AVI BIOPHARMA INC
Form 10-Q
November 09, 2007

UNITED STATES

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 September 30, 2007

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from to

Commission file number 0-22613

AVI BIOPHARMA, INC.

(Exact name of registrant as specified in its charter)

Oregon (State or other jurisdiction of incorporation or organization)	**93-0797222** (I.R.S. Employer Identification No.)
One SW Columbia Street, Suite 1105, Portland, Oregon (Address of principal executive offices)	**97258** (Zip Code)

Issuer s telephone number, including area code: **503-227-0554**

Indicate by check mark 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 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 o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Securities Exchange Act of 1934 (Check one):

Large accelerated filer o Accelerated filer x Non-accelerated filer o.

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

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Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock with $.0001 par value (Class)	**53,730,376** (Outstanding at November 2, 2007)

AVI BIOPHARMA, INC.

FORM 10-Q

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AVI BIOPHARMA, INC.

(A Development Stage Company)

BALANCE SHEETS

(unaudited)

	September 30, 2007	December 31, 2006
Assets		
Current Assets:		
Cash and cash equivalents	$ 3,861,272	$ 20,159,201
Short-term securities available-for-sale	10,188,487	12,992,931
Accounts receivable	1,751,367	51,498
Other current assets	952,987	736,283
Total Current Assets	16,754,113	33,939,913
Property and Equipment, net of accumulated depreciation and amortization of $11,472,216 and $10,174,712	7,099,321	4,329,583
Patent Costs, net of accumulated amortization of $1,674,130 and $1,496,699	2,976,692	2,558,541
Other Assets	34,709	34,709
Total Assets	$ 26,864,835	$ 40,862,746
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable	$ 5,274,320	$ 1,401,584
Accrued employee compensation	1,325,351	1,371,353
Long-term debt, current portion	70,261	
Warrant liability	1,642,246	5,192,576
Other liabilities	1,238,152	377,908
Total Current Liabilities	9,550,330	8,343,421
Commitments and Contingencies		
Long-term debt, non-current portion	2,088,797	
Shareholders Equity:		
Preferred stock, $.0001 par value, 20,000,000 shares authorized; none issued and outstanding		
Common stock, $.0001 par value, 200,000,000 shares authorized; 53,730,376 and 53,182,841 issued and outstanding	5,373	5,318
Additional paid-in capital	237,450,696	231,685,419
Accumulated other comprehensive income		18,418
Deficit accumulated during the development stage	(222,230,361)	(199,189,830)
Total Shareholders Equity	15,225,708	32,519,325
Total Liabilities and Shareholders Equity	$ 26,864,835	$ 40,862,746

See accompanying notes to financial statements.

AVI BIOPHARMA, INC.

(A Development Stage Company)

STATEMENTS OF OPERATIONS

(unaudited)

	Three months ended September 30, 2007	Three months ended September 30, 2006 (Restated)	Nine months ended September 30, 2007	Nine months ended September 30, 2006 (Restated)	July 22, 1980 (inception) through September 30, 2007
Revenues from license fees, grants and research contracts	$ 2,911,406	$ 13,252	$ 5,798,872	$ 97,772	$ 15,779,691
Operating expenses:					
Research and development	9,880,480	5,938,867	25,358,937	18,624,041	173,006,152
General and administrative	1,544,512	1,347,114	7,879,193	5,684,551	48,699,721
Acquired in-process research and development					19,545,028
	11,424,992	7,285,981	33,238,130	24,308,592	241,250,901
Other income (loss):					
Interest income, net	182,320	492,083	848,397	1,466,995	8,297,939
Gain on warrant liability	1,296,322	529,136	3,550,330	135,453	8,081,756
Realized gain on sale of short-term securities available-for-sale					3,862,502
Write-down of short-term securities available-for-sale					(17,001,348)
	1,478,642	1,021,219	4,398,727	1,602,448	3,240,849
Net loss	$ (7,034,944)	$ (6,251,510)	$ (23,040,531)	$ (22,608,372)	$ (222,230,361)
Net loss per share - basic and diluted	$ (0.13)	$ (0.12)	$ (0.43)	$ (0.43)	
Weighted average number of common shares outstanding for computing basic and diluted loss per share	53,693,693	52,964,049	53,500,250	52,546,293	

See accompanying notes to financial statements.

AVI BIOPHARMA, INC.

