

CHIRAL QUEST INC
Form 8-K/A
May 05, 2003

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K/A

AMENDMENT NO. 1 TO CURRENT REPORT

Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): February 18, 2003

Chiral Quest, Inc.

(Exact Name of Registrant as Specified in Charter)

Minnesota	33-13058-C	58-1486040
(State or Other Jurisdiction	(Commission	(IRS Employer
of Incorporation)	File Number)	Identification No.)

1981 Pine Hall Drive	18901
State College, PA	(Zip Code)
(Address of Principal Executive Offices)	

Registrant's telephone number, including area code: (814) 234-5054

Surg II, Inc.
2690 Nicollet Mall, Suite 2690
Minneapolis, Minnesota 55402
(Former Name or Former Address, if Changed Since Last Report)

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Item 2. Acquisition or Disposition of Assets.

Pursuant to a Merger Agreement dated as of November 12, 2002 (the "Merger Agreement"), by and among Chiral Quest, Inc., formerly known as Surg II, Inc. (the "Registrant"), Chiral Quest, LLC, a Pennsylvania limited liability company ("CQ"), and CQ Acquisition Corp., a Minnesota corporation and a wholly-owned subsidiary of the Registrant ("Merger Sub"), CQ merged with and into Merger Sub, with Merger Sub remaining as the surviving company (the "Merger"). The Merger was effective as of February 18, 2003. A copy of the Registrant's press release dated February 18, 2003 is attached hereto as Exhibit 99.1 and incorporated by reference herein.

In accordance with the terms of the Merger Agreement, each outstanding unit of CQ membership interest automatically converted into the right to receive 0.752374 shares of the Registrant's common stock. At the time of the Merger there were 11,500,000 units of CQ membership interest outstanding, requiring the Registrant to issue 8,652,301 shares of its common stock to the former members of CQ. Accordingly, after giving effect to the Merger, the Registrant has 13,001,021 shares of common stock outstanding. In addition, immediately prior to the effective time of the Merger, there were outstanding options, warrants and other rights to purchase an aggregate of 1,210,000 CQ membership units, which as a result of the Merger, now represent the right to purchase an aggregate of 910,374 shares of the Registrant's common stock. Since, as a result of the Merger, the members of CQ hold a majority of the voting shares of the Registrant, the Merger was accounted for as a reverse acquisition whereby CQ was the accounting acquirer (legal acquiree) and the Registrant was the accounting acquiree (legal acquirer).

At a special meeting of shareholders held on February 12, 2003, the Registrant's shareholders approved two amendments to the Registrant's Articles of Incorporation that were necessary to facilitate the Merger: (1) an amendment increasing the number of shares of authorized capital to 50,000,000; and (2) an amendment changing the name of the Registrant to "Chiral Quest, Inc."

The Registrant filed a current report on Form 8-K on March 5, 2003, disclosing the Merger. The Registrant is filing this Amendment No. 1 on Form 8-K/A to include financial statements required by Item 7 of Form 8-K.

Item 7. Financial Statements, Pro Forma Financial Information and Exhibits.

(a) Financial Statements of Business Acquired.

The financial statements of Chiral Quest, LLC are included in this report beginning at page F-1, below.

(b) Pro Forma Financial Information.

Not applicable.

(c) Exhibits

- 2.1 Merger Agreement by and among Chiral Quest, Inc. (formerly known as Surg II, Inc.), Chiral Quest, LLC and CQ Acquisition Corp. dated November 12, 2002.*
- 2.2 Articles of Merger relating to the merger of Chiral Quest, LLC with and into CQ Acquisition Corp., a wholly owned subsidiary of the Registrant.**
- 3.1 Articles of Amendment to Articles of Incorporation of Registrant dated February 12, 2003 increasing authorized capital to 50,000,000 shares.**

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3.2	Articles of Amendment to Articles of Incorporation of Registrant dated February 12, 2003 changing name to Chiral Quest, Inc.**
99.1	Press Release dated February 18, 2003.**

* Incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K filed with the Commission on November 27, 2002.

** Incorporated by reference to the same exhibit numbers included in the Registrant's Current Report on Form 8-K filed on March 5, 2003.

SIGNATURES

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

Chiral Quest, Inc.

Date: May 2, 2003

By: /s/ Alan. D. Roth

Alan D. Roth
President, Chief Executive Officer and
Chief Financial Officer

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of:
Chiral Quest, LLC

We have audited the accompanying balance sheets of Chiral Quest, LLC (the Company), as of December 31, 2002 and 2001 and the related statements of operations, changes in members' equity (deficiency) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of Chiral Quest, LLC as of December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

WEINBERG & COMPANY, P.A.

