VioQuest Pharmaceuticals, Inc.
Form 10KSB/A
July 28, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1 to
FORM 10-KSB/A

x Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004

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 0-16686

VIOQUEST PHARMACEUTICALS, INC.

(Exact name of issuer as specified in its charter)

Minnesota	58-1486040
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
7 Deer Park Drive, Suite E, Monmouth Junction, NJ	08852
(Address of Principal Executive Offices)	(Zip Code)

(732) 274-0399

(Issuer's telephone number)

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

None

Securities registered pursuant to Section 12(g) of the Exchange Act:
Common Stock, $.01 par value

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and no disclosure will 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-KSB or any amendment to this Form 10-KSB. o

The issuer's revenues for the fiscal year ended December 31, 2004 were $1,485,148.

The aggregate market value of the voting common stock of the issuer held by non-affiliates of the issuer on March 14, 2005 based on the $.90 closing price of the common stock as quoted by the NASD Over-the-Counter Bulletin Board on such date was $10,220,443.

As of March 14, 2005 there were 17,827,924 outstanding shares of common stock, par value $.01 per share.

Transitional Small Business Disclosure Format: Yes o No x

References to the "Company," the "Registrant,""we,""us,""our" or in this Annual Report on Form 10-KSB refer to VioQuest Pharmaceuticals, Inc., formerly Chiral Quest, Inc., a Minnesota corporation, and our consolidated subsidiaries, together taken as a whole, unless the context indicates otherwise.

EXPLANATORY NOTE

This Amendment No. 1 to the Company's Annual Report on Form 10-KSB/A for the year ended December 31, 2004, which amends the Company's Form 10-KSB originally filed on March 31, 2005, is being filed solely to amend Items 6 and 7 in response to comments received from the staff of the Securities and Exchange Commission in connection with its review of such report. This Form 10-KSB/A does not reflect events occurring after the filing of the original Form 10-KSB filed on March 31, 2005. The filing of this Form 10-KSB/A shall not be deemed an admission that the original filing, when made, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

Forward-Looking Statements

This Annual Report on Form 10-KSB contains statements that are not historical but are forward-looking in nature, including statements regarding our current expectations, beliefs, intentions or strategies regarding the future. In particular, the "Risk Factors" section following Item 1 in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004, which was filed on March 31, 2005, and the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section in Item 6 of this annual report include forward-looking statements that reflect our current views with respect to future events and financial performance. We use words such as we "expect,""anticipate,""believe," and "intend" and similar expressions to identify forward-looking statements. Investors should be aware that actual results may differ materially from our expressed expectations because of risks and uncertainties inherent in future events, particularly those risks identified in the subsection entitled "Risk Factors" following Item 1 in the Company's Annual Report on Form 10-KSB filed on March 31, 2005, and should not unduly rely on these forward looking statements.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OR PLAN OF OPERATIONS.

Overview

Since our inception in October 2000, we have focused our efforts and resources on the development of asymmetric catalysis technology, our primary intellectual property to which we hold an exclusive worldwide license from the Pennsylvania State Research Foundation ("PSRF"), the technology development arm of the Pennsylvania State University ("Penn State"). Our license from PSRF covers certain inventions discovered by our Chief Technology Officer ("CTO") prior to November 8, 2002.

In August 2004, the Company restructured operations by contributing all of its operating assets relating to its asymmetric catalysis business, which has been its historical business since inception, to its wholly- owned subsidiary, CQ Acquisition, Inc., which was subsequently renamed Chiral Quest, Inc. In addition, the Company changed its name to VioQuest Pharmaceuticals, Inc. and formed a new wholly-owned subsidiary, called VioQuest Drug Development, Inc. As a result, we have two subsidiaries - VioQuest Drug Development, Inc., which was created for the purpose of acquiring, developing and eventually commercializing human therapeutics, and Chiral Quest, Inc., which continues our historical business of providing chiral products, technology and services to the pharmaceutical and fine chemical industries. The Company develops chemical catalysts and other products used in the synthesis of desired isomers of chiral molecules.

Since inception we have incurred a cumulative deficit of $7,434,763 through December 31, 2004. We expect our operating losses to increase over the next several years, primarily due to expansion of our research and development programs, the hiring of additional chemists, and the expansion of our manufacturing capabilities.

The accompanying financial statements have been prepared assuming that we will continue as a going concern. We have had a net loss of $7,434,763 since inception, and cash used in operating activities totaled $3,786,173 in 2004. These matters raise doubt about our ability to continue as a going concern. Management's plan in regards to these matters is described in the Notes to the Financial Statements.

Our ability to achieve profitability depends upon, among other things, our ability to discover and develop products (specifically new "ligands"), and to develop our products on a commercial scale through a cost effective and efficient process. To the extent that we are unable to produce, directly or indirectly, ligands in quantities required for commercial use, we will not realize any significant revenues from our technology. Moreover, there can be no assurance that we will ever achieve significant revenues or profitable operations from the sale of any of our products or technologies. Risks associated with our business are more thoroughly addressed in the section entitled "Risk Factors."

Since our inception, we have generated sales revenue but not yet generated any net profits. Our management believes that our research and development ("R&D") and manufacturing capacity will need to grow in order for us to be able to obtain significant licensing and manufacturing agreements with large fine chemical and pharmaceutical companies. We believe that our manufacturing capacity will be enhanced with our new office and laboratory space located in Monmouth Junction, New Jersey that was leased in June 2003, in addition to the laboratory space acquired in October 2004, located in Jiashan, China.

On February 18, 2003, we acquired Surg II, Inc., a Minnesota corporation ("Surg"), in a reverse merger transaction (the "Merger"). Pursuant to the terms of the Merger, Chiral Quest, LLC merged with and into a wholly-owned subsidiary of Surg. In exchange for all of the outstanding membership interests of Chiral Quest, LLC, Surg issued to the former member of Chiral Quest, LLC a number of shares of Surg's common stock that resulted in the members of Chiral Quest, LLC owning two-thirds of Surg's outstanding shares following the Merger. In connection with the Merger, Surg changed its name to Chiral Quest, Inc., and adopted the business plan of Chiral Quest, LLC. Accordingly, when we refer to our business or financial information relating to periods prior to the Merger, we are referring to the business and financial information of Chiral Quest, LLC, unless the context indicates otherwise.

Results of Operations - Years Ended December 31, 2004 vs. 2003

Our revenues for the year ended December 31, 2004 were $1,485,148 as compared to $669,036 for the year ended December 31, 2003. For the year ended December 31, 2004, approximately 8% of total revenue was derived from the amortization of option fee income pertaining to the licensing of our intellectual property and 92% of total revenue was derived from customized process development services sold to third parties- (accounting for 47% of total 2004 revenue), sales of our catalysts and ligands (34% of total 2004 revenue), and feasibility screening reports provided to clients (11% of total 2004 revenue). The overall increase in 2004 revenue is attributable primarily from a 75% increase from 2003 revenue from contracts for customized process development services. In addition, the increase in 2004 revenues is also attributable to our selling and production capabilities transitioning from an academic Research and Development sales volume level, to a commercial sales volume quantity level for its ligands, catalysts, and customized process development services. As a result, revenue from sales of catalysts and ligands increased five fold from 2003 because we were able to sell greater quantities and a wider variety of our proprietary ligands and catalysts to an expanded customer base that more than doubled in 2004 compared to 2003. Revenue from feasibility screening in 2004 also increased three fold from 2003 levels. We anticipate that sales of our proprietary ligands and catalysts and customized process development services will continue to comprise a greater percentage of our revenues in the future as we expand our manufacturing capabilities.

Our gross profit decreased for the year ended December 31, 2004, as compared to December 31, 2003, as a result of our 2004 revenues being significantly derived from the sale of ligands and catalysts products and services versus a greater percentage of revenues derived from option fee income pertaining to a license agreement for the fiscal year ended 2003. For the year ended December 31, 2003, approximately 20% of total revenue was derived from the amortization of option fee income and 80% of total revenue was comprised of sales or our ligands.

