NEOSE TECHNOLOGIES INC
Form 10-Q
May 15, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2001.

OR

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

For the transition period from ________________________ to ___________________

Commission file number: 0-27718

NEOSE TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	13-3549286
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
102 Witmer Road Horsham, Pennsylvania	19044
(Address of principal executive offices)	(Zip Code)

(215) 441-5890
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 14,014,293 shares of common stock, $.01 par value, were outstanding as of April 30, 2001.

NEOSE TECHNOLOGIES, INC.
(a development-stage company)

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NEOSE TECHNOLOGIES, INC.
(a development-stage company)

CONSOLIDATED BALANCE SHEETS
(unaudited)
(in thousands, except per share amounts)

Assets	December 31, 2000
Current assets:	
Cash and cash equivalents	$ 66,989
Marketable securities	27,773
Restricted funds	893

Prepaid expenses and other current assets		583
Total current assets		96,238
Property and equipment, net		13,577
Other assets		4,953
Total assets	$	114,768
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$	1,100
Accounts payable		83
Accrued compensation		601
Accrued expenses		1,527
Deferred revenue		389
Total current liabilities		3,700
Long-term debt		6,200
Total liabilities		9,900
Stockholders' equity:		
Preferred stock, $.01 par value, 5,000 shares authorized, none issued		-
Common stock, $.01 par value, 30,000 shares authorized; 13,992 and 14,013 shares issued and outstanding		140
Additional paid-in capital		173,757
Deferred compensation		(717)
Deficit accumulated during the development-stage		(68,312)
Total stockholders' equity		104,868
Total liabilities and stockholders' equity	$	114,768

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

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NEOSE TECHNOLOGIES, INC.
(a development-stage company)

CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except per share amounts)

	Three months ended March 31,	Period from inception

	2000	2001	(January 17, 1989) to March 31, 2001
Revenue from collaborative agreements	$ 1,947	$ 312	$ 11,679
Operating expenses:			
Research and development	2,893	3,167	66,814
General and administrative	1,280	1,666	28,547
Total operating expenses	4,173	4,833	95,361
Operating loss	(2,226)	(4,521)	(83,682)
Interest income	519	1,321	15,287
Interest expense	(119)	(99)	(3,216)
Net loss	$(1,826)	$(3,299)	$(71,611)
Basic and diluted net loss per share	$ (0.15)	$ (0.24)	
Basic and diluted weighted-average shares outstanding	11,880	14,007	

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

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NEOSE TECHNOLOGIES, INC.
(a development-stage company)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	Three months ended March 31, 2000	Three months ended March 31, 2001
Cash flows from operating activities:		
Net loss	$ (1,826)	$ (3,299)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	472	566
Non-cash compensation	265	(112)
Common stock issued for non-cash and other charges	-	-
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	(2,287)	(500)
Accounts payable	(87)	(16)
Accrued compensation	(285)	(267)
Accrued expenses	344	(232)
Deferred revenue	(291)	(42)
Net cash used in operating activities	(3,695)	(3,902)

Cash flows from investing activities:		
Purchases of property and equipment	(466)	(288)
Proceeds from sale-leaseback of equipment	-	-
Purchases of marketable securities	(14,623)	(48,142)
Proceeds from sales of marketable securities	-	-
Proceeds from maturities of and other changes in marketable securities	22,744	27,477
Purchase of acquired technology	(500)	-
Purchase of preferred stock	-	-
Restricted cash related to acquired technology	500	-
Net cash provided by (used in) investing activities	7,655	(20,953)
Cash flows from financing activities:		
Proceeds from issuance of debt	-	-
Repayment of debt	-	-
Restricted cash related to debt	(267)	(281)
Proceeds from issuance of preferred stock, net	-	-
Proceeds from issuance of common stock, net	-	-
Proceeds from public offerings, net	68,540	-
Proceeds from exercise of stock options and warrants	1,859	286
Dividends paid	-	-
Net cash provided by financing activities	70,132	5
Net increase (decrease) in cash and cash equivalents	74,092	(24,850)
Cash and cash equivalents, beginning of period	10,365	66,989
Cash and cash equivalents, end of period	$ 84,457	$ 42,139
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 121	$ 107
Non-cash financing activities:		
Issuance of common stock for dividends	$ -	$ -
Issuance of common stock to employees in lieu of cash compensation	$ -	$ -

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

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NEOSE TECHNOLOGIES, INC.
(a development-stage company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

We have used generally accepted accounting principles for interim financial information to prepare unaudited consolidated financial statements:

- As of March 31, 2001;
- For the three months ended March 31, 2000 and 2001; and
- For the period from inception (January 17, 1989) to March 31, 2001.

