

AEROGEN INC
Form 10-Q
August 13, 2002

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2002

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: **0-31913**

Aerogen, Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

33-0488580
(I.R.S. Employer
Identification No.)

2071 Stierlin Court, Mountain View, CA
(Address of principal executive offices)

94043
(zip code)

Registrant's telephone number, including area code: **(650) 864-7300**

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 No

As of July 31, 2002 there were 20,270,735 shares of the Registrant's Common Stock outstanding, par value \$0.001 per share.

Aerogen, Inc.
(a development stage enterprise)
Form 10-Q

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Part I. Financial Information

Item 1. Condensed Consolidated Financial Statements

Aerogen, Inc.
(a development stage enterprise)

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Condensed Consolidated Balance Sheets
(unaudited; in thousands)

| | <u>June 30, 2002</u> | <u>December 31, 2001</u> |
|--|----------------------|--------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 17,493 | \$ 15,714 |
| Available-for-sale securities | 2,022 | 20,363 |
| Accounts receivable | 98 | 193 |
| Inventories | 328 | 488 |
| Prepaid expenses and other current assets | 713 | 1,201 |
| | <u> </u> | <u> </u> |
| Total current assets | 20,654 | 37,959 |
| Property and equipment, net | 5,465 | 2,889 |
| Goodwill and other intangible assets, net | 1,520 | 1,362 |
| Other assets | 1,250 | 1,258 |
| | <u> </u> | <u> </u> |
| Total assets | \$ 28,889 | \$ 43,468 |
| | <u> </u> | <u> </u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 619 | \$ 1,181 |
| Accrued liabilities | 1,670 | 3,321 |
| | <u> </u> | <u> </u> |
| Total current liabilities | 2,289 | 4,502 |
| Deferred rent | 576 | 223 |
| Other long-term liabilities | 229 | 212 |
| | <u> </u> | <u> </u> |
| Total liabilities | 3,094 | 4,937 |
| | <u> </u> | <u> </u> |
| Stockholders' equity: | | |
| Common stock | 20 | 20 |
| Additional paid-in capital | 109,518 | 110,428 |
| Notes receivable from stockholders | (423) | (693) |
| Deferred stock-based compensation, net | (2,199) | (4,069) |
| Accumulated other comprehensive gain (loss) | 130 | (14) |
| Deficit accumulated during the development stage | (81,251) | (67,141) |
| | <u> </u> | <u> </u> |
| Total stockholders' equity | 25,795 | 38,531 |
| | <u> </u> | <u> </u> |
| Total liabilities and stockholders' equity | \$ 28,889 | \$ 43,468 |
| | <u> </u> | <u> </u> |

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

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Aerogen, Inc.

(a development stage enterprise)

Condensed Consolidated Statements of Operations

(unaudited; in thousands, except per share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-------------------|---------------------------|--------------------|
| | 2002 | 2001 | 2002 | 2001 |
| Revenues: | | | | |
| Research and development | \$ 8 | \$ 889 | \$ 34 | \$ 1,501 |
| Product sales | 112 | | 112 | |
| Royalty, fee and other | 62 | 62 | 125 | 125 |
| Total revenues | 182 | 951 | 271 | 1,626 |
| Costs and expenses: | | | | |
| Cost of products sold and manufacturing start-up costs | 235 | | 466 | |
| Research and development | 4,947 | 5,701 | 9,970 | 10,712 |
| Selling, general and administrative | 2,160 | 2,209 | 4,287 | 3,729 |
| Total costs and expenses | 7,342 | 7,910 | 14,723 | 14,441 |
| Loss from operations | (7,160) | (6,959) | (14,452) | (12,815) |
| Interest income, net | 122 | 643 | 342 | 1,451 |
| Net loss | \$ (7,038) | \$ (6,316) | \$ (14,110) | \$ (11,364) |
| Net loss per common share, basic and diluted | \$ (0.35) | \$ (0.32) | \$ (0.70) | \$ (0.58) |
| Shares used in computing net loss per common share, basic and diluted | 20,180 | 19,628 | 20,103 | 19,543 |

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

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Aerogen, Inc.

(a development stage enterprise)

Condensed Consolidated Statements of Cash Flows

(unaudited; in thousands)

| | Six Months Ended June 30, | |
|---|---------------------------|-------------|
| | 2002 | 2001 |
| Cash flows from operating activities: | | |
| Net loss | \$ (14,110) | \$ (11,364) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |

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| | Six Months Ended June 30, | |
|---|----------------------------------|------------------|
| | 2019 | 2018 |
| Depreciation and amortization | 736 | 742 |
| Amortization of deferred stock-based compensation | 757 | 667 |
| Accrued interest on notes receivable from stockholders | (15) | (14) |
| Amortization of discount on available-for-sale securities | (15) | (85) |
| Loss on disposal of property and equipment | 165 | |
| Change in inventory reserves | 177 | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 95 | 41 |
| Inventories | 19 | (233) |
| Prepaid expenses and other current assets | 476 | 317 |
| Other assets | 8 | 22 |
| Accounts payable | (562) | (155) |
| Accrued liabilities | (1,686) | 1,240 |
| Deferred revenues | | (39) |
| Deferred rent | 353 | |
| Other long-term liabilities | (3) | 43 |
| | (13,605) | (8,818) |
| Cash flows from investing activities: | | |
| Acquisition of property and equipment | (3,459) | (408) |
| Purchases of available-for-sale securities | (2,021) | (12,011) |
| Proceeds from maturities of available-for-sale securities | 20,317 | 12,358 |
| | 14,837 | (61) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock | 209 | 224 |
| Repurchase of common stock | (6) | (8) |
| Repayment of notes receivable from stockholders | 285 | |
| | 488 | 216 |
| Effect of exchange rate changes on cash | 59 | (202) |
| Net increase (decrease) in cash and cash equivalents | 1,779 | (8,865) |
| Cash and cash equivalents, beginning of period | 15,714 | 48,810 |
| Cash and cash equivalents, end of period | \$ 17,493 | \$ 39,945 |

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

Note 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**Organization and business of the company**

Aerogen, Inc., (the "Company" or "Aerogen"), was incorporated in November 1991 to develop products using a proprietary aerosol generator. On May 14, 2002, at the Company's Annual Meeting of Stockholders, a motion to change the spelling of the Company's name from AeroGen, Inc. to Aerogen, Inc. was approved.

The Company is in the development stage and, since inception, has devoted substantially all of its efforts to developing products, including engaging in research and development activities with and without partners, raising capital, marketing of its initial products and recruiting personnel. The Company has incurred net losses since inception and expects to incur substantial losses for the next several years. To date, the Company has funded its operations primarily through the sale of equity securities, payments from collaboration partners, interest income and debt. The process of developing products will continue to require significant research and development, clinical trials and regulatory approvals. These activities, together with selling, general and administrative expenses, are expected to result in substantial operating losses for the next several years.

These financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company will require additional financing in the future and may raise funds by selling shares of its common or preferred stock through private placements or public offerings, by collaborative relationships or other arrangements. There can be no assurance that the Company will be able to obtain additional financing on terms acceptable to the Company. Additional equity or debt financing may involve substantial dilution to the Company's stockholders, restrictive covenants or high interest costs. Collaborative arrangements, if necessary to raise additional funds, may require the Company to relinquish rights to certain products, technologies or marketing territories. The failure to raise needed funds on sufficiently favorable terms could have a material adverse effect on the Company's business, operating results and financial condition.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Securities and Exchange Commission Regulation S-X. Accordingly, they do not contain all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of normal, recurring adjustments) considered necessary for a fair presentation of the Company's interim financial information. These financial statements and notes should be read in conjunction with the audited financial statements and notes thereto of the Company included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the operating results that may be reported for the fiscal year ending December 31, 2002 or for any other future period.

Inventories

Inventories are stated at the lower of cost (on a first-in, first-out basis) or market value. Inventories are summarized as follows (in thousands):

| | <u>June 30, 2002</u> | <u>December 31, 2001</u> |
|-------------------|----------------------|--------------------------|
| | (unaudited) | |
| Raw materials | \$ 196 | \$ 354 |
| Work-in-process | 127 | 99 |
| Finished goods | 5 | 35 |
| | <u> </u> | <u> </u> |
| Total inventories | <u>\$ 328</u> | <u>\$ 488</u> |

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Comprehensive income (loss)

Comprehensive income (loss) generally represents all changes in stockholders' equity except those resulting from investments or contributions by stockholders. The Company's unrealized gains and losses on available-for-sale securities and foreign currency translation gains and losses represent the only components of comprehensive income (loss) that are excluded from the Company's net loss.

Net loss per common share

Basic net loss per share is computed by dividing the net loss by the weighted average number of vested common shares outstanding for the period. Diluted net loss per share is computed giving effect to all potential dilutive common shares, including options and warrants. Options and warrants were not included in the diluted net loss per share calculations because the effect would be anti-dilutive.

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net loss per common share follows:

| | <u>Three Months Ended June 30,</u> | | <u>Six Months Ended June 30,</u> | |
|---|------------------------------------|-------------|----------------------------------|-------------|
| | <u>2002</u> | <u>2001</u> | <u>2002</u> | <u>2001</u> |
| | (unaudited, in thousands) | | | |
| Net loss per common share, basic and diluted: | | | | |
| Net loss | \$ (7,038) | \$ (6,316) | \$ (14,110) | \$ (11,364) |
| Weighted average common shares outstanding | 20,227 | 19,976 | 20,185 | 19,947 |
| Less: Weighted average shares subject to repurchase | 47 | 348 | 82 | 404 |
| Weighted average shares used in computing basic and diluted net loss per common share | 20,180 | 19,628 | 20,103 | 19,543 |