(A Development Stage Company)

STATEMENTS OF CASH FLOWS

(unaudited)

	Nine months ended September 30, 2007	Nine months ended September 30, 2006 (Restated)	For the Period July 22, 1980 (Inception) to September 30, 2007
Cash flows from operating activities:			
Net loss	$ (23,040,531)	$ (22,608,372)	$ (222,230,361)
Adjustments to reconcile net loss to net cash flows used in operating activities:			
Depreciation and amortization	1,506,768	1,560,636	14,327,007
Loss on disposal of assets	58,584	192,369	373,762
Realized gain on sale of short-term securities available-for-sale			(3,862,502)
Write-down of short-term securities available-for-sale			17,001,348
Issuance of common stock to vendors	700,000	700,000	2,075,000
Compensation expense on issuance of common stock and partnership units			861,655
Compensation expense to non-employees on issuance of options and warrants to purchase common stock or partnership units	312,637	525,126	2,955,690
Stock-based compensation	3,933,926	3,946,821	8,815,396
Conversion of interest accrued to common stock			7,860
Acquired in-process research and development			19,545,028
Gain on warrant liability	(3,550,330)	(135,453)	(8,081,756)
(Increase) decrease in:			
Accounts receivable and other current assets	(1,916,573)	737,997	(2,704,354)
Other assets		2,900	(34,709)
Net increase (decrease) in accounts payable, accrued employee compensation, and other liabilities	4,646,244	(390,094)	8,092,089
Net cash used in operating activities	(17,349,275)	(15,468,070)	(162,858,847)
Cash flows from investing activities:			
Purchase of property and equipment	(1,151,800)	(734,894)	(16,450,311)
Patent costs	(651,649)	(519,179)	(5,126,679)
Purchase of marketable securities	(110,417)	(4,400,635)	(112,976,213)
Sale of marketable securities	2,896,443	4,013,570	107,696,880
Acquisition costs			(2,377,616)
Net cash provided by (used in) investing activities	982,577	(1,641,138)	(29,233,939)
Cash flows from financing activities:			
Proceeds from sale of common stock, warrants, and partnership units, net of offering costs, and exercise of options and warrants	68,769	8,089,722	196,339,495
Buyback of common stock pursuant to rescission offering			(288,795)
Withdrawal of partnership net assets			(176,642)
Issuance of convertible debt			80,000
Net cash provided by financing activities	68,769	8,089,722	195,954,058

Increase (decrease) in cash and cash equivalents		(16,297,929)		(9,019,486)		3,861,272
Cash and cash equivalents:						
Beginning of period		20,159,201		34,597,734		
End of period	$	3,861,272	$	25,578,248	$	3,861,272
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES AND FINANCING ACTIVITIES:						
Short-term securities available-for-sale received in connection with the private offering	$		$		$	17,897,000
Change in unrealized gain (loss) on short-term securities available-for-sale	$	(18,418)	$	6,359	$	
Issuance of common stock and warrants in satisfaction of liabilities	$		$	175,000	$	545,000
Issuance of common stock for building purchase	$	750,000	$		$	750,000
Assumption of long-term debt for building purchase	$	2,199,792	$		$	2,199,792
Issuance of warrants in connection with financing arrangements	$		$		$	9,724,002

See accompanying notes to financial statements.

AVI BIOPHARMA, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The financial information included herein for the three and nine-month periods ended September 30, 2007 and 2006 and the financial information as of September 30, 2007 is unaudited; however, such information reflects all adjustments consisting only of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The financial information as of December 31, 2006 is derived from AVI BioPharma, Inc. s (the Company s) Form 10-K/A. The interim financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company s Form 10-K/A. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

Stock-based compensation costs are generally based on the fair value calculated from the Black-Scholes option-pricing model on the date of grant for stock options and on the date of enrollment for the Plan. The fair value of stock grants is amortized as compensation expense on a straight-line basis over the vesting period of the grants. Stock options granted to employees are service-based and typically vest over four years.

The fair market values of stock options granted during the periods presented were measured on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions:

Three and Nine Months Ended September 30,	2007	2006
Risk-free interest rate	4.83%	4.14%
Expected dividend yield	0%	0%
Expected lives	8.0 years	9.3 years
Expected volatility	89%	91%

The risk-free interest rate is estimated using an average of treasury bill interest rates. The expected dividend yield is zero as the Company has not paid any dividends to date and does not expect to pay dividends in the future. The expected lives are estimated using expected and historical exercise behavior. The expected volatility is estimated using historical calculated volatility and considers factors such as future events or circumstances that could impact volatility.

As part of the requirements of FSAS 123R, the Company is required to estimate potential forfeiture of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods.

