CARTERS INC
Form 10-Q
August 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007**

OR

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:
001-31829

CARTER S, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**13-3912933**
(state or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

The Proscenium
1170 Peachtree Street NE, Suite 900
Atlanta, Georgia 30309
(Address of principal executive offices, including zip code)

(404) 745-2700
(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 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 Exchange Act. (Check one)

Large Accelerated Filer x Accelerated Filer o Non-Accelerated Filer o

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

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

Common Stock	**Outstanding Shares at August 9, 2007**
Common stock, par value $0.01 per share	57,894,685

CARTER S, INC.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CARTER S, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except for share data)

(unaudited)

	June 30, 2007	December 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,848	$ 68,545
Accounts receivable, net	104,534	110,615
Finished goods inventories, net	231,588	193,588
Prepaid expenses and other current assets	15,000	7,296
Assets held for sale	6,109	
Deferred income taxes	19,087	22,377
Total current assets	396,166	402,421
Property, plant, and equipment, net	72,693	87,940
Tradenames	310,233	322,233
Cost in excess of fair value of net assets acquired	136,570	279,756
Deferred debt issuance costs, net	5,320	5,903
Licensing agreements, net	10,767	12,895
Leasehold interests, net	918	1,151
Other assets	9,568	10,892
Total assets	$ 942,235	$ 1,123,191
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 2,627	$ 2,627
Accounts payable	85,872	70,878
Other current liabilities	28,563	63,012
Total current liabilities	117,062	136,517
Long-term debt	340,653	342,405
Deferred income taxes	115,150	125,784
Other long-term liabilities	32,708	22,994
Total liabilities	605,573	627,700
Commitments and contingencies		
Stockholders equity:		
Preferred stock; par value $.01 per share; 100,000 shares authorized; none issued or outstanding at June 30, 2007 and December 30, 2006		
Common stock, voting; par value $.01 per share; 150,000,000 shares authorized; 58,185,355 and 58,927,280 shares issued and outstanding at June 30, 2007 and December 30, 2006, respectively	582	589
Additional paid-in capital	247,587	275,045
Accumulated other comprehensive income	5,187	5,301
Retained earnings	83,306	214,556

Total stockholders equity	336,662	495,491
Total liabilities and stockholders equity	$ 942,235	$ 1,123,191

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(dollars in thousands, except per share data)

(unaudited)

	For the three-month periods ended		For the six-month periods ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
Net sales	$ 287,775	$ 277,577	$ 607,903	$ 574,024
Cost of goods sold	192,357	180,342	406,105	368,625
Gross profit	95,418	97,235	201,798	205,399
Selling, general, and administrative expenses	84,635	82,466	172,881	165,448
Intangible asset impairment (Note 3)	154,886		154,886	
Closure costs	470	10	4,977	91
Royalty income	(6,700)	(6,654)	(14,245)	(13,828)
Operating (loss) income	(137,873)	21,413	(116,701)	53,688
Interest expense, net	5,704	6,929	11,432	13,813
(Loss) income before income taxes	(143,577)	14,484	(128,133)	39,875
(Benefit from) provision for income taxes	(128)	5,466	5,705	15,071
Net (loss) income	$ (143,449)	$ 9,018	$ (133,838)	$ 24,804
Basic net (loss) income per common share	$ (2.48)	$ 0.16	$ (2.30)	$ 0.43
Diluted net (loss) income per common share	$ (2.48)	$ 0.15	$ (2.30)	$ 0.41
Basic weighted-average number of shares outstanding	57,838,075	57,877,753	58,142,782	57,793,393
Diluted weighted-average number of shares outstanding	57,838,075	61,183,491	58,142,782	61,160,185

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(unaudited)

Cash flows from operating activities:
Net (loss) income
Adjustments to reconcile net (loss) income to net cash used in operating activities:
Depreciation and amortization
Amortization of debt issuance costs
Non-cash intangible asset impairment charges
Non-cash stock-based compensation expense
Income tax benefit from exercised stock options
Loss on sale of property, plant, and equipment
Deferred income taxes
Non-cash closure costs
Effect of changes in operating assets and liabilities:
Accounts receivable

Inventories	
Prepaid expenses and other assets	
Accounts payable and other liabilities	
Net cash used in operating activities	
Cash flows from investing activities:	
Capital expenditures	
Proceeds from sale of property, plant, and equipment	
Net cash used in investing activities	
Cash flows from financing activities:	
Payments on term loan	
Share repurchase	
Income tax benefit from exercised stock options	
Proceeds from exercise of stock options	
Net cash used in financing activities	

Pursuant to its terms, the agreement expired in February 2012, following the completion of the Phase 1 clinical tria
Company received the final reimbursement of $195,500 in February 2012 and a total of $1,550,000 over the life of
in the Company’s Condensed Statement of Operations.

6. CONVERTIBLE NOTES PAYABLE

On March 15, 2013, the Company entered into a convertible note purchase agreement with certain accredited inves
principal amount of up to $500,000 of secured convertible promissory notes (the “2013 Notes”) for an aggregate or
discount. The closing of the private placement also occurred on March 15, 2013, and resulted in the sale of the 201

aggregate original issue price of $382,500. The original issue discount is $67,500 and is being amortized to interest
unamortized balance of this original issue discount is $47,713.

The 2013 Notes, which have a maturity date of March 15, 2014, do not bear interest and may be prepaid without pe
Notes. The 2013 Notes are secured by a blanket lien on our assets pursuant to a security agreement dated March 15

The 2013 Notes contain an optional conversion feature that enables the Holder to convert all outstanding shares int
share equal to the average daily Closing Price over the ten consecutive trading days preceding the date of such prep
only if the Company chooses to prepay the Notes in whole or in part without penalty upon 30 days' prior written no
period).

Pursuant to the terms of the 2013 Notes, upon a Change of Control (as defined in the 2013 Notes) in which either (
exchanged for securities of another corporation, or (ii) the Company issues shares of common stock, with no securi
common stock (e.g., a merger transaction in which the Company acquires another corporation in exchange for shar
the applicable 2013 Note shall automatically convert, as of immediately prior to the effective time of the Change of
conversion price per share equal to the Closing Price (as defined in the Notes) on the effective date of the Change o
holder a five-year warrant entitling the holder to purchase, at an exercise price equal to the Closing Price on the eff
common stock obtained by dividing (a) the sum of the outstanding principal under the applicable Note by (b) the C
Change of Control other than as described in the preceding sentence, the Company shall pay to each 2013 Note hol
outstanding under the applicable Note. Upon payment of such amount to the 2013 Note holders, all of the obligatio

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Notes to Financial Statements

6. CONVERTIBLE NOTES PAYABLE (Continued)

The warrants issuable upon a Change of Control are considered an embedded derivative and were bifurcated from t
of the warrants was $203,400 on March 15, 2013, date of issuance and were recorded as additional debt discount (N
basis until the warrants are issued or the 2013 Notes are repaid in full. As of June 30, 2013, the fair value of the wa
warrants at issuance. Following the entry into the merger agreement with Capricor (Note 11), the probability of issu
assumptions for the Black-Scholes valuation of the 2013 Notes on March 15, 2013 and June 30, 2013:

	March 15, 2013		June 30, 2
Stock Price :	$ 0.09		$ 0.05
Strike Price :	$ 0.09		$ 0.05
Risk-free Rate:	0.84	%	1.41
Volatility	148	%	148
Term	5 years		5 years
Probability of issuance:	50	%	90

The discount is being amortized to interest expense over the one year term of the 2013 Notes. As of June 30, 2013,

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company defines fair value as the amount at which an asset (or liability) could be bought (or incurred) or sold
other than in a forced or liquidation sale. The fair value estimates presented in the table below are based on informa

The accounting standard regarding fair value measurements discusses valuation techniques, such as the market app
value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or repla
prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a b

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. T markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

The Company has determined the fair value of certain liabilities using the market approach. The following table pr at fair value on a recurring basis as of June 30, 2013:

	Fair Value June 30, 2013	Quoted Market Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inpu (Level 3)
Liabilities				
Warrant liability - April 2012 issuance	$ 104,687	$ -	$ -	$ 104,687
Warrant liability - 2013 Notes	407,400	-	-	407,400
Total	$ 512,087	$ -	$ -	$ 512,087

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(A Development Stage Company)

Notes to Financial Statements

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The fair value of the warrant liability relating to the 2013 Notes (Note 6) was estimated by management using the B
of the warrant liability are recorded in other income (expense) on the Condensed Statements of Operations.

The fair value of the warrant liability relating to the warrants issued in conjunction with the April 2012 financing (N
pricing model. The binomial option pricing model is a generally accepted valuation model used to generate a defin
estimate of the range of the Company's future expected stock prices, and their resulting probabilistic valuation. The
other income (expense) on the Condensed Statements of Operations.

The following table provides a summary of changes in fair value of the Company's liabilities, as well as the portion
that relate to those liabilities held at June 30, 2013:

	Fair Value Measurements Us Significant Unobservable Inp (Level 3) Warrant Liability
Balance at January 1, 2013	$ 63,384
Purchases, sales and settlements:	
Derivatives issued	203,400
Total gains or losses	
Unrealized appreciation	245,303
Balance at June 30, 2013	$ 512,087

8. STOCKHOLDERS' EQUITY

On July 7, 2013, the Company entered into an Agreement and Plan of Merger and Reorganization with Capricor, I
wholly-owned subsidiary of the Company. Pursuant to this agreement, Bovet Merger Corp. will merge with and int
and a wholly-owned subsidiary of the Company. In connection with this merger transaction, the current stockholde
stock a number of shares of the Company's common stock such that, following the merger, the former Capricor sto
common stock on a fully-diluted basis.

(a) Common Stock

On April 4, 2012, the Company closed an offering with certain purchasers pursuant to which it sold an aggregate o
purchasers for a purchase price of $0.40 per share. In addition, for each share purchased, each purchaser also receiv
share of common stock at an exercise price of $0.50 per share, which resulted in the issuance of warrants to purcha
stock. The warrants contain non-standard anti-dilution features (Note 8b) and as result will be classified as a liabilit

The total gross proceeds from the offering were $1.34 million, before deducting selling commissions and other offe
the offering, the Company engaged Roth Capital Partners, LLC, or Roth, to serve as placement agent. Pursuant to t
Roth a cash fee equal to seven percent of the gross proceeds received by the Company, or approximately $0.11 mil
Richard B. Brewer, the Company's former Executive Chairman, Joshua A. Kazam, the Company's former Presider
Company's Chief Financial Officer, and Hsiao Lieu, M.D., the Company's former Executive VP of Clinical Devel
unaffiliated purchasers, and collectively purchased 275,000 shares of common stock and warrants to purchase 206,
$110,000.

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Notes to Financial Statements

8. STOCKHOLDERS' EQUITY (Continued)

(b) Warrants

In connection with the April 2012 financing, as discussed above, the Company issued a total of 2,512,500 warrants
purchase one share of the Company's common stock at an exercise price of $0.50 per share. The warrants contain r
Company issues common shares at a price below the current exercise price of the warrants, the exercise price of the
Because of this anti-dilution provision and the inherent uncertainty as to the probability of future common share iss
for valuing stock options could not be used. Management used a binomial option pricing model to determine the wa
issuance and $0.1 million at June 30, 2013. The binomial option pricing model (Note 7) is used for the valuation of
until the warrants are exercised or they expire with the changes in fair value recorded in other income (expense) on

Significant assumptions used at June 30, 2013 for the warrants included a weighted average term of 3.75 years, vol

In connection with the 2011 Offering, the Company issued a total of 2,500,000 Warrants, each of which has a term
Company's common stock at an exercise price of $0.60 per share. In addition, the Company issued the Placement A
Company's common stock at an exercise price of $0.60 per share.

Below is a table that summarizes all outstanding warrants to purchase shares of the Company's common stock as o

Grant Date	Warrants Issued	Exercise Price Range	Weighted Average Exercise Price	Expiration Date	Exercised	Warrants Outstanding
7/15/2009	2,909,695	$1.25-2.28	$ 1.64	7/14/2014	5,000	2,904,695
4/21/2010	2,632,500	$0.94	$ 0.94	4/20/2015	-	2,632,500
6/20/2011	2,750,000	$0.60	$ 0.60	6/19/2016	-	2,750,000
4/4/2012	2,512,500	$0.50	$ 0.50	4/3/2017	-	2,512,500

10,804,695	$ 0.99	5,000	10,799,695

On August 1, 2013, the Company entered into warrant exchange agreements with each holder of the warrants to pu
were issued in connection with the 2011 Offering. Pursuant to such agreements, each such holder received 0.1667 s
purchasable under the warrants held by such holder. The Company issued a total number of 458,332 shares of its co
result, all of the warrants issued in connection with the 2011 Offering have been cancelled.

9. STOCK OPTION PLAN

The Company's Amended and Restated 2005 Stock Option Plan (the "Plan") was initially adopted by the Board of
2,000,000 shares of common stock for issuance. On September 17, 2007, pursuant to the merger with SMI, the Plan
Plan was substituted with 2.758838 shares of common stock, resulting in an aggregate of 5,517,676 shares availabl
approved an amendment to the Plan increasing the total number of shares authorized for issuance thereunder to 9,5
employees, directors, consultants, and advisors. Incentives under the Plan may be granted in any one or a combinat
non-statutory stock options, (b) stock appreciation rights, (c) stock awards, (d) restricted stock and (e) performance
committee appointed by the Board, which determines the recipients and types of awards to be granted, as well as th
vesting schedule. The term of stock options granted under the Plan cannot exceed ten years. Currently, stock option
the Company's common stock on the date of grant, and generally vest over a period of one to four years.

For the three and six months ended June 30, 2013 and June 30, 2012, the Company did not issue any employee stoc

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Notes to Financial Statements

9. STOCK OPTION PLAN (Continued)

A summary of the status of the options issued under the Plan at June 30, 2013, and information with respect to the

	Shares Available for Grant	Outstanding Stock Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Balance at January 1, 2013	4,537,522	4,571,046	$ 1.24	
Options granted under the Plan	-	-	$ -	
Options exercised	-	-	$ -	
Options forfeited	290,000	(290,000)	$ 2.33	
Balance at June 30, 2013	4,827,522	4,281,046	$ 1.25	$ -
Exercisable at June 30, 2013		4,281,046	$ 1.25	$ -

The following table summarizes information about stock options outstanding at June 30, 2013:

	Outstanding			Exercisable	
Range of Exercise Prices	Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Total Shares	Weighted-Average Exercise Price
$0.09 to $0.57	1,506,533	5.43	$ 0.40	1,506,533	$ 0.40
$0.68 to $0.93	1,469,820	4.62	$ 0.82	1,469,820	$ 0.82
$1.46 to $2.71	974,693	5.04	$ 2.12	974,693	$ 2.12
$4.50	330,000	4.21	$ 4.50	330,000	$ 4.50
Total	4,281,046	4.97	$ 1.25	4,281,046	$ 1.25

Share-based compensation is recognized only for those awards that are ultimately expected to vest; therefore, the C
awards for the purpose of calculating compensation cost. These estimates will be revised, if necessary, in future per
forfeiture estimates impact compensation cost in the period in which the change in estimate occurs.

Employee stock-based compensation costs for the three and six months ended June 30, 2013 and 2012 and for the c
30, 2013 are as follows:

	Three months ended June 30,		Six months ended June	
	2013	2012	2013	2012
General and administrative	$ 7,431	$ 75,030	14,845	$ 186,74
Research and development	-	7,188	-	67,286
Total	$ 7,431	$ 82,218	14,845	$ 254,03

The fair value of shares vested under the Plan for the three and six months ended June 30, 2013 and 2012 and for th
were $7,431, $14,862, $307,850, $408,859 and $7,620,918 respectively.

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(A Development Stage Company)

Notes to Financial Statements

9. STOCK OPTION PLAN (Continued)

At June 30, 2013, there were no unrecognized estimated employee (including directors) compensation costs related vested as of June 30, 2013.

Common stock, stock options or other equity instruments issued to non-employees (including consultants and all m consideration for goods or services received by the Company are accounted for based on the fair value of the equity received can be more reliably measured). The fair value of any options issued to non-employees is recorded as exp

The Company did not incur stock-based compensation costs for services by non-employees for the three and six mo $498,095 for the cumulative period from August 1, 2005 (inception) through June 30, 2013. These amounts were in administrative expenses in the accompanying Condensed Statements of Operations. As of June 30, 2013 all non-em

On August 9, 2013, holders of options to purchase, at exercise prices ranging from $0.301 to $4.50 per share, an ag pursuant to the Plan agreed to terminate all of their rights in such stock options effective immediately prior to the e holders, all of whom are directors or officers of the Company, did not receive any consideration for such agreemen

10. RELATED PARTIES

On June 24, 2009, the Company entered into a services agreement with Two River Consulting, LLC ("TRC") to pr services to the Company, including the part-time services of Joshua A. Kazam as the Company's President and Chi S. Belldegrun are each directors of the Company and partners of TRC. David M. Tanen, who served as the Compa on September 24, 2009, is also a partner of TRC. The terms of the services agreement were reviewed and approved consisting of independent directors (the "Special Committee"). None of the members of the Special Committee ha for the services contemplated by the services agreement, the Company agreed to pay to TRC a monthly cash fee of 750,000 shares of the Company's common stock at a price per share equal to $0.89, the closing sale price of the Co the stock options vested immediately and the remaining 75% were scheduled to vest pursuant to the achievement o cenderitide. On January 5, 2011, the final block of stock options vested. Of the 750,000 original stock options issue

In August 2010, the Company and TRC amended the services agreement to extend its term on a month-to-month ba immediately-exercisable stock options to purchase 250,000 shares of the Company's common stock at an exercise $82,200 that was expensed on the date of grant. In March 2011, the Company and TRC further amended the servic and to reduce the monthly cash fee payable to TRC to $31,702, which monthly fee was then reduced to $30,082 in eliminated. On August 1, 2012, the Company and TRC agreed that, upon the appointment of a full-time President a payable under the services agreement would be reduced to $6,600 to reflect the termination of Mr. Kazam's service and clinical development services may be provided by TRC, and billed to the Company, on an hourly basis. The Sp 2011, and August 2012 amendments to the services agreement.

On occasion, some of the Company's expenses are paid by TRC. No interest is charged by TRC on any outstanding June 30, 2013 and 2012 and for the period from August 1, 2005 (inception) through June 30, 2013, total cash servic $191,940, and $2,146,776, respectively. As of June 30, 2013 the Company had a payable to TRC of $13,200 which

11. COMMITMENTS AND CONTINGENCIES

Compensation of President and CEO.

On November 5, 2012, the Company entered into a letter agreement with Darlene Horton, M.D., its President and C reduce her monthly salary to $100 effective November 1, 2012, and defer the balance of her $28,314 monthly base completes an Interim Financing Event (defined below). The term "Interim Financing Event" means the consummat pursuant to which the Company shall have received, whether by a financing, strategic transaction or another means in gross proceeds. As of June 30, 2013, the Company has an accrual of $225,712, representing approximately 8 mo

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Notes to Financial Statements

11. COMMITMENTS AND CONTINGENCIES (Continued)

On March 21, 2013, the Company entered into a letter agreement with Dr. Horton, which letter agreement amends
dated August 3, 2012, as previously amended on November 5, 2012.

Dr. Horton's existing letter agreement provided that if, prior to the date of a "compensation adjustment event," the
the agreement) and Dr. Horton's employment was terminated by the Company (or any successor entity) without ca
of Control Transaction and ending on the six-month anniversary of such effective date, then she would have been e
Change of Control Proceeds (as defined in the agreement). For purposes of the agreement, the term "compensation
sufficient capital, whether by a financing or strategic transaction (or any combination thereof) or another means, in
Phase 2 clinical trial of the Company's cenderitide product candidate.

The March 21, 2013 letter agreement amends the payment terms described in the preceding paragraph and provides
Change of Control Transaction in which either (i) the outstanding shares of the Company's common stock are exch
issues shares of its common stock, with no securities or other consideration paid or payable to holders of the Comp
Company acquires another corporation in exchange for shares of the Company's common stock), then Dr. Horton w
the Change of Control Transaction, a number of shares of the Company's common stock equal to 5% of the shares
basis.

The agreement further provides that if, prior to December 31, 2013, the Company completes a Change of Control T
Dr. Horton will be entitled to receive a cash payment, on the date of such Change of Control Transaction, equal to
agreement).

Compensation of Chief Financial Officer.

On March 21, 2013, the Company entered into a letter agreement with Daron Evans, its Chief Financial Officer, pu
$100 effective February 1, 2013, and defer the balance of his $22,917 monthly base salary until such time as the Co
Financing Event" means the consummation on or before December 31, 2013, of one or more transactions pursuant

strategic transaction or another means (or any combination thereof), an aggregate of at least $1,000,000 in gross ca
$114,384, representing approximately 5 months of deferred salary for Mr. Evans.

In addition, the agreement provides that if, prior to December 31, 2013, the Company completes a Change of Contr
outstanding shares of the Company's common stock are exchanged for securities of another corporation, or (ii) the
other consideration paid or payable to holders of the Company's common stock (e.g., a merger transaction in which
of the Company's common stock), then Mr. Evans will be entitled to receive, immediately prior to the effective tim
Company's common stock equal to 4.5% of the shares of the Company's common stock then outstanding on a fully

The agreement further provides that if, prior to December 31, 2013, the Company completes a Change of Control T
Mr. Evans will be entitled to receive a cash payment, on the date of such Change of Control Transaction, equal to 4
the agreement).

In consideration of the foregoing, the agreement provides that the Company shall have no further obligations pursu
and Mr. Evans, dated July 24, 2010.

Termination of Lease Agreement.

On February 28, 2013, the Company terminated its office lease at 4 West 4th, Suite 400, San Mateo, CA. There wer
lease termination.

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

Overview

We are a development stage, biopharmaceutical company developing innovative products for the treatment of cardi
We currently have exclusive rights to develop two drug candidates:

- ***Cenderitide*** *(formerly CD-NP),* our lead product candidate, is a chimeric natriuretic peptide that we are developin cenderitide for the treatment of patients for up to 90 days following admission for acutely decompensated heart fa 2011, we completed a 58-patient Phase 1 clinical trial of cenderitide in the post-acute setting. We conducted this cenderitide through continuous intravenous infusion using Medtronic's pump technology. Following that Phase cenderitide, pending availability of capital resources. However, to date we have been unable to raise the capital n Any further development of cenderitide is subject to our ability to either raise additional capital or enter into a str the capital necessary to continue development activities. In addition to treating heart failure, we believe cenderiti indications.

- ***CU-NP***, is a pre-clinical rationally designed natriuretic peptide that consists of amino acid chains identical to thos C-type natriuretic peptide, or CNP, and the N- and C-termini of Urodilatin, or URO. All development of CU-NP alternatives.

We have no product sales to date and we will not generate any product revenue until we receive approval from the foreign regulatory bodies to begin selling our pharmaceutical product candidates. Developing pharmaceutical produ capital necessary for us to continue the development of our product candidates, whether through a strategic transac a product candidate for several years, if ever. To date, most of our development expenses have related to our lead p development of cenderitide and as we further develop CU-NP, our second product candidate, our research and deve successful in acquiring additional product candidates for our development pipeline, our need to finance further rese Accordingly, our success depends not only on the safety and efficacy of our product candidates, but also on our abi of working capital have been proceeds from private and public sales of our common stock, and debt financings.

On July 7, 2013, we entered into an Agreement and Plan of Merger and Reorganization (the "Merger Agreement") Los Angeles, CA, and Bovet Merger Corp., a Delaware corporation and our wholly-owned subsidiary ("Merger Su contained in the Merger Agreement, will merge with and into Capricor and Capricor will become a wholly-owned Merger, each outstanding share of Capricor common stock, and each security convertible into Capricor common st shares of our common stock, or, as applicable, securities convertible into our common stock, such that, after giving immediately prior to the Merger will hold, in the aggregate, 90% of the total number of shares of our common stoc to improve the treatment of heart disease by commercializing cardiac stem cell therapies for patients.

The Merger Agreement contains customary representations and warranties by us and Capricor with respect to each
Merger Agreement. Closing of the Merger is conditioned on, among other things, accuracy of such representations
number of Capricor's stockholders, conversion of each share of Capricor preferred stock into Capricor common sto
Incorporation authorizing a reverse split of our common stock at a ratio not to exceed 1-for-100. In addition, the cl
amendment to our technology license agreement with the Mayo Foundation and evidence of payment or other satis
obligations (with the exception of obligations not to exceed the aggregate amount of $72,000, which may remain o
Agreement may be terminated for certain reasons, including by either party if the closing thereof does not occur pri
other customary terms and provisions as are common in similar agreements.

We do not have the capital resources available to continue the development of our product development programs
have sought either additional financing to fund such activities or a collaboration or other strategic agreement with a
further development of our product candidates. Prior to our entry into the Capricor merger agreement, we had have
merger with Capricor is subject to several conditions, including the approval of our stockholders of a reverse split
conditions are not satisfied, we may be unable to complete the planned merger. In that case, we would be forced to

Research and development, or R&D, expenses consist primarily of salaries and related personnel costs, fees paid to
and manufacturing development, legal expenses resulting from intellectual property prosecution, contractual reviev
and enhancement of our product candidates. We expense our R&D costs as they are incurred.

General and administrative, or G&A, expenses consist primarily of salaries and related expenses for executive, fina
accounting, legal and other professional fees, business development expenses, rent, business insurance and other co

Our results include non-cash compensation expense as a result of the issuance of stock, stock options, and warrants
vesting period. When more precise pricing data is unavailable, we determine the fair value of stock options using th
schedules for share-based awards vary by type of grant and the employment status of the grantee. Generally, the aw
Performance-based conditions generally include the attainment of goals related to our financial performance and pr
in the respective categories of expense in the statements of operations. We expect to record additional non-cash cor

Results of Operations

General and Administrative Expenses. G&A expenses for the three months ended June 30, 2013 and 2012 were app
no significant changes in G&A expenses for the three months ended June 30, 2013 as compared to the three month

G&A expenses for the six months ended June 30, 2013 and 2012 were approximately $0.6 million and $0.9 million
same period in 2012 is primarily due to a decrease of approximately $0.1 million in stock compensation costs and a
fees due the reduced use outside management consultants during the first quarter of 2013 compared to the same per
$0.1 million in general operating expenses during the six months ended June 30, 2013 as compared to the same per
in 2013 as we cut as many costs as possible to preserve remaining funds.

Research and Development Expenses. R&D expenses for the three months ended June 30, 2013 and 2012 were app
decrease of approximately $0.3 million over the same period of 2012 is primarily due to the fact that during the sec
development activities of cenderitide while during the second quarter of 2013, we had almost no development activ
resulted in a decrease of approximately $0.2 million in development costs. Additionally, we had a reduction of appr
compensation, due to having no R&D employees during the three months ended June 30, 2013, compared to one en

R&D expenses for the six months ended June 30, 2013 and 2012 were approximately $0.1 million and $0.8 million
the same period of 2012 is primarily due to the fact that during the six months ended June 30, 2012, we were still c
during the second quarter of 2013, we had almost no development activities as we have wound down development
million in development costs. Additionally, we had a reduction of approximately $0.2 million in compensation cost

employees during the six months ended June 30, 2013, compared to one employee during the same period in 2012.

Cenderitide. Since acquiring our rights to cenderitide in 2006, we have incurred approximately $19.9 million in exp
development of cenderitide is on hold pending the results of our efforts to pursue strategic alternatives, including o
with Capricor, we expect that development of cenderitide will eventually continue by the combined company.

CU-NP. Since acquiring our rights to CU-NP in June 2008, we have incurred a total of approximately $0.7 million
pending the results of our efforts to pursue strategic alternatives, including our planned merger with Capricor. Subj
development of CU-NP will eventually continue by the combined company.

Our expenditures on current and future clinical development programs, particularly our cenderitide program, are ex
our available capital resources. In addition, assuming we complete our planned merger with Capricor, the research
increase substantially with the addition of Capricor's R&D programs. However, these planned expenditures are sub
whether we develop any of our drug candidates with a partner or independently. As a result of such uncertainties, w
duration and completion costs of our research and development projects or whether, when and to what extent we w
our product candidates. The duration and cost of clinical trials may vary significantly over the life of a project as a
and a variety of factors, including:

- the number of trials and studie
- the number of patients who p
- the number of sites in
- the rates of patient recruit
- the duration of patient trea
- the costs of manufacturing ou
- the costs, requirements, timing of, and the ability

Interest Income. Interest income for the three and six months ended June 30, 2013 and 2012 was approximately $1
income in 2013 over the same periods in 2012 is primarily due to lower average cash balances in 2013 than 2012 le

Collaboration Income. As a result of our February 2011 collaboration agreement with Medtronic pursuant to whic
connection with our Phase 1 trial of cenderitide, we recognized income of $0, $0, $0 and $0.2 million for the three
amounts due under the agreement were paid as of February 2012 at which time the agreement expired.

Interest Expense. Interest expense for the three and six months ended June 30, 2013 and 2012 were approximately
interest expense of approximately $0.1 million is due to the convertible notes issued in March 2013. During 2012, t

Other Income (Expense). Other expense for the three months ended June 30, 2013 was approximately $0.1 million
warrant liability in connection with the 2013 convertible notes during the three months ended June 30, 2013. This i
the increased probability of issuance as a result of the announced merger with Capricor, Inc. There was no such wa
same period of 2012 as the notes were not issued until 2013. Offsetting this increase in other expense for the three
approximately $0.1 million relating to a decrease in the April 2012 warrant liability, primarily as a result of the dec
2012, there was other income of approximately $0.4 million as a result of a decrease in the warrant liability relating
during the three months ended June 30, 2012 was primarily driven by a decrease in the Company's stock price.

Other expense for the six months ended June 30, 2013 was approximately $0.2 million due primarily to an approxi
with the 2013 convertible notes issued in March 2013. This increase in the warrant liability valuation was driven pr
announced merger with Capricor, Inc. There was no such warrant liability in connection with the convertible notes

issued until 2013. During the six months ended June 30, 2012, there was other income of approximately $0.4 millio
April 2012 warrants. This decrease in the warrant liability during the six months ended June 30, 2012 was primarily

Liquidity and Capital Resources

The following table summarizes our liquidity and capital resources as of June 30, 2013 and December 31, 2012 and
ended June 30, 2013 and 2012 (the amounts stated are expressed in thousands):

Liquidity and capital resources	June 30, 2013	Decembe
Cash and cash equivalents	$ 229	$ 47
Working capital deficiency	$ (726)	$ (159
Stockholders' equity (deficit)	$ (1,223)	$ (167

Cash flow data	Six Months 2013
Cash used in:	
Operating activities	$ (200
Investing activities	-
Cash provided by:	
Financing activities	383
Net increase (decrease) in cash and cash equivalents	$ 183

Our total cash resources as of June 30, 2013 was $0.2 million compared to $0.05 million as of December 31, 2012.
liabilities, of which, approximately $0.5 million represented a noncash warrant liability, and $0.7 million in net wo
million and had negative cash flow from operating activities of approximately $0.2 million for the six months ende
2013, we have incurred an aggregate net loss of approximately $47.8 million, while negative cash flow from operat
obtain sufficient capital and are able to continue developing our product candidates, we expect to continue to incur
negative net cash flows from operating activities as we expand our technology portfolio and engage in further resea
pre-clinical studies and clinical trials.

We need substantial additional capital in order to continue the development of cenderitide, for which the next step i
approximately $15 million to $20 million and take approximately 30 months to complete. During the last 12 month
transaction that would provide us with the capital necessary to fund the Phase 2 trial, and it is doubtful that we will
also pursued, and continue to pursue, alternative strategic transactions that would provide for the means to continue
collaborating with another biotechnology or pharmaceutical company to further develop cenderitide, or engaging in
cenderitide’s development would be assumed by a purchaser of our company. As discussed above, in July 2013, we
biotechnology company focused on the development of cardiac stem cell therapeutics to repair damaged heart muse
the development of Capricor’s current technologies, we believe the resulting company will also be able to eventual
programs. Other than our merger agreement with Capricor, we have not been able to secure an agreement or other c
continued development of our cenderitide and CU-NP programs. All of further clinical and other development activ
the completion of our planned merger with Capricor, and thereafter at such time as the resulting company has the a

From inception through June 30, 2013, we have financed our operations through public and private sales of our equ
from operations to date, and we do not expect to generate revenue for several years, if ever, we will need to raise su
corporate activities and, thereafter, to fund our research and development, including our long-term plans for clinica
additional funds through various potential sources, such as equity and debt financings, or through strategic collabor
will be able to secure such additional sources of funds to support our operations, or if such funds are available to us
needs. Moreover, to the extent that we raise additional funds by issuing equity securities, our stockholders may exp
available, may involve restrictive covenants. To the extent that we raise additional funds through collaboration and
rights to our technologies or our product candidates, or grant licenses on terms that may not be favorable to us.

On March 15, 2013, we entered into a convertible note purchase agreement with certain purchasers under which we purchasers in consideration for an aggregate purchase price of $382,500. See "—Financing Activities," below. We existing cash resources, only provides us with sufficient capital to fund our minimal operating expenses until the m corporate activities, we need substantial additional capital to fund our planned Phase 2 clinical trial of cenderitide. the development of our product candidates, whether through a financing, strategic or other transaction, we will be f

Our estimates regarding the sufficiency of our financial resources are based on assumptions that may prove to be w or in greater amounts than we currently anticipate. The actual amount of funds we will need to operate is subject to include the following:

- the progress of our
- the number and scope of o
- the progress of our pre-clinical and clin
- the progress of the development efforts of parties with whom we have entered
- our ability to maintain current research and development programs and to establish new res
- the cost involved in prosecuting and enforcing patent claims and
- the cost and timing of r

Financing Activities

March 2013 Financing. On March 15, 2013, we entered into a convertible note purchase agreement with certain ac principal amount of up to $500,000 of secured convertible promissory notes (the "Notes") for an aggregate original The closing of the private placement also occurred on March 15, 2013, and resulted in the sale of Notes in the aggr price of $382,500.

The Notes, which have a maturity date of March 15, 2014, do not bear interest and may be prepaid by us without pe Notes. The Notes are secured by a blanket lien on our assets pursuant to a security agreement dated March 15, 201

The 2013 Notes contain an optional conversion feature that enables the Holder to convert all outstanding shares int share equal to the average daily Closing Price over the ten consecutive trading days preceding the date of such prep only if the Company chooses to prepay the Notes in whole or in part without penalty upon 30 days' prior written no period).

Upon a Change of Control (as defined in the Notes) in which either (i) the outstanding shares of our common stock issue shares of common stock, with no securities or other consideration paid or payable to holders of our common s

corporation in exchange for shares of our common stock), then (A) the entire unpaid principal under the applicable
effective time of the Change of Control, into shares of our common stock at a conversion price per share equal to th
the Change of Control, and (B) we shall also issue to each Note holder a five-year warrant entitling the holder to pu
effective date of the Change of Control, that number of shares of our common stock obtained by dividing (a) the su
Closing Price on the effective date of the Change of Control.

Upon a Change of Control other than as described in the preceding paragraph, we shall pay to each Note holder an
outstanding under the applicable Note. Upon payment of such amount to the Note holders, all of the obligations un

April 2012 Financing. On April 4, 2012, we closed an offering with certain purchasers pursuant to which we sold a purchasers for a purchase price of $0.40 per share. In addition, for each share purchased, each purchaser also receiv share of common stock at an exercise price of $0.50 per share, which resulted in the issuance of warrants to purcha gross proceeds from the offering were $1.34 million, before deducting selling commissions and other offering expe offering, we engaged Roth Capital Partners, LLC, or Roth, to serve as placement agent. Pursuant to the terms of the seven percent of the gross proceeds received by us, or approximately $0.1 million, plus a non-accountable expense Chairman, Joshua A. Kazam, our former President and Chief Executive Officer and a director, Daron Evans, our C VP of Clinical Development, participated in the offering on the same terms as the unaffiliated purchasers, and colle purchase 206,250 shares of common stock for an aggregate purchase price of $110,000.

The offer and sale of the shares and warrants was made pursuant to our shelf registration statement on Form S-3 (S 2010. Pursuant to the subscription agreements that we entered into with the purchasers in the April 2012 financing, offering, a registration statement covering the issuance of the shares of our common stock upon exercise of the war Registration Statement"), and to cause such registration statement to be declared effective within 90 days following Statement was not declared effective by the SEC within such 90-day period, we agreed to pay liquidated damages t investment amount for each 30-day period until the Additional Registration Statement is declared effective, subject investment amount. The Additional Registration Statement was filed on April 25, 2012 and was declared effective

License Agreement Commitments

Cenderitide License Agreement

Pursuant to our license agreement with the Mayo Foundation for Medical Education and Research ("Mayo") for ce Mayo upon the dosing of the first patient in a Phase 2 trial. Subsequent milestones achieved will require us to make contingent cash payments up to an aggregate of $31.9 million upon successful completion of specified clinical and amount is subject to increase upon the receipt of regulatory approval for each additional indication of cenderitide a intellectual property.

The cenderitide license agreement, unless earlier terminated, will continue in full force and effect until January 20, issued with an expiration date beyond January 20, 2026, the term of the agreement will continue until such expirati material breach of the agreement that remains uncured after 90 days' written notice to us, (ii) our insolvency or ban of the patents in any manner. We may terminate the agreement without cause upon 90 days' written notice.

As of June 30, 2013, we were not in compliance with several terms of the cenderitide license agreement, including, maintenance fee and actively pursue the development of cenderitide. We are in discussions with the Mayo Foundat be able to reach an agreement with Mayo that allows us to maintain our rights to cenderitide. See "Item 1A. Risk F

license agreements with the Mayo Foundation. If we are unable to renegotiate these agreements, then we will lose c

CU-NP License Agreement

On June 13, 2008, we entered into a second license agreement with Mayo pursuant to which we acquired the rights a worldwide, exclusive license for the rights to commercially develop CU-NP for all therapeutic indications. We al arose out of the laboratory of Dr. John Burnett and Dr. Candace Lee, the inventors of CU-NP and employees of the

Under the terms of the CU-NP license agreement, we made an up-front cash payment to Mayo and agreed to make million upon achievement of specific clinical and regulatory milestones relating to CU-NP, including a milestone p clinical trial of the licensed product. This aggregate amount of $24.3 million is subject to increase upon the receipt well as for additional compounds or analogues contained in the intellectual property. Pursuant to the agreement, we of net sales of licensed products.

The CU-NP License Agreement, unless earlier terminated, will continue in full force and effect until June 13, 2028 with an expiration date beyond June 13, 2028, the term of the agreement will continue until such expiration date. M of the agreement that remains uncured after 90 days' written notice to us, (ii) our insolvency or bankruptcy, (iii) if any manner, or (iv) or upon receipt of notice from us that we have terminated all development efforts under the agr days' written notice.

As of June 30, 2013, we were not in compliance with several terms of the CU-NP license agreement, including, but maintenance fee and actively pursue the development of CU-NP. We are in discussions with the Mayo Foundation be able to reach an agreement with Mayo that allows us to maintain our rights to cenderitide. See "Item 1A. Risk F license agreements with the Mayo Foundation. If we are unable to renegotiate these agreements, then we will lose

Collaboration Agreement

In February 2011, we entered into a Clinical Trial Funding Agreement with Medtronic, Inc. Pursuant to the agreem us to conduct a Phase 1 clinical trial to assess the pharmacokinetics and pharmacodynamics of cenderitide when de infusion using Medtronic's diabetes pump technology.

Under the agreement, we agreed not to enter into an agreement with a third party to develop or commercialize cend agreement until the earlier of: (i) three months following delivery to Medtronic of a final database with respect to t The final database was delivered to Medtronic on November 19, 2011.

The agreement also provided that intellectual property conceived in or otherwise resulting from the performance of Medtronic (the "Joint Intellectual Property"), and that we shall pay royalties to Medtronic based on the net sales of claimed in one or more issued patents constituting Joint Intellectual Property. The agreement further provided that agreement with respect to cenderitide, then each party shall have a right of first negotiation to license exclusive rig patent applications are considered Joint Intellectual Property.

Pursuant to its terms, the agreement expired in February 2012, following the completion of the Phase 1 clinical tria received the final reimbursement of $195,500 in February 2012 and a total of $1,550,000 over the life of the agreem Condensed Statement of Operations.

Merger Agreement with Capricor, Inc.

On July 7, 2013, the Company entered into an Agreement and Plan of Merger and Reorganization (the "Merger Ag
incorporated in Delaware, and Bovet Merger Corp., a Delaware corporation and a wholly-owned subsidiary of the
certain conditions contained in the Merger Agreement, will merge with and into Capricor and Capricor will becom
completion of the Merger, each outstanding share of Capricor common stock, and each security convertible into Ca
receive a number of shares of the Company's common stock, or, as applicable, securities convertible into the Comp
holders of Capricor capital stock immediately prior to the Merger will hold, in the aggregate, 90% of the total numb
basis. Capricor is a company whose mission is to improve the treatment of heart disease by commercializing cardia

The Merger Agreement contains customary representations and warranties by the Company and Capricor with resp
Merger Agreement. Closing of the Merger is conditioned on, among other things, accuracy of such representations
number of Capricor's stockholders, conversion of each share of Capricor preferred stock into Capricor common sto
Certificate of Incorporation authorizing a reverse split of the Company's common stock at a ratio not to exceed 1-fo
Company amending its technology license agreement with the Mayo Foundation and evidence of payment or other
obligations of the Company (with the exception of obligations not to exceed the aggregate amount of $72,000, whi
Merger). The Merger Agreement may be terminated for certain reasons, including by either party if the closing ther
Agreement also contains other customary terms and provisions as are common in similar agreements.

Off -Balance Sheet Arrangements

There were no off-balance sheet arrangements as of June 30, 2013.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with generally accepted accounting principles. The preparation
assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We e
including research and development and clinical trial accruals, and stock-based compensation estimates. Our estima
assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these es
reflect the more significant judgments and estimates used in the preparation of our financial statements and accomp

Collaboration Income

In February 2011, we entered into a collaboration agreement whereby we were reimbursed for work performed on
milestones. We recorded all of these expenses as research and development expenses and the reimbursements upon

We recognize milestone payments as income upon achievement of the milestone only if (1) the milestone payment
the milestone, (3) the amount of the milestone is reasonable in relation to the effort expended or the risk associated
for both parties. If any of these conditions are not met, we defer the milestone payment and recognize it as income
contract as we complete our performance obligations.

Research and Development Expenses and Accruals

R&D expenses consist primarily of salaries and related personnel costs, fees paid to consultants and outside service
development, legal expenses resulting from intellectual property prosecution, contractual review, and other expense
our product candidates. Except for capitalized patent expenses, R&D costs are expensed as incurred. Amounts due
and may include upfront payments, monthly payments, and payments upon the completion of milestones or receipt

Our cost accruals for clinical trials and other R&D activities are based on estimates of the services received and eff
centers and CROs, clinical study sites, laboratories, consultants, or other clinical trial vendors that perform the acti
a fixed amount, a variable amount based on actual costs incurred, capped at a certain limit, or for a combination of
communication with the CROs and other clinical trial vendors, including detailed invoice and task completion revi
work performed against approved contract budgets and payment schedules, and recognition of any changes in scop
clinical trial vendors provide an estimate of costs incurred but not invoiced at the end of each quarter for each indiv
or vendor as necessary, and are included in R&D expenses for the related period. For clinical study sites, which are
performing the clinical study, we accrue an estimated amount based on subject screening and enrollment in each qu
subsequently invoiced, which may occur several months after the related services were performed.

In the normal course of business we contract with third parties to perform various R&D activities in the on-going d
agreements are subject to negotiation and vary from contract to contract and may result in uneven payment flows. I
achievement of certain events, the successful enrollment of patients, and the completion of portions of the clinical t
match the recording of expenses in our financial statements to the actual services received and efforts expended. As
activities are recognized based on our estimate of the degree of completion of the event or events specified in the sp

No adjustments for material changes in estimates have been recognized in any period presented.

Stock-Based Compensation

Our results include non-cash compensation expense as a result of the issuance of stock, stock options and warrants. and Scientific Advisory Board members under our Amended and Restated 2005 Stock Option Plan.

We expense the fair value of stock-based compensation over the vesting period. When more precise pricing data is Black-Scholes option-pricing model. This valuation model requires us to make assumptions and judgments about th assumptions include the weighted-average period of time that the options granted are expected to be outstanding, th estimated rate of forfeitures of unvested stock options.

Stock options or other equity instruments to non-employees (including consultants and all members of our Scientif received by us are accounted for based on the fair value of the equity instruments issued (unless the fair value of th value of stock options is determined using the Black-Scholes option-pricing model and is periodically remeasured a to non-employees is recorded as expense over the applicable service periods.

The terms and vesting schedules for share-based awards vary by type of grant and the employment status of the gra performance-based conditions. Performance-based conditions generally include the attainment of goals related to o compensation expense is included in the respective categories of expense in the Statements of Operations. We expe future, which may be significant.

Warrant Liability

We account for the warrants issued in connection with the April 2012 financing and the embedded derivative warra guidance on Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, whic its fair value and adjust the instrument to fair value at each reporting period. This liability is subject to re-measuren fair value is recognized as a component of other income or expense. The fair value of warrants issued in connection using a binomial options pricing model. The binomial option pricing model is a generally accepted valuation mode develop a reasonable estimate of the range of our future expected stock prices, and their resulting probabilistic valu contained in the 2013 Notes was estimated by management using Black-Scholes option-pricing model.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our exposure to market risk for changes in interest rates relates primarily to our cash and cash equivalents. The goa
rated credit issuers and limit the amount of credit exposure to any one issuer. We seek to improve the safety and lik
risk and market risk. Our policy is to mitigate default risk by investing in high credit quality securities and currentl
make investments with short-term maturities, we do not believe that an increase in market rates would have any ma

As of June 30, 2013, our portfolio consisted primarily of bank savings and checking accounts and we did not have
mortgage market issues. Based on our investment portfolio and interest rates at June 30, 2013, we believe that a de
fair value of our cash and cash equivalents of approximately $0.2 million.

Item 4. Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclose
summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and
to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for
evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no ma
assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluati
procedures.

As required by Commission Rule 13a-15(b), we carried out an evaluation, under the supervision and with the partic
and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedu
foregoing, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure c
level.

There has been no change in our internal control over financial reporting during the most recent fiscal quarter that h
our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

We are not a party to any material pending legal proceedings.

Item 1A. Risk Factors.

An investment in our common stock involves significant risk. You should carefully consider the information describ
appearing elsewhere in this report, before making an investment decision regarding our common stock. You should
Form 10-K for the year ended December 31, 2012 ("2012 Annual Report"), and in our Quarterly Report on Form
such reports entitled "Item 1A. Risk Factors." If any of the risks described below or in such prior reports actually
future growth prospects would likely be materially and adversely affected. In these circumstances, the market price
of your investment in our common stock. Moreover, the risks described below and in our prior reports are not the
or that we currently deem immaterial may also affect our business, operating results, prospects or financial condit

Our ability to continue as a going concern is substantially, if not entirely, dependent on our ability to complete o

We do not have the capital resources available to continue the development of our product development programs o
have sought either additional financing to fund such activities or a collaboration or other strategic agreement with a
further development of our product candidates. Prior to our entry into the Capricor merger agreement, we have bee
merger with Capricor is subject to several conditions, including the approval of our stockholders of a reverse split o
conditions are not satisfied, we may be unable to complete the planned merger. In that case, we would be forced to
investment in our common stock.

Capricor's technology is not yet proven, and Capricor is still in an early stage of its product development.

Capricor has not completed the development of any products and may not have products to sell commercially for m
additional research and development time and expense, as well as extensive clinical trials and perhaps additional pr
occur. There can be no assurance that products will be developed successfully, perform in the manner anticipated, o

***Capricor has a limited operating history, and has experienced losses*.**

Capricor has a limited operating history and it expects a number of factors to cause its operating results to fluctuate predict its future performance. Capricor's operations to date have been primarily limited to organizing and staffing studies and clinical trials of its product candidates. Capricor has not yet obtained regulatory approvals for any of its Capricor's future success or viability may not be as accurate as they could be if it had a longer operating history. Sp varied significantly in the past and will continue to fluctuate from quarter-to-quarter and year-to-year in the future c Capricor has a history of net losses, expects to continue to incur substantial and increasing net losses for the foresee

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

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Warrant Exchange Agreements

On August 1, 2013, the Company entered into warrant exchange agreements with each holder of the warrants to pu
were issued in connection with the Company's June 2011 private placement. Pursuant to such agreements, each suc
for each warrant share purchasable under the warrants held by such holder. The Company issued total number of 4
exchange agreements. As a result, all of the warrants issued in connection with the 2011 private placement have be
for the exchange of such warrants was not registered under the Securities Act of 1933, as amended (the "Securities
upon the exemption from federal registration under Section 4(2) of the Securities Act and/or Rule 506 promulgated
of such shares did not involve a public offering, as each purchaser of such securities was an "accredited investor" a

Termination of Options under 2005 Stock Option Plan

In August 2013, the holders of options to purchase, at exercise prices ranging from $0.301 to $4.50 per share, an ag
pursuant to the Company's 2005 Stock Option Plan, as amended, agreed to terminate all of their rights in such stoc
Company's planned merger with Capricor. Such holders, all of whom are directors or officers of the Company, did

Item 6. Exhibits.

Exhibit No.	Exhibit Description
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-15(e)/15d-15(2002.
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-15(e)/15d-15(e 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to S
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Se
101	The following financial information from Nile Therapeutics, Inc.'s Quarterly Report on Form 10-Q fo Business Reporting Language (XBRL): (i) Condensed Balance Sheets as of June 30, 2013 and Decem three and six months ended June 30, 2013 and June 30, 2012, and for the period from August 1, 2005 Stockholders' Equity for the period from August 1, 2005 (inception) through June 30, 2013, (iv) Cond 2013 and June 30, 2012, and for the period from August 1, 2005 (inception) through June 30, 2013, a

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 to this Quarterly Report on Fo of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registrati Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be

NILE THERAPEUTICS, INC.

Date: August 14, 2013 By: /s/ Darlene Horton, M.D.
Darlene Horton, M.D.
Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2013 By: /s/ Daron Evans
Daron Evans
Chief Financial Officer
(Principal Financial and Accounting Officer)

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INDEX TO EXHIBITS FILED WITH THIS REPORT

Exhibit No.	Exhibit Description
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-15(e)/15d-15(2002.
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32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Se
101	The following financial information from Nile Therapeutics, Inc.'s Quarterly Report on Form 10-Q fo Business Reporting Language (XBRL): (i) Condensed Balance Sheets as of June 30, 2013 and Decem three and six months ended June 30, 2013 and June 30, 2012, and for the period from August 1, 2005 Stockholders' Equity for the period from August 1, 2005 (inception) through June 30, 2013, (iv) Cond 2013 and June 30, 2012, and for the period from August 1, 2005 (inception) through June 30, 2013, a

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 to this Quarterly Report on Fo of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registrati Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.