Cost of goods sold for the year ended December 31, 2004 was $837,653 as compared to $196,045 during the year ended December 31, 2003. The increase of cost of goods sold is attributed to increased sales, associated manufacturing costs of scaling operations to a commercialized level, in addition to the allocation of direct labor and overhead expenses to finished goods. These expenses were allocated from compensation and rent expenses as part of overall general operating expenses.

Management and consulting expenses for the year ended December 31, 2004 were $626,709 as compared to $361,622 during the year ended December 31, 2003. The overall increase in 2004 from 2003 was primarily caused by an increase in consulting expense. Consulting expense increased due to the consultant agreement entered with our CTO, which required us to make payments to our CTO of $10,000 per month effective May 15, 2003. Management and consulting expense also increased as a result of consulting fees paid to our Scientific Advisory Board members for services provided during 2004. In addition, consulting expense increased from the amortization of stock options issued to consultants, Scientific Advisory Board members, during the second, third and fourth quarters of 2003.

Our Research and Development ("R&D") expenses for the year ended December 31, 2004 were $1,526,561 as compared to $639,426 during the year ended December 31, 2003. This increase resulted primarily from the R&D costs associated to preparing and analyzing several test pilot programs of our proprietary technology related to the

Company's developmental manufacturing processes and commercial scale up capabilities to satisfy manufacturing requirements. The R&D costs include the sponsoring of four post doctorates at Penn State to develop reports on our technological feasibility of our proprietary technology in addition to preparing sample batches for analysis in the Princeton, NJ office. Also included in R&D are the purchases of additional laboratory materials and supplies such as chemicals, solvents, glassware used as part of the facility's test pilot programs used for the formulation and analyzing of our proprietary products during 2004 to determine their technological feasibility and to further develop and enhance our R&D processes to determine the Company's manufacturing capabilities. The agreement with Penn State required us to fund services of four post-doctorate fellows who, under the supervision of the CTO, conduct research and provide research quantities of chiral ligands to us. This agreement has been extended to April 14, 2005. The approximate obligation payable by us for the remaining period from January 1, 2005 through the end of the agreement dated April 14, 2005 is approximately $98,000. From October 2002 through December 31, 2004, the Company has paid and incurred expenses of approximately $596,000 pursuant to the agreement. This amount consists principally of four post-doctorate salaries, fringe benefits, materials and supplies for the stated period. In addition, during the first and second quarters of 2004, we expanded our laboratory facility in New Jersey, which enabled us to commercialize our proprietary ligands and catalysts. In connection with the facility's expansion, numerous lab supplies and chemicals were purchased. Accordingly, we incurred significant R&D expenses in the first and second quarters due to the laboratory expansions of the New Jersey facility, along with the increased costs of using the facility and chemists at Penn State.

Selling, general and administrative ("SG&A") expenses for the year ended December 31, 2004 were $2,377,021 as compared to $1,415,182 during the year ended December 31, 2003. This increase in SG&A expenses was due in part by the resignation of our CEO in April 2004, of which we incurred $375,000 in severance costs in 2004. In addition, SG&A increased due to the hiring of several laboratory chemists to work at the newly expanded laboratory facility in New Jersey. SG&A also increased as a result of the reporting obligations as a public company, increased rent expense for the New Jersey facility, additional spending on advertising and promotion expenses, increased travel expenses for new business development opportunities and higher administrative expenses associated with having more employees such as insurance and employer payroll taxes.

Depreciation and amortization expenses for the year ended December 31, 2004 were $179,034 as compared to $86,325 during the year ended December 31, 2003. This increase was primarily related to fixed asset purchases for office equipment, computer equipment, laboratory equipment and leasehold improvements for the newly expanded leased facility in New Jersey.

Interest expense for the year ended December 31, 2004 was $0 as compared to $2,809 during the year ended December 31, 2003. The interest expense for the year ended December 31, 2003 is attributed to the promissory notes issued between July 2002 through February 2003 owed to a related party, which were fully paid and discharged in February 2003.

Interest income for the year ended December 31, 2004 was $38,272 as compared to $13,973 during the year ended December 31, 2003. The increase in interest income was caused by significantly higher cash reserves obtained after private placement of our common stock during February 2004.

Our net loss for the year ended December 31, 2004 was $4,023,558 as compared to $2,018,400 for the year ended December 31, 2003. The increased net loss in 2004 from 2003 was primarily due to increased SG&A expense from severance compensation to our former CEO and the hiring of additional personnel, together with increased R&D expense incurred as a result of the commercial scale up of our proprietary catalysts and ligands, as well as increased legal and accounting expenses associated with the private placement of our common stock, and expenses in reporting as a public company. We expect losses to continue and increase in the next year as we expand our laboratory space in China, purchase more chemicals and raw material compounds, and hire additional employees.

Results of Operations - Years Ended December 31, 2003 vs. 2002

Our revenues for the year ended December 31, 2003 were $669,036 as compared to $191,613 for the year ended December 31, 2002. The increase from fiscal 2002 can be attributed to sales resulting from our proprietary catalyst and ligand technology, contract research development and feasibility screening services provided. For the year ended December 31, 2003 approximately 80% of total revenue was derived from sales of our ligands, feasibility screening and customized process development services sold to third parties and 20% of total revenue was derived from the amortization of option fee income pertaining to the licensing of our intellectual property. For the year ended December 31, 2002, approximately 85% of total revenue was derived from the amortization of option fee income and 15% of total revenue was comprised of sales or our ligands. Revenues are comprised of our proprietary technology ligands and catalysts, contract research development, feasibility screening in addition to licensing of PSRF’s technology. We assume the financial risks related to these revenues by financing the research and development of PSRF’s technology as well as the defense of PSRF’s patents. It is anticipated that sales of our ligands, molecular building blocks and customized chiral services will continue to comprise a greater percentage of our revenues in the future as we expand our manufacturing capabilities.

Cost of goods sold for the year ended December 31, 2003 was $196,045 as compared to $6,763 during the year ended December 31, 2002. The increase of cost of goods sold is attributed to allocating material costs to specific projects as part of finished goods during the year ended December 31, 2003, as compared to primarily expensing materials, laboratory chemicals and supplies as part of operating expenses during the year ended December 31, 2002.

Management and consulting expense fees for the year ended December 31, 2003 were $361,622 as compared to $231,424 during the year ended December 31, 2002. The overall change for the years ended December 2003 vs. 2002 was primarily caused by a consulting agreement entered with our CTO at a rate of $10,000 per month effective May 15, 2003.

Our R&D expenses for the year ended December 31, 2003 were $639,426 as compared to $63,728 during the year ended December 31, 2002. This change was primarily caused by the Company sponsoring four post doctorates at Penn

State University to perform research analysis related to the Company's proprietary technology in addition to hiring several chemists during the year ended 2003, in addition to the increased laboratory supplies and chemicals purchased during the year ended 2003 in connection with the development and testing the feasibility of its new proprietary products of ligands and catalysts.

SG&A expenses for the year ended December 31, 2003 were $1,415,182 as compared to $193,449 during the year ended December 31, 2002. SG&A expenses increased due in part to the hiring of a vice president of business development, controller and additional chemists to work at our New Jersey office and laboratory facility. SG&A expenses also increased as a result of higher legal and accounting fees associated with our reporting obligations as a public company, increased rent expense for the New Jersey facility, additional spending on advertising and promotion expenses, increased travel expenses for new business development opportunities and higher administrative expenses associated with having more employees such as insurance and employer payroll taxes.

Depreciation and amortization expenses for the year ended December 31, 2003 were $86,325 as compared to $36,631 during the year ended December 31, 2002. This increase was primarily related to fixed asset purchases for office equipment, computer equipment, and laboratory equipment, for our newly leased facility in New Jersey during May 2003.

Interest expense for the year ended December 31, 2003 was $2,809 as compared to $0 during the year ended December 31, 2002. The interest expense for the year ended December 31, 2003 is attributed to the promissory notes issued between July 2002 through February 2003 owed to a related party, which were fully paid and discharged in February 2003.

Interest income for the year ended December 31, 2003 was $13,973 as compared to $0 during the year ended December 31, 2002. The increase in interest income in 2003 was caused by higher cash reserves as a result of the proceeds received from the reverse merger with Surg II, Inc. completed in February 2003.