A summary of the Company s stock option compensation activity with respect to the nine months ended September 30, 2007 follows:

Stock Options	**Shares**		**Weighted Average Exercisable Price**	**Weighted Average Remaining Contractual Term**		**Aggregate Intrinsic Value**
Outstanding at January 1, 2007	5,571,470	$	5.12			
Granted	1,197,548	$	2.79			
Exercised	(11,639)	$	2.49			
Canceled or expired	(457,853)	$	5.91			
Outstanding at September 30, 2007	6,299,526	$	4.62	5.54	$	(11,531,643)
Vested at September 30, 2007 and expected to vest	6,262,580	$	4.63	5.52	$	(11,481,940)
Exercisable at September 30, 2007	4,452,205	$	4.83	4.32	$	(9,046,519)

The weighted average fair value per share of stock-based payments granted to employees during the nine months ended September 30, 2007 and September 30, 2006 was $2.26 and $6.09, respectively. During the same periods, the total intrinsic value of stock options exercised were $4,937 and $773,798, and the total fair value of stock options that vested were $2,876,554 and $3,113,321, respectively.

As of September 30, 2007, there was $3,520,157 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. These costs are expected to be recognized over a weighted-average period of 1.9 years.

During the nine months ended September 30, 2007, $29,002 was received for the exercise of stock options. The Company is obligated to issue shares from the 2002 Equity Incentive Plan upon the exercise of stock options. The Company does not currently expect to repurchase shares from any source to satisfy its obligations under the Plan.

The following are the stock-based compensation costs recognized in the Company s statements of operations:

		Three Months Ended September 30, 2007		**Nine Months Ended September 30, 2007**
Research and development	$	497,002	$	1,381,687
General and administrative		282,088		1,494,867
Total	$	779,090	$	2,876,554

		Three Months Ended September 30, 2006		**Nine Months Ended September 30, 2006**
Research and development	$	644,304	$	1,822,385
General and administrative		359,246		1,290,936
Total	$	1,003,550	$	3,113,321

The 2000 Employee Stock Purchase Plan (ESPP) provides that eligible employees may contribute, through payroll, deductions, up to 10% of their earnings toward the purchase of the Company s Common Stock at 85% of the fair market value at specific dates. On January 1, 2006, the Company adopted SFAS 123R, which requires the measurement and recognition of compensation expense for all share based payment awards made to the Company s employees and directors related to the Employee Stock Purchase Plan, based on estimated fair values. During the three and nine-month periods ended September 30, 2007 the total compensation expense for participants in the ESPP was $10,751 and $29,465, respectively, using the Black-Scholes option-pricing model with a weighted average estimated fair value per share of $1.09, expected life of six months, risk free interest rate of 4.93%, volatility of 56.92%, and no dividend yield. During the three and nine-month periods ended September 30, 2006 the total compensation expense for participants in the ESPP was $12,531 and $45,250, respectively, using the Black-Scholes option-pricing model with a weighted average estimated fair value per share of $1.44, expected life of six months, risk free interest rate of 4.32%, volatility of 88.15%, and no dividend yield. At September 30, 2007, 230,687 shares remain available for purchase through the plan and there were 95 employees eligible to participate in the plan, of which 31 were participants.

On March 27, 2007, in connection with his resignation, the Company entered into a Separation and Release Agreement with AVI s former Chairman and Chief Executive Officer. Pursuant to this agreement, he may exercise his previously granted options until the earlier of the termination date specified in the respective stock option grant agreements or March 28, 2010. This modification of these stock options in the first quarter of 2007 increased compensation costs by $1,057,372.

On March 15, 2006 unvested stock options for nine employees in the Company s Colorado facility were accelerated. These employees joined Cook Group Inc. in April 2006. The acceleration of these stock options in the first quarter of 2006 increased compensation costs by $833,500.

During the three and nine-month periods ended September 30, 2007 the total compensation expense for stock-based compensation was $779,090 and $3,933,926, respectively. During the three and nine-month periods ended September 30, 2006 the total compensation expense for stock-based compensation was $1,003,550 and $3,946,821, respectively.

The Company records the fair value of stock options granted to non-employees in exchange for services in accordance with EITF 96-18 *Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. The fair value of the options granted is expensed when the measurement date is known. The performance for services was satisfied on the grant date for stock options granted to non-employees. The total fair value of the options granted to non-employees during the nine months ended September 30, 2007 and September 30, 2006 was $312,637 and $525,126, respectively, which was expensed to research and development.