Our consolidated financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete consolidated financial statements. In our opinion, the unaudited information includes all the normal recurring adjustments that are necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. You should not base your estimate of our results of operations for 2001 solely on our results of operations for the three months ended March 31, 2001. You should read these consolidated financial statements in combination with:

- The other Notes in this section;
- "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing in the following section; and
- The Consolidated Financial Statements, including the Notes to the Consolidated Financial Statements, included in our Annual Report on Form 10-K for the year ended December 31, 2000.

2. Net Loss Per Share

Basic and diluted net loss per share are presented in conformity with Statement of Financial Accounting Standards No. 128, "Earnings per Share." Basic loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding for the period. Diluted loss per share reflects the potential dilution from the exercise or conversion of securities into common stock. For the three months ended March 31, 2000 and 2001, the effects of the exercise of outstanding stock options and warrants were antidilutive; accordingly, they were excluded from the calculation of diluted earnings per share.

3. Comprehensive Loss

Our comprehensive loss for the three months ended March 31, 2000 and 2001 was approximately $1.8 million and $3.3 million, respectively. Comprehensive loss is comprised of net loss and other comprehensive income or loss. We had no other comprehensive income or loss during the three months ended March 31, 2000 and 2001.

4. Reclassifications

Certain prior year amounts have been reclassified to conform with our current year presentation.

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

CAUTIONARY STATEMENT PURSUANT TO SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION ACT OF 1995:

This report and the documents incorporated by reference herein contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. When used in this report and the documents incorporated herein by reference, the words "anticipate," "believe," "may," "expect," "estimate," and similar expressions are generally intended to identify forward-looking statements. These forward-looking statements include, among others, the statements in Management's Discussion and Analysis of Financial Conditions and Results of Operations about our:

- estimate of the sufficiency of our existing cash and cash equivalents and investments to finance our operating and capital

requirements; and
- expectations for future capital requirements.

Our actual results could differ materially from those results expressed in, or implied by, these forward-looking statements. Potential risks and uncertainties that could affect our actual results include the following:

- our ability to commercialize any of our products or technologies;
- our ability to maintain our existing collaborative arrangements and enter into new collaborative arrangements;
- unanticipated cash requirements to support current operations or research and development;
- the timing and extent of funding requirements for the activities of our joint venture with McNeil Specialty; and
- general economic conditions.

These and other risks and uncertainties that could affect our actual results are discussed in greater detail in this report and in our other filings with the Securities and Exchange Commission. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, events, levels of activity, performance, or achievements. We do not assume responsibility for the accuracy and completeness of the forward-looking statements.

We do not undertake any duty to update after the date of this report any of the forward-looking statements in this report to conform them to actual results.

You should read this section in combination with the Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2000, included in our Annual Report on Form 10-K and in our 2000 Annual Report to Stockholders.

Overview

Neose develops proprietary technologies for the synthesis and manufacture of complex carbohydrates, which are chains of simple sugar molecules that can be joined together in many different combinations. Our enzymatic glycosylation technology platform makes feasible the synthesis of a wide range of complex carbohydrates for pharmaceutical, biotechnology, nutritional, and consumer product applications. Our GlycoAdvance program uses our technologies to enable the completion and correction of glycosylation in recombinant glycoprotein discovery, development, and manufacture. Our GlycoTherapeutics program uses our technologies to develop and produce novel carbohydrate-based therapeutics, and our GlycoActives program uses our technologies to develop and produce novel carbohydrate-based food ingredients. We have incurred operating losses each year. As of March 31, 2001, we had an accumulated deficit of approximately $72 million. We expect additional losses for some time as we expand research and development efforts, expand manufacturing scale-up activities, and begin sales and marketing activities.

Results of Operations

Revenues

Revenues from collaborative agreements for the three months ended March 31, 2001 decreased to $312,000 from $1,947,000 for the corresponding period in 2000. Payments under our agreement with Bristol-Myers accounted for approximately $1.6 million of our collaborative revenues in the three months ended March 31, 2000. We do not expect any future payments under this agreement unless Bristol-Myers advises us to resume our activities.

Operating Expenses

Research and development expenses for the three months ended March 31, 2001 increased to $3,167,000 from $2,893,000 for the corresponding period in 2000. The increase during the 2001 period was primarily attributable to increased personnel and related costs.

General and administrative expenses for the three months ended March 31, 2001 increased to $1,666,000 from $1,280,000 for the corresponding period in 2000. The increase during the 2001 period was primarily attributable to the hiring of additional business development and administrative personnel and related costs.

Interest Income and Expense

Interest income for the three months ended March 31, 2001 increased to $1,321,000 from $519,000 for the corresponding period in 2000. The increase was due to higher average cash and marketable securities balances during the 2001 period.

Interest expense for the three months ended March 31, 2001 decreased to $99,000 from $119,000 for the corresponding period in 2000. The decrease was due to lower interest rates and lower average loan balances outstanding during the 2001 period.

Net Loss

Our net loss for the three months ended March 31, 2001 increased to $3,299,000, or $0.24 per share, from $1,826,000, or $0.15 per share, for the corresponding period in 2000.

Liquidity and Capital Resources

We have incurred operating losses each year since our inception. As of March 31, 2001, we had an accumulated deficit of approximately $72 million. We have financed our operations through private and public offerings of our securities, and revenues from our collaborative agreements. We had $90.6 million in cash and marketable securities as of March 31, 2001, compared to $94.8 million in cash and marketable securities as of December 31, 2000.

During the quarter ended March 31, 2001, we purchased approximately $288,000 of property, equipment, and building improvements. We anticipate making capital expenditures during 2001 of at least $10 million to provide additional cGMP manufacturing capacity in our Horsham, Pennsylvania facility to support the initial requirements of our anticipated GlycoAdvance customers. Even if we make these capital expenditures, we may not be able to enter into collaborations with potential GlycoAdvance customers. In addition, we anticipate in the next 12 to 24 months we will obtain, either through lease or purchase, another facility of at least 70,000 square feet. We plan to relocate all non-cGMP research laboratories and corporate office space from our current facility in Horsham, Pennsylvania into the new facility, leaving our current facility available for future expansion of our cGMP manufacturing capacity.

We may be required to make additional investments in our joint venture with McNeil Specialty to fund capital expenditures. If the joint venture builds additional production facilities, and we wish to maintain our 50% ownership interest in the joint venture, we are required to invest up to $8.85 million to fund half of such expenditures. However, we may elect to fund as little as $1.85 million of the cost of the facilities, so long as our aggregate investments in the joint venture are at least 15% of the joint venture's aggregate capital expenditures. In this case, McNeil Specialty will fund the remainder of our half of the joint venture's capital expenditures, and our ownership percentage will be proportionately reduced. We have an option, expiring in September 2006, to return to 50% ownership of the joint venture by reimbursing McNeil Specialty for this amount.

In 1997, we issued, through the Montgomery County (Pennsylvania) Industrial Development Authority, $9.4 million of taxable and tax-exempt bonds. The bonds were issued to finance the purchase of our previously leased building and the construction of a pilot-scale manufacturing facility within our building. The bonds are supported by an AA-rated letter of credit, and a reimbursement agreement between our bank and the letter of credit issuer. The interest rate on the bonds will vary weekly, depending on market rates for AA-rated taxable and tax-exempt obligations, respectively. As of March 31, 2001, the weighted-average, effective interest rate was 6.5% per year, including letter-of-credit and other fees.The terms of the bond issuance provide for monthly, interest-only payments and a single repayment of principal at the end of the twenty-year life of the bonds. However, under our agreement with our bank, we are making monthly payments to an escrow account to provide for an annual prepayment of principal. As of March 31, 2001, we had restricted funds relating to the bonds of $1,174,000, which consisted of our monthly payments to an escrow account plus interest revenue on the balance of the escrow account.