Our net loss for the year ended December 31, 2003 was $2,018,400 as compared to $537,978 for the year ended December 31, 2002. The higher loss for the year ended December 31, 2003 as compared to December 31, 2002 was primarily due to higher R&D expenses incurred with the purchases of laboratory supplies and chemicals, management and consulting fees, in addition to the leasehold improvement related to the newly leased facility in New Jersey as of May 2003.

Liquidity and Capital Resources

As of December 31, 2004, we had working capital of $2,721,707 and cash and cash equivalents of $3,065,547. The Company will be unable to continue as a going concern unless we are able to significantly increase our revenues or obtain additional financing. We will most likely require additional financing by the end of the second quarter of 2005 in order to continue operations. The most likely source of such financing includes private placements of our equity or debt securities or bridge loans to us from third party lenders.

Our net cash used in operating activities for the year ended 2004 was $3,786,173 and our net loss of $4,023,558 was offset by amortization of deferred expenses of $296,385, deferred revenue of $304,134, and depreciation and amortization of $179,034. The Company received prepayments from customers during 2004, which are classified as deferred revenue, as agreed upon by customers' signed purchase order contracts, and has provided early funding for the Company to purchase raw materials for goods and services ordered. Operating activities also included increases in accounts receivable of $266,880 and inventory of $283,255. Net cash used in the Company's operating activities as a result of the Company's net loss, also include additional employees hired during 2004, primarily chemists, in addition to purchases for laboratory supplies, and chemicals used for the manufacturing scale up related to the Company's production capabilities transitioning from an academic sales volume, to a commercial sales volume level.

Our net cash used in investing activities for the year ended 2004 was $549,029. Investing activities expenditures consisted of purchases of property and equipment of $356,548 which was attributed to the laboratory expansions during the second and third quarters of 2004, and payments for increased patent filings of intellectual property rights of $192,481.

Our net cash provided by financing activities for the year ended 2004 was $6,741,632. Financing activities consisted of cash received as a result of a February 2004 private placement of approximately 4.8 million shares of our common stock at a price per share of $1.50, and 5-year warrants to purchase one share of common stock at $1.65 per share for every two common shares purchased in the offering.

Our working capital requirements will depend upon numerous factors, including without limitation the progress of our R&D programs, the resources we devote to developing manufacturing and marketing capabilities, technological advances, the status of competitors, and our ability to establish sales arrangements with new customers. Working capital will also be affected by the China facility expansion of office and laboratory space lease agreements that were entered into during 2004, along with the hiring of additional employees. Our management believes that by opening a facility in China to produce non-proprietary chemical building blocks and related compounds, we will be able to significantly decrease our manufacturing costs and expenses, which will enable us to cost-effectively produce our ligands and end products and make our products substantially more competitive and even more attractive to current and potential customers. We expect operations to commence on a limited basis by April 2005.

Our working capital requirements will also be substantially impacted by the costs associated with the company's drug development process. These costs of acquiring, developing and eventually commercializing human therapeutics in the

areas of oncology, metabolic and inflammatory diseases and disorders that are current unmet medical needs will significantly impact our working capital based upon milestone payments, license fees and manufacturing costs. Upon acquiring a drug candidate, we will need substantial additional capital to fund the activities necessary to develop and eventually gain regulatory approval to sell the drug.

Critical Accounting Policies and Estimates

Impairment of Intellectual Property Rights

The Company evaluates the recoverability of its long-lived assets, where indicators of impairment are present, by reviewing current and projected profitability or undiscounted cash flows of such assets. Intangible assets that are subject to amortization are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. Intangible assets not subject to amortization are tested for impairment at least annually. For the years ended December 31, 2004 and 2003, the Company determined that impairment to its long-lived assets did not occur. Accordingly, no impairment loss was recorded for the years ended December 31, 2004 and 2003. Management has determined based upon the useful lives of its intellectual property rights the future economic benefits exceed their carrying costs.

Revenue Recognition

Revenues are comprised principally of four main components: (1) the licensing of PSRF's technology, (2) the sale of proprietary ligands and catalysts, (3) feasibility screening, and (4) custom contract development. Revenues as they relate to the licensing of the Company's rights to PSRF's intellectual property are recognized upon over the applicable license periods. In determining net revenues, the Company recognizes revenues based upon shipments and the invoicing of its products and services. Accordingly, the Company does not have a sales allowance, sales discount or sales returns reserve policy in place and, accordingly, does not make any material judgments or estimates relating to net revenues. For the year ended December 31, 2004, approximately 8% of total revenue was derived from the amortization of option fee income pertaining to the licensing of our intellectual property and 92% of total revenue was derived from customized process development services sold to third parties, sales of our catalysts and ligands, and feasibility screening reports provided to clients. For the year ended December 31, 2003 approximately 80% of total revenue was derived from sales of our ligands, feasibility screening and customized process development services sold to third parties and 20% of total revenue was derived from the amortization of option fee income pertaining to the licensing of our intellectual property. For the year ended December 31, 2002, approximately 85% of total revenue was derived from the amortization of option fee income and 15% of total revenue was comprised of sales or our ligands. The Company assumes the financial risks related to these revenues by financing the research and development of PSRF's technology as well as the defense of PSRF's patents. Deferred revenue in the accompanying consolidated balance sheets represents amounts prepaid by customers to the Company for services to be performed and products to be delivered at a subsequent date. These deferred amounts will be recognized as revenue when earned. Revenues as they relate to the sale of manufactured proprietary ligands and catalysts are recognized upon the shipment of the ligands to the customer. Revenues as they relate to feasibility screening are recognized upon the completion of project reports and investigational studies. Revenues as they relate to custom contract development are recognized upon the shipment of finished products.

Accounting for Stock-Based Compensation

The Company accounts for its employee and director stock option plans in accordance with APB 25, "Accounting For Stock Issued To Employees," and related interpretations. The Company measures compensation expense for employee and director stock options as the aggregate difference between the market value of its common stock and exercise prices of the options on the date that both the number of shares the grantee is entitled to receive and the exercise prices are known. Compensation expense associated with restricted stock grants is equal to the market value of the shares on the date of grant and is recorded pro rata over vesting period. Management has determined the estimates used for the volatility, and criteria in the Black-Scholes calculation for accounting for stock-based compensation are deemed to be reasonably accurate and the approach to estimating stock-based compensation will not materially change in the future.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

Recently Issued Accounting Standards

In July 2002, the FASB issued SFAS No. 146, "Accounting for Restructuring Costs." SFAS No. 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts and relocating plant facilities or personnel. Under SFAS No. 146, the Company will record a liability for a cost associated with an exit or disposal activity when that liability is incurred and can be measured at fair value. SFAS No. 146 will require the Company to disclose information about its exit and disposal activities, the related costs, and changes in those costs in the notes to the interim and annual financial statements that include the period in which an exit activity is initiated and in any subsequent period until the activity is completed. SFAS No. 146 is effective prospectively for exit or disposal

activities initiated after December 31, 2002, with earlier adoption encouraged. Under SFAS No. 146, a company cannot restate its previously issued financial statements and the new statement grandfathers the accounting for liabilities that a company had previously recorded under Emerging Issues Task Force Issue 94-3.

In May 2003, the FASB issued SFAS No. 150, “Accounting For Certain Financial Instruments with Characteristics of both Liabilities and Equity.” SFAS No. 150 changes the accounting for certain financial instruments with characteristics of both liabilities and equity that, under previous pronouncements, issuers could account for as equity. The new accounting guidance contained in SFAS No. 150 requires that those instruments be classified as liabilities in the balance sheet.

SFAS No. 150 affects the issuer’s accounting for three types of freestanding financial instruments. One type is mandatorily redeemable shares, which the issuing company is obligated to buy back in exchange for cash or other assets. A second type includes put options and forward purchase contracts, which involves instruments that do or may require the issuer to buy back some of its shares in exchange for cash or other assets. The third type of instruments that are liabilities under SFAS No. 150 are obligations that can be settled with shares, the monetary value of which is fixed, tied solely or predominantly to a variable such as a market index, or varies inversely with the value of the issuers’ shares. SFAS No. 150 does not apply to features embedded in a financial instrument that is not a derivative in its entirety.