Warrants. Certain of the Company s warrants issued in connection with financing arrangements are classified as liabilities in accordance with EITF 00-19, *Accounting for derivative financial instruments indexed to, and potentially settled in, a Company s own stock.*

The fair market value of these warrants is recorded on the balance sheet at issuance and marked to market at each financial reporting period. The change in the fair value of the warrants is recorded in the Statement of Operations as a non-cash gain (loss) and is estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

Three and Nine Months Ended September 30,	**2007**	**2006**
Risk-free interest rate	3.9%-4.0%	4.5%-4.6%
Expected dividend yield	0%	0%
Expected lives	1.2-2.6 years	2.2-3.6 years
Expected volatility	57.6%-71.2%	86.8%-91.3%

The risk-free interest rate is estimated using an average of treasury bill interest rates. The expected dividend yield is zero as the Company has not paid any dividends to date and does not expect to pay dividends in the future. The expected lives are based on the remaining contractual lives of the related warrants. The expected volatility is estimated using historical calculated volatility and considers factors such as future events or circumstances that could impact volatility.

For warrants classified as permanent equity in accordance with EITF 00-19, the fair value of the warrants is recorded in shareholders equity and no further adjustments are made.

Commitments and Contingencies. In the normal course of business, the Company may be named as a party to various legal claims, actions and complaints, including matters involving employment, intellectual property, effects from the use of drugs utilizing our technology, or others. It is impossible to predict with certainty whether any resulting liability would have a material adverse effect on the Company s financial position, results of operations or cash flows.

Financial Instruments. The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable, and other current monetary assets and liabilities approximate fair value because of the immediate or short-term maturity of these financial instruments.

License Arrangements. License arrangements may consist of non-refundable upfront license fees, data transfer fees, research reimbursement payments, exclusive licensed rights to patented or patent pending compounds, technology access fees, various performance or sales milestones and future product royalty payments. Some of these arrangements are multiple element arrangements.

The Company defers recognition of non-refundable upfront fees if it has continuing performance obligations without which the technology, right, product or service conveyed in conjunction with the non-refundable fee has no utility to the licensee that is separate and independent of Company performance under the other elements of the arrangement. In addition, if the Company has continuing involvement through research and development services that are required because its know-how and expertise related to the technology is proprietary to the Company, or can only be performed by the Company, then such up-front fees are deferred and recognized over the period of continuing involvement.

Payments related to substantive, performance-based milestones in a research and development arrangement are recognized as revenue upon the achievement of the milestones as specified in the underlying agreements when they represent the culmination of the earnings process.

Government Research Contract Revenue. The Company recognizes revenues from federal research contracts during the period in which the related expenditures are incurred. The Company presents these revenues and related expenses at gross in the consolidated financial statements in accordance with EITF 99-19 *Reporting Revenue Gross as a Principal versus Net as an Agent*.

Income Taxes. In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for the Company as of January 1, 2007, with cumulative effect, if any, of applying FIN 48 recorded as an adjustment to opening retained earnings in the year of adoption. The Company adopted FIN 48 on January 1, 2007, which did not have a material impact on the consolidated financial statements. See Note 8.

Note 2. Restatement of Prior Financial Information:

In December 2003, January 2004, January 2005 and November 2005, the Company issued warrants in connection with various financing transactions in registered offerings. Previously, the Company had classified these warrants in the shareholders equity section of the Company s balance sheet. In accordance with EITF 00-19, if a financial instrument requires settlement in registered shares, the financial instrument cannot be classified within equity, as the company s ability to maintain an effective registration statement is outside that company s control. The warrants issued by the Company require settlement in registered shares and accordingly, should be recorded as a liability at fair value at the date of grant, and marked to market at each reporting period.

The Company has evaluated the financial statement impact in each of the previously filed reporting periods effected, and concluded that the changes are quantitatively material to its previously filed financial statements. The amounts previously recorded in each of the three and nine month periods ended September 30, 2006 will be adjusted to reduce equity and increase liabilities for the issued warrants, and changes in fair value will be recorded on their own line item.

The effect of the correction of this error on the statement of operations for the three month period ended September 30, 2006 is summarized as follows:

	September 30, 2006 As Previously Reported	Adjustments	September 30, 2006 As Restated
Gain on warrant liability		529,136	529,136
Net loss	(6,780,646)	529,136	(6,251,510)
Net loss per share (basic and diluted)	(0.13)	0.01	(0.12)

The effect of the correction of this error on the statement of operations for the nine month period ended September 30, 2006 is summarized as follows: