will be able to achieve profitability on a sustained basis, if at all.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

*Interest Rate Risk.* Our exposure to market risk from changes in interest rates relates primarily to our cash, cash equivalents and available-for-sale investments (collectively referred to as our investment portfolio). As of December 31, 2007, our cash and cash equivalents were \$20.4 million and investments, which consisted of mutual funds, were \$2.4 million. Due to the average maturity of our investment portfolio, we do not believe that short term fluctuations in interest rates would materially affect the value of it.

**Item 4. Controls and Procedures.**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e), as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

As discussed in our annual report on Form 10-K for our fiscal year ended June 30, 2007, we were the respondent in an arbitration proceeding before the American Arbitration Association initiated by CTI alleging breach of the terms of our license agreement for patent rights related to certain compounds and methods of treatment for sexual dysfunction and other actions asserted to arise out of the license agreement, and were also the defendant in a suit filed by CTI in Connecticut Superior Court asserting, among other claims, breach of the settlement agreement of an earlier arbitration between CTI and us. On January 21, 2008, we entered into a settlement agreement and release with CTI, resolving all outstanding disputes between us. The arbitration proceeding and the Connecticut Superior Court proceeding have been dismissed with prejudice. The existing license agreement between CTI and us has been terminated. CTI retains all rights to a peptide called variously MT-II or PT-14, which peptide was developed at the University of Arizona, and we expressly relinquished all claims to any contractual or intellectual property rights to that peptide or any patents licensed under the terminated license agreement. We retain all rights to bremelanotide, and CTI expressly relinquished all claims to any contractual or intellectual property rights to bremelanotide, including any claim that making, using or selling bremelanotide infringes any patents licensed under the terminated license agreement. We ceased developing the peptide called MT-II or PT-14 in 2000. The settlement agreement and release also includes mutual covenants not to sue and releases of all claims by either party against the other based on, arising out of or in any way involving the subject matter of the license agreement, the arbitration or the Connecticut Superior Court proceeding. We remitted a one-time payment of \$800,000 to CTI pursuant to the settlement; there are no obligations for any future payments to CTI with respect to bremelanotide or any other matter.

**Item 1A. Risk Factors.**

There have been no material changes in our risk factors disclosed in our annual report on Form 10-K for the fiscal year ended June 30, 2007 in Item 1A., Part I of such Form 10-K, with the exception of the following:

**Stockholders may experience dilution from the exercise of outstanding options and warrants and the vesting of restricted stock units.**

As of December 31, 2007, options and warrants to purchase 13,471,915 shares of common stock were outstanding at various exercise prices ranging from \$0.26 per share to \$6.50 per share, 1,503,529 shares were issuable under restricted stock units granted to our employees that will vest if the employee remains employed with Palatin through September 30, 2008 or earlier under certain conditions, and 975,000 shares were issuable under restricted stock units that will vest if shares of our common stock trade at certain share prices. The issuance or potential issuance of common stock upon the exercise of these options and warrants and vesting of restricted stock units may adversely affect the market price of our common stock and result in substantial dilution to our existing stockholders.

**Our stock price is, and we expect it to remain, volatile, which could limit investors' ability to sell stock at a profit.**

The volatile price of our stock makes it difficult for investors to predict the value of their investment, to sell shares at a profit at any given time, or to plan purchases and sales in advance. A variety of factors may affect the market price of our common stock. These include, but are not limited to:

publicity regarding actual or potential clinical results relating to products under development by our competitors or us;

delay or failure in initiating, completing or analyzing pre-clinical or clinical trials or unsatisfactory designs or results of these trials;

interim decisions by regulatory agencies, including the FDA, as to clinical trial designs, acceptable safety profiles, and the benefit/risk ratio of products under development;

achievement or rejection of regulatory approvals by our competitors or by us;

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

developments concerning proprietary rights, including patents;

developments concerning our collaborations;

regulatory developments in the U.S. and foreign countries;

economic or other crises and other external factors;

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period-to-period fluctuations in our revenue and other results of operations;

changes in financial estimates by securities analysts; and

sales of our common stock.