Most of the provisions of SFAS No. 150 are consistent with the existing definition of liabilities in FASB Concepts Statement No. 6, “Elements of Financial Statements.” The remaining provisions of SFAS No. 150 are consistent with the FASB’s proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own shares. SFAS No. 150 shall be effective for financial instruments entered into or modified after May 31, 2003 and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003.

In December 2003, the FASB issued revised FIN 46R, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51." ("FIN 46R"). FIN 46R required the consolidation of an entity in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity (variable interest entities, or "VIEs"). Currently, entities are generally consolidated by an enterprise when it has a controlling financial interest through ownership or a majority voting interest in the entity. FIN 46R is applicable for financial statements of public entities that have interests in VIEs or potential VIEs refereed to as special-purpose entities for periods ending after December 31, 2003. Applications by public entities for all other types of entities are required in financial statements for periods ending after March 15, 2004.

In December 2004, the FASB issued SFAS No. 123R "Accounting for Stock-Based Compensation." SFAS 123R establishes standards for the accounting for transactions in which, an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123R requires that the fair value of such equity instruments, including employee stock options, be recognized as an expense in the historical financial statements as services are performed. Prior to SFAS 123R, only certain pro forma disclosures of fair value were required. SFAS 123R shall be effective for the Company as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The Company is evaluating the impact of this pronouncement and its affects on our financial statements.

ITEM 7. CONSOLIDATED FINANCIAL STATEMENTS

For a list of the consolidated financial statements filed as part of this report, see the Index to Consolidated Financial Statements beginning at Page F-1 of this annual report.

ITEM 13. EXHIBITS

Exhibit No.	Description
2.1	Merger Agreement dated November 12, 2002, by and among the Registrant, CQ Acquisition, Inc. and Chiral Quest, LLC (incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K filed November 27, 2002).
3.1	Articles of Incorporation, as amended to date (incorporated by reference to Exhibit 3.1 of Registrant's Annual Report in Form 10-KSB for the year ended December 31, 2004).
3.2	Bylaws, as amended to date (incorporated by reference to Exhibit 3.2 of Registrant's Annual Report on Form 10-KSB for the year ended December 31, 2003).
4.1	Common Stock Purchase Warrant dated as of February 18, 2003 issued to Key West Associates, LLC (incorporated by reference to Exhibit 4.1 to the Registrant's Form 10-QSB for the period ended March 31, 2003).
4.2	Option Agreement No. LL-1 dated May 6 , 2003 issued to Princeton Corporate Plaza, LLC. (incorporated by reference to Exhibit 4.1 to the Registrant's Form 10-QSB for the period ended June 30, 2003).
4.3	Form of Option Agreement dated May 6 , 2003 issued to Princeton Corporate Plaza, LLC (incorporated by reference to Exhibit 4.2 to the Registrant's Form 10-QSB for the period ended June 30, 2003).
4.4	Schedule of Options substantially identical to Exhibit 4.3 (incorporated by reference to Exhibit 4.3 to the Registrant's Form 10-QSB for the period ended June 30, 2003).
4.5	Form of Common Stock Purchase Warrant issued in connection with February 2004 private placement (incorporated by reference to the Registrant's Form SB-2 filed March 26, 2004 (File No. 333-113980)).
10.1	License Agreement dated on or about October 27, 2000, as amended, between Chiral Quest, LLC and The Penn State Research Foundation (incorporated by reference to Exhibit 10.2 to the Registrant's Form

10-QSB for the period ended March 31, 2003).

10.2 Consulting Agreement dated May 15, 2003 between the Registrant and Xumu Zhang, Ph.D. (incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-QSB for the period ended June 30, 2003).

10.3 2003 Stock Option Plan (incorporated by reference to Exhibit 10.4 to the Registrant's Form 10-KSB for the year ended December 31, 2003).

10.4 Separation Agreement dated April 2, 2004 between the Registrant and Alan D. Roth (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on April 19, 2004).

10.5 Employment Agreement dated October 6, 2003 between the Company and Ronald Brandt (incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-QSB for the period ended June 30, 2004).
10.6 Employment Agreement dated February 1, 2005 between the Company and Daniel Greenleaf (as previously filed).

16.1 Letter regarding change in independent accountants (incorporated by reference to Exhibit 16.1 to the Registrant's Form 8-K/A filed January 5, 2004).
16.2 Letter regarding change in independent accountants (incorporated by reference to Exhibit 16.1 to the Registrant's Form 8-K filed April 25, 2003).
31.1 Certification of Chief Executive Officer
31.2 Certification of Chief Financial Officer.
32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act, VioQuest Pharmaceuticals, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on July 27, 2005.

VioQuest Pharamceuticals, Inc.

By: /s/ Daniel Greenleaf

Daniel Greenleaf
President & Chief Executive Officer

In accordance with the Securities Exchange Act, this report has been signed below by the following persons on behalf of VioQuest Pharmaceuticals, Inc. and in the capacities and on the dates indicated.

Signature	**Title**	**Date**
/s/ Daniel Greenleaf Daniel Greenleaf	President & Chief Executive Officer and Director	July 27, 2005
/s/ Brian Lenz Brian Lenz	Chief Financial Officer and Secretary	July 27, 2005
/s/ Vincent M. Aita Vincent M. Aita	Director	July 27, 2005
/s/ Kenneth W. Brimmer Kenneth W. Brimmer	Director	July 27, 2005
/s/ Stephen C. Rocamboli Stephen C. Rocamboli	Director	July 27, 2005
/s/ Stephen A. Roth Stephen A. Roth	Director	July 27, 2005
/s/ David M. Tanen David M. Tanen	Director	July 27, 2005
/s/ Michael Weiser Michael Weiser	Director	July 27, 2005
/s/ Xumu Zhang Xumu Zhang	Director	July 27, 2005

Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

VioQuest Pharmaceuticals, Inc.

We have audited the accompanying consolidated balance sheets of VioQuest Pharmaceuticals, Inc. and Subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity (deficiency) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of VioQuest Pharmaceuticals, Inc. and Subsidiaries as of December 31, 2004 and 2003, and their results of operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company incurred a net loss of $4,023,558 and used $3,786,173 of cash in operating activities during the year ended December 31, 2004 and, as of that date, it had an accumulated deficit of $7,434,763. These matters raise substantial doubt about the Company's ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/J.H. Cohn LLP

Roseland, New Jersey

February 19, 2005

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2004 AND 2003

	2004	2003
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 3,065,547	$ 659,117
Accounts receivable, net of allowance for doubtful accounts of $0 and $11,490 at December 31, 2004 and 2003 respectively	318,585	51,705
Inventory	360,147	76,892
Other current assets	64,377	50,052
Total Current Assets	3,808,656	837,766
PROPERTY AND EQUIPMENT, NET	493,632	254,649
SECURITY DEPOSITS	31,000	31,000
DEFERRED FINANCING COSTS	-	50,000
INTELLECTUAL PROPERTY RIGHTS, NET	543,453	412,442
TOTAL ASSETS	$ 4,876,741	$ 1,585,857
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 303,392	$ 273,414
Accrued expenses	219,715	226,200
Due to related party	-	1,201
Deferred revenue, current portion	563,842	220,592
Total Current Liabilities	1,086,949	721,407
LONG-TERM LIABILITIES		
Deferred revenue, long-term portion	-	39,116
TOTAL LIABILITIES	1,086,949	760,523
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value, 50,000,000 shares authorized, 17,827,924 shares issued and outstanding at December 31, 2004, and 13,001,018 shares issued and outstanding at December 31, 2003	178,279	130,010
Additional paid-in capital	11,508,715	4,865,353
Deferred consulting expenses	(462,439)	(758,824)
Accumulated consulting deficit	(7,434,763)	(3,411,205)
Total Stockholders' Equity	3,789,792	825,334
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 4,876,741	$ 1,585,857

See accompanying notes to consolidated financial statements.

VIOQUEST PHARAMCEUTICALS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
REVENUE	$ 1,485,148	$ 669,036
COST OF GOODS SOLD (Excluding Depreciation)	837,653	196,045
GROSS PROFIT	647,495	472,991
OPERATING EXPENSES		
Management and consulting expenses	626,709	361,622
Research and development	1,526,561	639,426
Selling, general and administrative	2,377,021	1,415,182
Depreciation and amortization	179,034	86,325
Total Operating Expenses	4,709,325	2,502,555
LOSS FROM OPERATIONS	(4,061,830)	(2,029,564)
INTEREST EXPENSE	-	(2,809)
INTEREST INCOME	38,272	13,973
NET LOSS	$ (4,023,558)	$ (2,018,400)
NET LOSS PER COMMON SHARE - BASIC AND DILUTED	$ (.24)	$ (.16)
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC AND DILUTED	17,100,582	12,476,789

See accompanying notes to consolidated financial statements.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIENCY)

FOR THE YEARS ENDED DECEMBER 31, 2004 and 2003

	Equity Units			Common Stock					
	Units	Amount	Additional Members' Equity	Shares	Amount	Additional Paid-In Capital	Deferred Consulting Expenses	Accumulated Deficit	Total Equity (Deficiency)
Balance, January 1, 2003	11,500,000	$ 1,213,000	$ 135,050	-	$ -	$ -	$ (356,400)	$ (1,392,805)	$ (401,155)
Conversion of Chiral Quest LLC member units to common stock at 2/18/03 at a rate of .752374 share per unit (See Note 1 (B))	(11,500,000)	(1,213,000)	(135,050)	8,652,298	86,523	1,261,527			-
Recapitalization of the Company (See Note 1(B))				4,348,720	43,487	2,964,211			3,007,698
Options issued for services and rent						639,615	(639,615)		-
Amortization of deferred consulting expenses							237,191		237,191
Net loss								(2,018,400)	(2,018,400)
Balance, December 31, 2003	-	-	-	13,001,018	130,010	4,865,353	(758,824)	(3,411,205)	825,334
February 25, 2004 Private Placement, net of costs				4,826,906	48,269	6,643,362			6,691,631
Amortization of deferred consulting expenses							296,385		296,385
Net loss								(4,023,558)	(4,023,558)
Balance, December 31, 2004	-	-	-	17,827,924	$ 178,279	$ 11,508,715	$ (462,439)	$ (7,434,763)	$ 3,789,792

See accompanying notes to consolidated financial statements.

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VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (4,023,558)	$ (2,018,400)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	179,034	86,325
Amortization of deferred consulting expenses	296,385	237,191
Changes in operating assets and liabilities:		
Increase in accounts receivable	(266,880)	(39,249)
Increase in inventory	(283,255)	(48,470)
Increase in other current assets	(14,325)	(50,052)
Increase in security deposits	-	(31,000)
Increase in accounts payable	29,978	161,582
Increase (decrease) in accrued expenses and due to related party	(7,686)	112,481
Increase (decrease) in deferred revenue	304,134	(47,342)
Net Cash Used In Operating Activities	(3,786,173)	(1,636,934)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments for purchased property and equipment	(356,548)	(237,222)
Payments for intellectual property rights	(192,481)	(130,865)
Net Cash Used In Investing Activities	(549,029)	(368,087)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable	-	40,000
Payment of note payable	-	(376,625)
Cash received in merger and recapitalization	-	3,017,243
Cash received in private placement of common stock	6,741,632	-
Payments for deferred financing costs	-	(50,000)
Net Cash Provided By Financing Activities	6,741,632	2,630,618
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,406,430	625,597
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	659,117	33,520
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 3,065,547	$ 659,117
Supplemental Schedule of Non-Cash Investing and Financing Activities:		
Reclassification of deferred financing costs to additional paid-in capital in connection with private placement	$ 50,000	$ -

See accompanying notes to consolidated financial statements.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NATURE OF OPERATIONS

(A) Nature of Operations and Liquidity

Since its inception in October 2000, VioQuest Pharmaceuticals, Inc. (formerly Chiral Quest, Inc.) has provided pharmaceutical and fine chemical companies in all stages of the product lifecycles with innovative chiral products and services (as used herein, the "Company" refers to VioQuest Pharmaceuticals, Inc. or VioQuest Pharmaceuticals, Inc. together with its subsidiaries). Since August 2004, the Company has provided such products and services through its wholly-owned subsidiary, Chiral Quest, Inc. Chiral Quest, Inc. develops chemical catalysts used in the synthesis of desired isomers of chiral molecules using asymmetrical catalysis technology (the "Technology") owned by the Pennsylvania State University Research Foundation ("PSRF"), the technology arm of The Pennsylvania State University ("Penn State"). Chiral Quest, Inc. has a worldwide, exclusive license from PSRF for the inventions covered by the license. The original license agreement was entered into on November 8, 2000 (See Note 5).

In August 2004, the Company formed VioQuest Drug Development, Inc., a wholly-owned subsidiary, which will focus on acquiring and bringing to market therapies for oncology, metabolic and inflammatory diseases and disorders that are current unmet medical needs. To date, VioQuest Drug Development, Inc. has not yet acquired any product candidates, has not realized any revenue and has not incurred any expenses.

From the Company's inception through December 31, 2004, it has generated sales revenue but not any net profits. Management believes that the Company's research and development ("R&D") and manufacturing capacity will need to grow in order for the Company to be able to obtain significant licensing and manufacturing agreements with large fine chemical and pharmaceutical companies. Management believes that the Company's manufacturing capacity will be enhanced with its expanded office and laboratory space located in Monmouth Junction, New Jersey that was leased in May 2003, in addition to the leased space located in Jiashan, China.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Since inception the Company has incurred a cumulative deficit of $7,434,763 through December 31, 2004. For the year ended December 31, 2004 the Company had a net loss of $4,023,558. These matters raise doubt about its ability to continue as a going concern. Management expects the Company's losses to increase over the next several years, primarily due to expansion of its research and development programs, the hiring of additional chemists, the expansion of its manufacturing capabilities, and the costs related to acquiring a drug candidate. There can be no assurance that the Company will ever be able to operate profitably.

As of December 31, 2004, the Company had working capital of $2,721,707 and cash and cash equivalents of $3,065,547. Unless the Company is able to significantly increase its revenues, it will most likely require additional financing by the end of the second quarter of 2005 in order to continue operations. The most likely sources of financing include private placements of the Company's equity or debt securities or bridge loans to the Company from third party lenders.

The Company's net cash used in operating activities for the year ended 2004 was $3,786,173. The Company's net loss of $4,023,558 was offset by amortization of deferred expenses of $296,385, deferred revenue of $304,134, and depreciation and amortization of $179,034. Operating activities also included increases in accounts receivable of $266,880 and inventory of $283,255.

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VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

The Company's net cash used in investing activities for the year ended 2004 was $549,029. Investing activities expenditures consisted of purchases of property and equipment of $356,548 which was attributed to the laboratory expansions during the second and third quarters of 2004 and payments for increased patent filings of intellectual property rights of $192,481.

The Company's net cash provided by financing activities for the year ended 2004 was $6,741,632. Financing activities consisted of cash received as a result of the private placement of the Company's common stock in February 2004.

The Company's capital requirements will depend on numerous factors, including: competing technological and market developments, changes in our existing collaborative relationships, the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights and the outcome if any potentially related litigation or other dispute, the purchase of additional capital equipment, acquisition of technologies, the establishment and funding of the Chiral Quest, Jiashan, China facility, and the development and regulatory approval progress of its customers' product candidates into which the Company's technology will be incorporated, in addition to the costs associated with the drug development process related to acquiring a drug candidate.

Additional capital that may be needed by the Company in the future may not be available on reasonable terms, or at all. If adequate financing is not available, the Company may be required to terminate or significantly curtail its operations, or enter into arrangements with collaborative partners or others that may require the Company to relinquish rights to certain of its technologies, or potential markets that the Company would not otherwise relinquish.

The Company's ability to achieve profitability depends upon, among other things, its ability to discover and develop products (specifically new "ligands"), and to develop its products on a commercial scale through a cost effective and efficient process. To the extent that the Company is unable to produce, directly or indirectly, ligands in quantities required for commercial use, it will not realize any significant revenues from its technology. Moreover, there can be no assurance that it will ever achieve significant revenues or profitable operations from the sale of any of its products or technologies.

(B) Merger

On February 18, 2003, Chiral Quest, LLC merged (the "Merger") with and into CQ Acquisition, Inc., a wholly owned subsidiary of Surg II, Inc. ("Surg"), a reporting public corporation with no current operations. Each member equity unit of Chiral Quest, LLC issued and outstanding on February 18, 2003 ("Effective Date") was automatically converted into 0.752374 shares of Surg common stock. There were 4,348,720 shares of Surg common stock issued and outstanding and options to purchase an additional 682,875 shares immediately prior to the Effective Date. At the Effective Date, Chiral Quest, LLC had 11,500,000 member equity units outstanding. Accordingly, as a result of the Merger, Surg issued 8,652,298 shares of its common stock to the former members of Chiral Quest, LLC. In addition, immediately prior to the Effective Date, there were non-vested contingent options and warrants outstanding to purchase an aggregate of up to 1,210,000 of Chiral Quest LLC's member equity units, which following the Merger represented the right to purchase an aggregate of up to 910,374 shares of Surg common stock at $1.49 per share. In connection with the Merger, Surg changed its name to Chiral Quest, Inc. In August 2004, Chiral Quest, Inc. changed its name to VioQuest Pharmaceuticals, Inc. and renamed CQ Acquisition, Inc. as Chiral Quest, Inc. Subsequent to the Effective Date, the Company has reported its results of operations on a consolidated basis.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

Generally accepted accounting principles in the United States of America require that the company whose equity holders retain a majority interest in a business combination, maintain the majority of board memberships and hold key management positions to be treated as the acquiror for accounting purposes. Since, following upon completion of the Merger, the former members of Chiral Quest, LLC held approximately two-thirds of the outstanding common stock of the Company, designees of Chiral Quest LLC comprised the majority of the Company's Board of Directors, and the officers of Chiral Quest, LLC immediately prior to the Merger were appointed the officers of the Company, the merger was accounted for as a reverse acquisition with Chiral Quest, LLC as the accounting acquirer (legal acquiree) and Surg II as the accounting acquiree (legal acquirer).

If the Merger between Surg II and Chiral Quest, Inc. had occurred as of January 1, 2003 unuaudited pro forma revenues, net loss and net loss per share would have been as illustrated in the following table for the year ended December 31, 2003:

		Pro Forma (Unaudited) Year Ended December 31, 2003
REVENUES	$	669,036
NET LOSS	$	(2,074,531)
BASIC AND DILUTED LOSS PER COMMON SHARE	$	(0.16)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC AND DILUTED		13,001,018

The above pro forma financial information is not necessarily indicative of what the Company's results of operations would have been had the Merger occurred on January 1, 2003.

(C) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of VioQuest Pharmaceuticals, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

(D) Cash and Cash Equivalents

The Company considers all highly-liquid investments with an original maturity of three months or less when acquired to be cash equivalents.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

(E) Fair Value of Financial Instruments

The carrying value of financial instruments including cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the relatively short maturity of these instruments. The carrying value of the note payable approximates fair value based on the incremental borrowing rates currently available to the Company for financing with similar terms and maturities.

(F) Allowance for Doubtful Accounts

The Company establishes an allowance for uncollectible accounts receivable, when appropriate, based on historical collection experience and management’s evaluation of collectibility of outstanding accounts receivable.

(G) Inventory

Inventory consists of raw materials, work in process and finished goods which are stated at the lower of cost (first-in, first-out) or market. Raw materials consist of chemical compounds. Work in process and finished goods, referred to as proprietary ligands, consist of material, direct labor and manufacturing overhead.

(H) Property and Equipment

Property and equipment is recorded at cost and depreciated over the estimated useful lives of the assets, principally using the straight-line method. For tax purposes, accelerated methods are used. The estimated useful lives used for depreciation and amortization were three, five and seven years for leasehold improvements, laboratory/computer equipment and office equipment, respectively (See Note 3).

(I) Intellectual Property Rights

Intellectual property rights are being amortized over the lives of the underlying patents, which generally are 17 years. Amortization expense recorded for the years ended December 31, 2004 and 2003 was $61,471 and $36,792, respectively. Accumulated amortization as of December 31, 2004 and December 31, 2003 was $112,131 and $50,660, respectively. Amortization expense for each of the five years subsequent to the year ended December 31, 2004, is approximately $39,000 per year.

(J) Revenue Recognition

Revenues are comprised principally of four main components: (1) the licensing of PSRF’s Technology, (2) the sale of proprietary ligands, (3) feasibility screening, and (4) custom contract development. Revenues as they relate to the licensing of the Company's rights to PSRF's intellectual property are recognized over the applicable license periods. The Company assumes the financial risks related to these revenues by financing the research and development of PSRF's technology as well as the defense of PSRF's patents. Deferred revenue in the accompanying consolidated balance sheets represents amounts prepaid by customers to the Company for services to be performed and products to be delivered at a subsequent date. These deferred and unearned amounts will be recognized as revenue when earned. Revenues as they relate to the sale of manufactured proprietary ligands are recognized upon the shipment of the ligands to the customer. Revenues as they relate to feasibility screening are recognized upon the completion of project

reports and investigational studies. Revenues as they relate to custom contract development are recognized upon the shipment of finished products. However, revenue is not recognized unless collectibility is reasonably assured.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

(K) Income Taxes

Under Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," ("SFAS 109") deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. 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 are expected to be recovered or settled. Under SFAS 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when it is more likely than not that deferred tax assets will not be realized.

(L) Stock-Based Compensation

The Company accounts for its employee and director stock option plans using the intrinsic value method in accordance with APB Opinion No. 25, "Accounting For Stock Issued To Employees," and related interpretations. The Company measures compensation expense for employee and director stock options as the aggregate difference, if any, between the market value of its common stock and exercise prices of the options on the date that both the number of shares the grantee is entitled to receive and the exercise prices are known. However, the Company has not recorded any expense for employee options since they were granted at market value. If the Company had elected to recognize compensation cost for all outstanding options granted by the Company to employees by applying the fair value recognition provisions of SFAS 123 "Accounting for Stock Based Compensation" to employee stock options, and amortizing the fair value over the vesting period, net loss and loss per share for the years ended December 31, 2004 and 2003, would have been increased to the pro forma amounts indicated below:

	Year Ended December 31, 2004	Year Ended December 31, 2003
Net loss as reported	$ (4,023,558)	$ (2,018,400)
Less: Total stock-based employee compensation expense using the fair value based method for all awards, net of related tax effects	(315,003)	(165,272)
Pro forma net loss	$ (4,338,561)	$ (2,183,672)
Basic and diluted net loss per common share:		
As reported	$ (0.24)	$ (0.16)
Pro forma net loss	$ (0.25)	$ (0.18)

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

For pro forma disclosure purposes and for the purpose of valuing options granted to non-employees, the Company has valued the options using the Black-Scholes option pricing model with the following assumptions used in 2004 and 2003:

	December 31, 2004	December 31, 2003
Risk-free interest rate	3%-5%	2.3%-4%
Volatility	39%-98%	64%-127%
Lives in years	10	10
Dividend yield	0%	0%

As a result of amendments to SFAS 123, the Company will be required to expense the fair value of employee stock options beginning with the first quarter of 2006. In addition, options are issued to non-employees such as consultants, scientific advisory board members and directors. Any options issued to non-employees are recorded in the consolidated financial statements in deferred expenses in stockholders' equity using the fair value method and then amortized to expense over the applicable service periods (See Note 6).

(M) Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(N) Impairment of Long-Lived Assets

The Company evaluates the recoverability of its long-lived assets, where indicators of impairment are present, by reviewing current and projected profitability or undiscounted cash flows of such assets. Intangible assets that are subject to amortization are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. Intangible assets not subject to amortization are tested for impairment at least annually. For the years ended December 31, 2004 and 2003, the Company determined that an impairment charge on its long-lived assets was not required.