To provide credit support for this arrangement, we have given a first mortgage on the land, building, improvements, and certain machinery and equipment to our bank. We have also agreed to a covenant, which was renegotiated in May 2000, to maintain a minimum required cash and short-term investments balance of at least two times the current loan balance. At March 31, 2001, we were required to maintain a cash and short-term investments balance of $14.6 million, rather than $20 million as required under the original covenant. If we fail to comply with this covenant, we are required to deposit with the lender cash collateral up to, but not more than, the loan's unpaid balance, which was $7.3 million as of March 31, 2001.

We expect that our existing cash and short-term investments will be adequate to fund our operations through at least 2002, although changes in our collaborative relationships or our business, whether or not initiated by us, may cause us to deplete our cash and short-term investments sooner than the above estimate. The timing and amount of our future capital requirements and the adequacy of available funds will depend on many factors, including if or when any products manufactured using our technology are commercialized.

Joint Venture with McNeil Specialty

Our joint venture with McNeil Specialty is owned equally by Neose and McNeil Specialty. Each of Neose and McNeil Specialty contributed various intellectual property to the joint venture. In addition, McNeil Specialty contributed to the joint venture the pilot commercial manufacturing facility, for which 50% of the cost will be reimbursed by the joint venture. We account for our investment in the joint venture under the equity method, under which we recognize our share of the income and losses of the joint venture. In 1999, we reduced the carrying value of our initial investment in the joint venture of approximately $350,000 to zero to reflect our share of the joint venture's losses. We recorded this amount as research and development expense in our Consolidated Statements of Operations. We will record our share of post-1999 losses of the joint venture, however, only to the extent of our actual or committed investment in the joint venture.

If the joint venture becomes profitable, we will recognize our share of the joint venture's profits only after the amount of our capital contributions to the joint venture is equivalent to our share of the joint venture's accumulated losses. As of March 31, 2001, the joint venture had an accumulated loss since inception of approximately $5 million, of which our 50% share is approximately $2.5 million. Until the joint venture is profitable, McNeil Specialty is required to fund, as a non-recourse, no-interest loan, all of the joint venture's aggregate capital expenditures in excess of an agreed-upon amount, and all of the joint venture's operating losses. The loan balance would be repayable by the joint venture to McNeil Specialty over a seven-year period commencing on the earlier of September 30, 2006 or the date on which Neose attains a 50% ownership interest in the joint venture after having had a lesser ownership interest. In the event of any dissolution of the joint venture, the loan balance would be payable to McNeil Specialty before any distribution of assets to us. As of March 31, 2001, the joint venture owed McNeil Specialty approximately $7 million.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Our holdings of financial instruments are comprised primarily of government agency securities. All such instruments are classified as securities held to maturity. We seek reasonable assuredness of the safety of principal and market liquidity by investing in rated fixed income securities, while at the same time, seeking to achieve a favorable rate of return. Our market risk exposure consists principally of exposure to changes in interest rates. Our holdings are also exposed to the risks of changes in the credit quality of issuers. We typically invest in the shorter-end of the maturity spectrum. The approximate principal amount and weighted-average interest rate of our investment portfolio at March 31, 2001 was $90,534,000 and 5.2%, respectively.

We have exposure to changing interest rates on our taxable and tax-exempt bonds, and we are currently not engaged in hedging activities. Interest on approximately $7.3 million of outstanding indebtedness is at an interest rate which varies weekly, depending on the market rates for AA-rated taxable and tax exempt obligations. As of March 31, 2001, the weighted-average, effective interest rate was 6.5% per year.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.

(a) List of Exhibits: None

(b) Reports on Form 8-K. None.

SIGNATURES

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

NEOSE TECHNOLOGIES, INC.

Date: May 15, 2001

By: /s/ P. Sherrill Neff

P. Sherrill Neff
President, Chief Operating Officer and
Chief Financial Officer