Boca Raton, Florida
March 15, 2003

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CHIRAL QUEST, LLC
BALANCE SHEETS
AS OF DECEMBER 31, 2002 AND 2001

ASSETS

	2002	2001
	<hr/>	<hr/>
CURRENT ASSETS		
Cash	\$ 33,520	45,008
Accounts receivable, net	12,456	13,542
Inventory	28,422	6,447
Other current assets, net		1,817
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Total Current Assets	74,398	66,814
EQUIPMENT, NET	67,011	98,090
INTELLECTUAL PROPERTY RIGHTS, NET	318,320	136,867
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TOTAL ASSETS	\$ 459,729	\$ 301,771
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LIABILITIES AND MEMBERS DEFICIENCY

CURRENT LIABILITIES		
Accounts payable	\$ 111,832	\$ 125,710
Accrued expenses	105,377	126,338
Loan payable		50,000
Notes payable	336,625	
Deferred revenue	133,967	
	<hr/>	<hr/>
Total Current Liabilities	687,801	302,048
	<hr/>	<hr/>
LONG-TERM LIABILITIES		
Deferred revenue	173,083	
	<hr/>	<hr/>
Total Long-Term Liabilities	173,083	
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TOTAL LIABILITIES	860,884	302,048
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MEMBERS DEFICIENCY		
Equity units, no par value, 100,000,000 units authorized, 11,500,000 and 10,750,000 issued and outstanding, in 2002 and 2001, respectively	1,213,000	1,205,500
Additional members equity	135,050	135,050
Accumulated deficit	(1,392,805)	(854,827)
Deferred consulting expense	(356,400)	(486,000)
	<hr/>	<hr/>
Total Members Deficiency	(401,155)	(277)
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TOTAL LIABILITIES AND MEMBERS DEFICIENCY	\$ 459,729	\$ 301,771
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See accompanying notes to financial statements.

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CHIRAL QUEST, LLC
STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>2002</u>	<u>2001</u>
REVENUE, NET	\$ 191,613	\$ 167,683
OPERATING EXPENSES		
Management and consulting fees	231,424	261,600
Research and development	70,491	224,592
Selling, general and administrative	193,449	137,371
Compensation	197,596	111,706
Bad debt expense		50,000
Depreciation and amortization	36,631	24,611
Total Operating Expenses	<u>729,591</u>	<u>809,880</u>
LOSS FROM OPERATIONS	(537,978)	(642,197)
INTEREST INCOME		1,804
NET LOSS	<u>\$ (537,978)</u>	<u>\$ (640,393)</u>

See accompanying notes to financial statements.

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CHIRAL QUEST, LLC
STATEMENT OF CHANGES IN MEMBERS' EQUITY (DEFICIENCY)
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

	Equity Units	Amount	Additional Members Equity	Deferred Consulting Expense	Accumulated Deficit	Total Equity
	Units					
Balance, January 1, 2001	10,000,000	\$ 1,198,000	\$ 135,050	\$ (615,600)	\$ (214,434)	\$ 503,016
Exercise of unit options	750,000	7,500				7,500
Amortization of deferred consulting fees				129,600		129,600
Net loss, 2001					(640,393)	(640,393)
Balance, December 31, 2001	10,750,000	1,205,500	135,050	(486,000)	(854,827)	(277)
Exercise of unit options	750,000	7,500				7,500
Amortization of deferred consulting fees				129,600		129,600
Net loss, 2002					(537,978)	(537,978)
BALANCE, DECEMBER 31, 2002	11,500,000	\$ 1,213,000	\$ 135,050	\$ (356,400)	\$ (1,392,805)	\$ (401,155)

See accompanying notes to financial statements.

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CHIRAL QUEST, LLC
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>2002</u>	<u>2001</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (537,978)	\$ (640,393)
Adjustments to reconcile net loss to net cash (used in) operating activities:		
Depreciation and amortization	36,631	24,611
Amortization of member units for consulting fees	129,600	129,600
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	1,086	(11,117)
Decrease in other current assets	1,817	
(Increase) in inventory	(21,975)	(6,447)
(Decrease) increase in accounts payable	(13,878)	114,460
(Decrease) increase in accrued expenses	(20,961)	122,531
Increase in deferred revenue	307,050	
Net Cash Used In Operating Activities	<u>(118,608)</u>	<u>(266,755)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of laboratory equipment	8,684	
Purchase of equipment	(318)	(122,701)
Payments for intellectual property rights	<u>(195,371)</u>	<u>(136,867)</u>
Net Cash Used In Investing Activities	<u>(187,005)</u>	<u>(259,568)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from loans payable		50,000
Payment of loan payable	(50,000)	
Exercise of unit options	7,500	7,500
Proceeds from notes payable	<u>336,625</u>	
Net Cash Provided by Financing Activities	<u>294,125</u>	<u>57,500</u>
NET DECREASE IN CASH	<u>(11,488)</u>	<u>(468,823)</u>
CASH BEGINNING OF YEAR	<u>45,008</u>	<u>513,831</u>
CASH END OF YEAR	<u>\$ 33,520</u>	<u>\$ 45,008</u>

See accompanying notes to financial statements.

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**CHIRAL QUEST, LLC
NOTES TO FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2002 AND 2001**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) Nature of Operations

Chiral Quest, LLC (the Company), a Pennsylvania Limited Liability Company, is a life sciences chemistry company that provides chiral products and services to the pharmaceutical and fine chemical industries (See Note 9 for subsequent merger). The Company 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 University's technology transfer unit. The Company has a worldwide, exclusive license from PSRF for the inventions covered by the license. The original license agreement was signed and effectuated November 8, 2000 (See Note 4).

The Company signed a five-year consulting agreement in 2000 with a Pennsylvania State University employee (the Employee) to act as the Company's Chief Technology Officer (CTO). The Employee is responsible for all aspects of PSRF's inventions, compound development and other technologies to which the Company has rights. The agreement may be terminated by either the Company or the Employee upon sixty days notice. In the event that the Employee's services to the Company survive his employment relationship with PSRF, or in the event that the Company develops independent research capabilities that would allow the Company to generate other intellectual property, such inventions will be owned exclusively by the Company.

(B) Revenue Recognition

Revenues from the Company's rights to PSRF's intellectual property are recognized upon a signed agreement with the customer or remittance of an invoice and allocated over the applicable periods. The revenues are comprised principally of the licensing of PSRF's Technology. 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.

(C) Inventories

Inventories, consisting of mixtures of raw material compounds, are stated at the lower of cost or market. These compounds are intermediates in the production of finished products that are used by the Company for further research and development of the Technology or sold to third parties.

(D) Depreciation

Depreciation is provided over the estimated useful lives of the assets, principally using the straight-line method. For tax purposes, accelerated methods are used. The Company had only office and laboratory equipment as of December 31, 2002 and 2001. The estimated useful lives used for the years ended December 31, 2002 and 2001 were five and seven years for laboratory equipment and office equipment, respectively (See Note 3).

(E) Intangibles

Under Statement No. 142, Goodwill and Other Intangible Assets (SFAS 142), subsequent to June 30, 2002, goodwill should not be amortized. Effective January 1, 2002, intangibles existing as of June

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**CHIRAL QUEST, LLC
NOTES TO FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2002 AND 2001**

30, 2001 having a finite life will be amortized and those with indefinite lives will no longer be amortized, but rather, evaluated for impairment on an annual basis using a fair value based test. Intangibles of the Company as of December 31, 2002 and 2001 consisted of rights to PSRF's intellectual property of \$318,320, net of amortization of \$13,918, and \$136,867 which was not amortized because such amount was immaterial. See Note 4 for more discussion on the Company's Rights to Intellectual Property.

(F) Income Taxes

Since inception to September 30, 2002, the Company had elected to file its income tax returns as a partnership for federal and state income tax purposes. As such, the Company did not pay income taxes, as any income or loss through September 30, 2002 was included in the tax returns of the individual members. Accordingly, no provision was made for income taxes in the accompanying financial statements through September 30, 2002. On October 1, 2002, the Company elected to file its income tax returns as a C corporation and has adopted SFAS No. 109 Accounting for Income Taxes.

Commencing October 1, 2002, the Company accounts for income taxes under the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 109 Accounting for Income Taxes (Statement 109). Under Statement 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to 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 Statement 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.

A deferred tax asset as of December 31, 2002 consisting primarily of the tax effect of net operating loss carryforwards of approximately \$257,000 has been fully offset by a valuation allowance because it is management's belief that realization of such amount is not considered more likely than not.

(G) Stock-Based Compensation

Employee stock-based compensation is recognized using the intrinsic value method. For disclosure purposes, pro forma net income and earnings per share impacts are provided as if the fair value method had been applied. See Note 5 for more discussion on the Company's stock-based compensation.