(O) Research and Development Expense

R&D costs are expensed as incurred. These expenses include the cost of the Company's proprietary R&D efforts, as well as costs incurred in connection with the Company's third-party collaboration efforts.

(P) Advertising

The Company expenses the cost of advertising and promotions as incurred. Advertising costs charged to operations amount to $101,712 and $174,514 for the years ended December 31, 2004 and 2003, respectively.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

(Q) Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted-average number of shares outstanding for the period. Diluted net loss per share is the same as basic net loss per share, since potentially dilutive securities from the assumed exercise of stock options and stock warrants would have an antidilutive effect because the Company incurred a net loss during each period presented. The amount of potentially dilutive securities including options and warrants in aggregate excluded from the calculation was 5,141,009 at December 31, 2004 and 2,841,607 at December 31, 2003.

NOTE 2 INVENTORY

The principal components of inventory are as follows:

	December 31, 2004	December 31, 2003
Raw material compounds	$ 308,456	$ 25,796
Work in process	47,691	42,251
Finished goods	4,000	8,845
Total Inventory	$ 360,147	$ 76,892

NOTE 3 PROPERTY AND EQUIPMENT, NET

The cost of the major classes of property and equipment are as follows:

	December 31, 2004	December 31, 2003
Laboratory equipment	$ 519,231	$ 272,713
Office equipment	7,849	4,780
Computer equipment	35,241	26,131
Leasehold improvements	145,783	47,932
Property and Equipment	708,104	351,556
Less Accumulated depreciation	214,472	96,907
Property and Equipment, Net	$ 493,632	$ 254,649

Depreciation expense for property and equipment for the years ended December 31, 2004 and 2003 was $125,467 and $49,583, respectively.

NOTE 4 INCOME TAXES

There was no income tax expense or benefit for the years ended December 31, 2004 and 2003 because of the nonrecognition of the income tax benefit from the Company’s net operating loss carryforwards.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

The significant components of the Company's net deferred tax assets are summarized as follows:

	Year Ended December 31	
	2004	2003
Net operating loss carryforwards	$ 2,870,000	$ 1,260,000
Valuation allowance	(2,870,000)	(1,260,000)
Net deferred tax assets	$ -	$ -

Deferred tax assets of $2,870,000 and $1,260,000 as of December 31, 2004 and 2003, respectively, consist primarily of the potential tax benefit of net operating loss carryforwards of $-7,175,000 and $3,150,000 at December 31, 2004 and 2003, respectively, and have been fully offset by a valuation allowance because it is management's belief that it is more likely than not that those benefits will not be realized. Accordingly, the Company recognized no tax benefit for its pre-tax loss in 2004 or 2003. The net operating loss carryforwards, if not used, expire through 2024.

Following is a reconciliation of the expected income tax benefit computed at the U.S. Federal statutory rate to the Company's actual income tax benefit:

	December 31, 2004	December 31, 2003
Income tax benefit at statutory rate	(1,368,010)	(686,256)
State income taxes net of Federal tax	(241,413)	(121,104)
Increase in valuation allowance	1,609,423	807,360
	$ -	$ -

NOTE 5 RIGHTS TO INTELLECTUAL PROPERTY

The Company's exclusive right to certain PSRF patents are of material importance to the Company's success. These PSRF patents result from inventions by the Company's Chief Technology Officer ("CTO"), who is also an employee at Pennsylvania State University. The PSRF patents cover chemical formulations, processes for or intermediates useful in the manufacture of products and the uses of products. Protection for PSRF's individual products extends for varying periods in accordance with the date of grant and the legal life of patents in the various countries. The protection afforded, which may also vary from country to country, depends upon the type of patent and its scope of coverage. The Company is financially responsible for all aspects of these PSRF inventions, including legal and R&D expenses associated with the chemical developments. The Company is no longer obligated to license future inventions of the CTO.

For the years ended December 31, 2004 and 2003, the Company has not recognized any impairment charges to its patents, as management believes that the Company's patents have useful lives equivalent to their amortization period of seventeen years. The capitalized amounts of intellectual property are comprised of domestic and international patent filing fees, patent enhancement fees, in addition to legal application and prosecution fees associated to the defense of the Company's patents. The gross patent increase for the year ended 2004 of approximately $195,000 relate to fees charged by our patent attorneys for a combination of domestic and foreign legal patent application filing fees, and prosecution filing fees in the successful defense of our patents.

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VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

NOTE 6 STOCKHOLDERS' EQUITY

In connection with the Merger (see Note 1), the Company issued a warrant to purchase 550,000 shares of common stock at an exercise price of $1.25 to an independent consultant for services related to the Merger.

During May 2003, the Company issued options to purchase, at a price of $1.50 per share, an aggregate of 20,000 shares of common stock to the landlord of new office space that the Company is leasing in New Jersey. The option issuance resulted in a charge to deferred expenses in stockholders' equity of $9,845 for the value of the shares and is being amortized to rent expense over the term of the lease beginning in July 2003.

In June 2003, the Company issued options to purchase an aggregate of 740,052 shares of common stock at exercise prices of $1.49 and $1.50 per share to two consultants (including 650,052 options issued to the CTO) and two members of the Company's Scientific Advisory Board. The total value of the option issuances of $619,864 was valued using the Black-Scholes option pricing model with the following assumptions: a risk-free interest rate of approximately 2.4%, volatility of approximately 87%, lives of five years and an assumed dividend yield of 0%. The option issuances were charged to deferred expense in the stockholders' equity and are being amortized to consulting expense over the applicable service periods.

In October 2003, a consultant for the Company received options to purchase 4,300 shares of common stock at an exercise price of $1.96 per share. These options became fully vested on February 14, 2004. The total value of the option issuance resulted in a charge to deferred expenses in stockholders' equity of $6,263 was valued using the Black-Scholes option pricing model with the following assumptions.

In November 2003, a consultant for the Company received options to purchase 2,500 shares of common stock at an exercise price of $1.96 per share. These options vested in April 2004. The total value of option issuance resulted in a change to deferred expenses in stockholders' equity of $3,643 was valued using the Black-Scholes option pricing model with the following assumptions: a risk-free rate of 3%, volatility of 128%, estimated lives of three years and an assumed dividend yield of 0%.

On February 25, 2004, the Company completed a private placement of its securities to accredited investors that resulted in gross proceeds of approximately $7.2 million. Investors in the private placement purchased an aggregate of approximately 4.8 million shares of the Company's common stock at a price per share of $1.50 and received 5-year warrants to purchase one share of common stock at $1.65 per share for every two common shares purchased in the offering (a total of 2.4 million warrants). ThinkEquity Partners LLC, Paramount BioCapital, Inc. and Casimir Capital L.P. acted as the placement agents for this offering and received fees of approximately $500,000 of which Paramount BioCapital, Inc., a related party, received $300,000. Net proceeds to the Company, after deducting commissions and other expenses relating to the private placement, were approximately $6.7 million.

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The following table summarizes the total number of shares outstanding, shares issued to non-employees, directors, consultants, scientific advisory board members and options that have expired:

	2004		2003	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,841,607	$ 1.47	998,105	$ 1.48
Granted	366,000	$ 1.22	1,843,752	$ 1.47
Cancelled	(962,730)	$ 1.49	(250)	$ 2.80
Outstanding at end of year	2,244,877	$ 1.42	2,841,607	$ 1.47
Options exercisable at year-end	1,024,488	$ 1.38	1,114,755	$ 1.37
Weighted-average fair value of options granted during the year	$ 1.14		$ 0.63	

The following table summarizes the information about Plan stock options outstanding at December 31, 2004:

Range of Exercise Prices	Outstanding Options	Weighted Average Exercise Price	Weighted Average Remaining Life In Years
$1.00 - $1.99	2,225,252	$ 1.41	8
$2.00-$2.99	16,500	$ 2.15	7
$3.00-$3.99	875	$ 3.20	2
$4.00-$12.00	2,250	$ 7.29	0
Total	2,244,877		

The following table summarizes information related to warrants outstanding at December 31, 2004:

Remaining Contractual Life In Years	Price	Number of Exercisable Outstanding Warrants
4.15	$ 1.65	2,896,132

NOTE 7 AGREEMENTS

Pursuant to a January 2002 agreement between the Company and a pharmaceutical product development customer, the Company granted the customer a worldwide, non-exclusive, royalty free license to certain of the Company's Intellectual Property Rights for research purposes only in connection with certain of the customer's compounds. The customer paid the Company a nonrefundable license fee of $400,000 in 2002. The fee is being amortized to revenue through September 2005 when the agreement terminates. For each of the years ended December 31, 2004 and 2003, the Company recognized income of $114,241 related to this agreement.