We will not be able to control many of these factors, and we believe that period-to-period comparisons of our financial results will not necessarily be indicative of our future performance. If our revenues, if any, in any particular period do not meet expectations, we may not be able to adjust our expenditures in that period, which could cause our operating results to suffer further. If our operating results in any future period fall below the expectations of securities analysts or investors, our stock price may fall by a significant amount.

For the six months ended December 31, 2007, the price of our stock has been extremely volatile, ranging from a high of \$2.09 per share to a low of \$0.19 per share. The volatility in our stock price related primarily to our announcement that we delayed initiation of Phase 3 clinical trials of bremelanotide for ED, following responses in late August 2007 from the FDA raising serious concerns about the acceptable benefit/risk ratio to support progression into Phase 3 as a first-line therapy in the general population.

In addition, the stock market in general, and the market for biotechnology companies in particular, has experienced extreme price and volume fluctuations that may have been unrelated or disproportionate to the operating performance of individual companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our operating performance.

The American Stock Exchange and other national stock exchanges maintain standards for initial and continued listing of shares for trading. These standards include requirements for minimum per share stock prices, aggregate market values of shares outstanding, minimum stockholders' equity and related factors. We are listed on the American Stock Exchange, and continue to meet standards for continued listing. If we are unable to meet these requirements and are delisted, the ability of investors to buy or sell our shares will be restricted, in which case the market value of our common stock and our ability to obtain additional financing on acceptable terms may be adversely affected.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

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

At our annual meeting of stockholders, which convened on December 7, 2007, the stockholders voted on the following issues:

Election of directors;

Ratification of the appointment of our independent registered public accounting firm for the fiscal year ending June 30, 2008; and

Approval of the 2005 Stock Plan amendment to increase the shares of common stock available for issuance from 5,000,000 to 10,000,000.

Common stock and Series A convertible preferred stock voted as a single class on all matters. The following tables show the votes cast. All directors identified below were re-elected and their term of office continues after the meeting.

<u>Election of directors:</u>	<u>For</u>	<u>Withheld</u>	
Carl Spana, Ph.D.	67,516,203	3,565,175	
John K.A. Prendergast, Ph.D.	67,817,647	3,263,731	
Perry B. Molinoff, M.D.	67,742,322	3,339,056	
Robert K. deVeer, Jr.	67,779,393	3,301,985	
Zola P. Horovitz, Ph.D.	63,748,963	7,332,415	
Robert I. Taber, Ph.D.	67,811,837	3,269,541	
Errol De Souza, Ph.D.	67,832,662	3,248,716	
J. Stanley Hull	67,806,119	3,275,259	

  

<u>Other</u>	<u>For</u>	<u>Against</u>	<u>Abstain</u>
Ratification of independent registered public accounting firm	69,877,041	1,081,532	122,805
Approval of the 2005 Stock Plan amendment	21,682,884	2,517,953	120,956

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

Exhibits filed with this report:

- 3.1 Bylaws, as amended effective December 14, 2007. \*
- 10.1 First Amendment to the Employment Agreement dated as of July 1, 2007 Between Palatin and Carl Spana. \*
- 10.2 First Amendment to the Employment Agreement dated as of July 1, 2007 Between Palatin and Stephen T. Wills. \*

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- 10.3 First Amendment to the Employment Agreement dated as of July 1, 2007 Between Palatin and Trevor Hallam. \*
- 10.4 Palatin Technologies, Inc. 2007 Change in Control Severance Plan. \*
- 10.5 2005 Stock Plan, as amended effective December 7, 2007. Incorporated by reference to Exhibit 4 of our registration statement on Form S-8, Commission File No. 333-149093, filed with the SEC on February 7, 2008.
- 31.1 Certification of Chief Executive Officer. \*
- 31.2 Certification of Chief Financial Officer. \*
- 32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002. \*

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32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002. \*

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\* Exhibit filed with this report.  
Management contract or compensatory plan or arrangement.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Palatin Technologies, Inc.**  
(Registrant)

Date: February 8, 2008

/s/ Carl Spana  
Carl Spana, Ph.D.  
President and  
Chief Executive Officer

Date: February 8, 2008

/s/ Stephen T. Wills  
Stephen T. Wills  
Executive Vice President and  
Chief Financial Officer (Principal  
Financial and Accounting Officer)

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