(H) Use of Estimates

The financial statements are prepared in conformity with accounting principles generally accepted in the United States (GAAP) and, accordingly, include amounts that are based on management's best estimates and judgments. Estimates for the Company are used in determining such items as provisions for bad debts, depreciable/amortizable lives, impairment of intangibles and other reserves. Because of the uncertainty inherent in such estimates, actual results may differ from these estimates. The Company is not aware of reasonably likely events or circumstances, which would result in different amounts being reported that would have a material impact on results of operations or financial condition.

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**CHIRAL QUEST, LLC
NOTES TO FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2002 AND 2001**

(I) Research and Development Expense

Research and development (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. The amounts charged in 2002 and 2001 were \$70,491 and \$224,592, respectively.

(J) Recent Accounting Pronouncements

The Financial Accounting Standards Board has recently issued several new Statements of Financial Accounting Standards.

Statement No. 143 Accounting for Asset Retirement Obligations establishes standards for the initial measurement and subsequent accounting for obligations associated with the sale, abandonment, or other type of disposal of long-lived tangible assets arising from the acquisition, construction, or development and/or normal operation of such assets. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002, with earlier application encouraged.

In August 2002, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which supersedes SFAS No. 121, Accounting for the Impairment of Long-lived Assets and Long-lived Assets to be Disposed of and APB No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. SFAS No. 144 established a single accounting model for assets to be disposed of by sale whether previously held and used or newly acquired. SFAS No. 144 retains the provision of APB No. 30 for presentation of discontinued operations in the income statement but broadens the presentation to include a component of an entity. SFAS No. 144 is effective for fiscal years beginning after December 15, 2002 and the interim periods within.

In April 2002, the FASB issued Financial Accounting Standards No. 145 (FAS 145) Rescission of FASB Statement Nos. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections . This statement rescinds FAS 4 Reporting Gains and Losses from Extinguishment of Debt and an amendment of that statement, FAS 64 Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements . The statements also rescinds FAS 44 Accounting for Intangible Assets of Motor Carriers and amends FAS 13 Accounting for Leases to eliminate an inconsistency between the required accounting for sale-leaseback transactions. FAS 145 also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. FAS 145 is effective for fiscal years beginning after May 15, 2002 and to certain transactions occurring after that date.

In July 2002, the FASB issued Financial Accounting Standards No. 146 (FAS 146) Accounting for Costs Associated with Exit or Disposal Activities . This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) issue No. 94-3 Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including certain costs incurred in a restructuring) . FAS 146 requires that a liability for a cost associated with exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of the entity's commitment to the exit plan. FAS 146 is effective for fiscal years beginning after December 31, 2002, with early application encouraged.

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CHIRAL QUEST, LLC
NOTES TO FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2002 AND 2001

In December 2002, the Financial Accounting Standards Board issued Statement No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure - an amendment of FASB Statement No. 123, (SFAS 148). SFAS 148 amends FASB Statement No. 123, Accounting for Stock Based Compensation (SFAS 123) and provides alternative methods for accounting for a change by registrants to the fair value method of accounting for stock-based compensation. Additionally, SFAS 148 amends the disclosure requirements of SFAS 123 to require disclosure in the significant accounting policy footnote of both annual and interim financial statements of the method of accounting for stock based-compensation and the related pro forma disclosures when the intrinsic value method continues to be used. The statement is effective for fiscal years beginning after December 15, 2002, and disclosures are effective for the first fiscal quarter beginning after December 15, 2002.

The Company believes that the adoption of these pronouncements will not have a material impact on the Company's financial position or results of operations.

NOTE 2 INVENTORIES

The principal components of inventory, which was all current as of December 31, 2002 and 2001, are as follows:

	<u>2002</u>	<u>2001</u>
Raw material compounds	\$ 28,422	\$ 6,447
Finished goods		
	<u>28,422</u>	<u>6,447</u>
Total inventory	<u>\$ 28,422</u>	<u>\$ 6,447</u>

NOTE 3 EQUIPMENT, NET

The major classes of equipment and the related estimated useful lives are as follows:

	<u>December 31, 2002</u>	<u>December 31, 2001</u>	<u>Life</u>
Laboratory equipment	\$ 112,044	\$ 120,728	
Accumulated depreciation	(47,020)	(24,540)	5 Years
Laboratory equipment, net	<u>65,024</u>	<u>96,188</u>	
Office equipment	\$ 2,291	\$ 1,973	
Accumulated depreciation			