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In August 2002, the Company entered into a one-year scientific research agreement with another pharmaceutical product development customer to assist in the completion of a feasibility screening program and report. In consideration for the experimental activity, the customer paid a fee of $30,000. The fee has been amortized to revenue through August 2003. For the year ended December 31, 2003, the Company recognized income of $19,726.

In May 2003, the Company entered into a four-year consulting agreement with the CTO at an annual rate of $120,000 per year. In addition, the CTO received an option to purchase 650,052 shares of common stock at $1.49 per share as mentioned in Note 5.

In May 2003, the Company entered into an option agreement with the Science and Technology Bureau of Jiashan County in Zhejiang, Province of the People's Republic of China, China ("Jiashan"), whereby the Company has an option to acquire a laboratory facility in an industrial park near Shanghai. Jiashan is currently building laboratory space to the Company's specifications, which is expected to be completed by the second quarter of 2005. The Company will not pay rent for the initial three years of the lease, following which the Company, at its sole option, may rent the space for annual rent of no more than $60,000. In addition, the Company will have the option to purchase the lab on commercially reasonable terms. Should the Company wish to occupy the laboratory after its estimated completion in the second quarter of 2005, it will begin to pay a maintenance fee of $4,500 per month which consists of operating expenses related to property management fees and waste removal. For purposes of entering into the lease, the Company established a wholly owned subsidiary in Hong Kong, Chiral Quest Ltd., which in turn will be the sole shareholder of a subsidiary in the People's Republic of China (the "China Sub"). The Company has provided $66,000 of capital to the China Sub through December 31, 2004. In addition, the Company was also granted the option to purchase for $750,000 approximately 33 acres of land adjacent to the industrial park where the lab will be established.

Pursuant to an October 2002 agreement with Penn State, the Company funded the services of four post-doctorate fellows who, under the supervision of the CTO, conducted research and provided research quantities of chiral ligands to the Company. From October 2002 through December 31, 2004, the Company has paid and incurred expenses of approximately $596,000 pursuant to the agreement. This amount consists principally of four post-doctorate salaries, fringe benefits, materials and supplies for the stated period. The agreement expires on April 14, 2005. The approximate obligation payable by the Company for the remaining period through April 14, 2005 is $98,000.

NOTE 8 BUSINESS AND CREDIT CONCENTRATIONS

The Company had two customers which accounted for approximately 34% and 26%, a major pharmaceutical company and a biotechnology company respectively, of revenue for the year ended December 31, 2004. The Company had two customers who accounted for approximately 54% and 17%, respectively, of revenue for the year ended December 31, 2003.

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The Company had two customers who accounted for approximately 42% and 19%, respectively, of net customer accounts receivable as of December 31, 2004. The Company had two customers who accounted for approximately 52% and 39%, respectively, of net accounts receivable as of December 31, 2003.

NOTE 9 COMMITMENTS AND CONTINGENCIES

The Company entered into a written employment agreement dated as of February 1, 2005 with Daniel Greenleaf, its newly-appointed President and Chief Executive Officer. The agreement provides for a 3-year term and an initial annual base salary of $360,000, plus a guaranteed annual bonus of $100,000 during each year of the term of the agreement. In addition, Mr. Greenleaf is entitled to a signing bonus in the amount of $50,000, of which one-half is payable following the execution of the employment agreement and the remaining one-half is payable on the 6-month anniversary of the agreement. Mr. Greenleaf is further entitled to a “Discretionary Bonus” under the employment agreement of up to $250,000 per year upon the attainment of certain performance criteria specified in the employment agreement, and such other benefits generally made available to the Company’s other senior management.

The employment agreement also provides that Mr. Greenleaf is entitled to receive an option to purchase 891,396 shares of the Company’s common stock, which represents 5 % of the Company’s currently outstanding common stock. The option will vest in three equal annual installments, commencing February 2006. In addition, until the Company has raised $20 million through the sale of equity securities and has obtained the rights to one clinical stage human therapeutic, Mr. Greenleaf shall be entitled to receive such additional options to purchase common stock in order to maintain his beneficial ownership (assuming the exercise of all stock options issued to Mr. Greenleaf) at 5% of the Company’s outstanding common stock. To the extent any additional stock options are issued pursuant to the foregoing sentence, the options will vest in installments over the term of the employment agreement as long as Mr. Greenleaf remains employed by the Company and will be exercisable at the market value of the Company’s common stock at the time of issuance.

In the event Mr. Greenleaf’s employment is terminated by the Company during the term upon a “change of control” (as defined in the employment agreement) and on the date of such termination the Company’s aggregate market capitalization is less than $38 million, he is entitled to receive his base salary for six months thereafter and all of his stock options scheduled to vest in the calendar year of such termination shall accelerate and be deemed vested upon termination and will remain exercisable for 12 months following such termination. In the event the Company terminates Mr. Greenleaf’s employment during the term of the agreement other than as a result of death, disability, cause or in connection with a change of control where the Company’s aggregate market capitalization is less than $38 million, then (i) Mr. Greenleaf is entitled to receive his base salary for 12 months from such termination, his guaranteed bonus for the calendar year in which such termination occurs, and the portion of any discretionary bonus earned as of the termination, and (ii) the vesting of his stock options shall accelerate and be deemed vested and will remain exercisable for 12 months following such termination.

The Company leases laboratory and office space located in Monmouth Junction, New Jersey. The lease as amended commenced effective June 1, 2003 and is for a three-year term with a total rent, utilities and maintenance to be paid in monthly installments that increase each year. Due to the escalation clause in the lease, the Company is straight-lining the expense of the lease over the term of the lease. The Company also issued the landlord options to purchase 20,000 shares of common stock, as described in Note 6. The fair value of the options issued to the landlord of $9,845 is being amortized on a straight-line basis over the term of the option agreement and included in rent expense.

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Future minimum rental payments subsequent to December 31, 2004 are as follows:

		Years ended December 31,
2005	$	281,000
2006		119,000
	$	400,000

Total rent expense (which includes base rent, utilities, and operating escalations for both the New Jersey lease and a month to month lease of laboratory space in Pennsylvania) for the Company for the year ended December 31, 2004 and 2003 was approximately $333,000 and $101,000 respectively.

NOTE 10 RETIREMENT PLAN

The Company sponsors a defined contribution 401(k) plan which allows eligible employees to defer a portion of their salaries for income tax purposes by making contributions to the plan. There have been no Company contributions to the plan for the years ended December 31, 2004 and 2003.

NOTE 11 RELATED PARTY TRANSACTIONS

Paramount BioCapital Investments, LLC, a related party, has been performing certain administrative functions for the Company since July 12, 2002, and financed the Company through loans for working capital evidenced by a series of promissory notes (the “Notes”) aggregating $376,625. The Notes bore interest at 5% per annum. The Company satisfied in full all principal and accrued interest under the Notes on February 28, 2003.

Additionally, from September 2002 through April 2004, the Company was paying $4,000 per month to Paramount BioCapital Investments, LLC, for an office and general and administrative services. For the years ended December 31, 2004 and 2003, this resulted in charges to operations of $6,000 and $48,000, respectively. As of December 31, 2003, the Company owed $1,201 to Paramount BioCapital Investments, LLC.

On February 25, 2004, the Company completed the sale of its securities in a private placement to accredited investors for gross proceeds of approximately $7.2 million. Paramount BioCapital, Inc. participated as one of three placement agents for this transaction, for which it received approximately $300,000 in commissions.