The following outstanding options, common stock subject to repurchase and warrants were excluded from the computation of diluted net loss per share as they had an antidilutive effect:

| | <u>June 30,</u> | |
|---|---------------------------|-------------|
| | <u>2002</u> | <u>2001</u> |
| | (unaudited, in thousands) | |
| Options to purchase common stock | 3,134 | 2,390 |
| Common stock subject to repurchase | 30 | 301 |
| Warrants, based on common stock equivalents | 32 | 32 |

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Note 2 RECENT ACCOUNTING PRONOUNCEMENTS

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142 "Goodwill and other Intangible Assets" on January 1, 2002. Under the new rules, goodwill is no longer amortized, but is subject to an annual impairment test. As of June 30, 2002, the goodwill impairment test had been completed and it was determined that there was no impairment of goodwill at that time.

The following table reconciles the Company's net income for the three and six months ended June 30, 2002 and 2001, adjusted to exclude goodwill amortization pursuant to SFAS No. 142 to amounts previously reported: (unaudited, in thousands, except for per share data).

| | <u>Three Months Ended</u> <u>June 30,</u> | <u>Six Months Ended June 30,</u> |
|--|--|----------------------------------|
|--|--|----------------------------------|

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| | 2002 | 2001 | 2002 | 2001 |
|---------------------------------------|---------------------------|------------|-------------|-------------|
| | (unaudited, in thousands) | | | |
| Reported net loss | \$ (7,038) | \$ (6,316) | \$ (14,110) | \$ (11,364) |
| Add back: Goodwill amortization | | 87 | | 179 |
| Adjusted net loss | \$ (7,038) | \$ (6,229) | \$ (14,110) | \$ (11,185) |
| Net loss per share, basic and diluted | \$ (.35) | \$ (.32) | \$ (.70) | \$ (.58) |
| Add back: Goodwill amortization | | 0.00 | | 0.01 |
| Adjusted net loss | \$ (.35) | \$ (.32) | \$ (.70) | \$ (.57) |

In April of 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 145 ("SFAS 145"), "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections," which is effective for fiscal years beginning after May 15, 2002. Under SFAS 145, gains and losses from the extinguishment of debt should be classified as extraordinary items only if they meet the criteria of Accounting Principles Board Opinion No. 30. SFAS 145 also addresses financial accounting and reporting for capital leases that are modified in such a way as to give rise to a new agreement classified as an operating lease. The Company believes that the adoption of SFAS 145 will not have a material impact on the consolidated financial position or results of the operations of the Company.

In June of 2002, the FASB issued Statement of Financial Accounting Standards No. 146 ("SFAS 146"), "Accounting for Costs Associated with Exit or Disposal Activities," which is effective for exit or disposal activities initiated after December 31, 2002. SFAS 146 nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Under SFAS 146, a liability is required to be recognized for a cost associated with an exit or disposal activity when the liability is incurred. SFAS 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with a retirement or disposal activity covered by FASB Statements No. 143, "Accounting for Asset Retirement Obligations," and No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The Company believes that the adoption of SFAS 146 will not have a material impact on the consolidated financial position or results of the operations of the Company.

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

In addition to historical information, this report contains predictions, estimates and other 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. Actual results could differ materially from any future performance suggested in this report as a result of many factors, including those referred to in "Factors That May Affect Future Operating Results," elsewhere in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2001 (the "Form 10-K"). The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and notes included elsewhere in this report and the information included in the Form 10-K.

Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are described in Item 7 of our Form 10-K, and have not changed materially since that date.

Overview

Aerogen was incorporated in November 1991. We specialize in the controlled delivery of drugs to the lungs for respiratory therapy or systemic drug delivery. We are using our technology to develop respiratory products for marketing by us, and we are developing products for ourselves and in collaboration with pharmaceutical and biotechnology companies for both respiratory therapy and for the delivery of drugs via the lungs to the bloodstream.

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We are in the development stage and, since inception, have devoted substantially all of our efforts to the development of products. We have an accumulated deficit of approximately \$81.3 million as of June 30, 2002. We expect to incur significant additional operating losses over the next several years, and cumulative losses may increase, primarily due to the expansion of our research and development activities, an increase in the number and size of clinical trials, the costs associated with marketing recently introduced and additional products and the general expansion of our business activities. We anticipate that our quarterly financial results will fluctuate for the foreseeable future. Therefore, period to period comparisons should not be relied upon as predictive of the results in future periods. Our sources of working capital have been equity financings, research and development revenues, interest earned on investments, equipment lease financings and royalties.

Results of Operations

Revenues

Research and development revenues for the three and six months ended June 30, 2002 were \$8,000 and \$34,000, respectively, compared with \$0.9 million and \$1.5 million for the same periods of 2001. The decrease resulted primarily from a lower level of product development activities performed for one partner program. We announced in December 2001 the termination of our development program with Chiron for TOBI®, their proprietary formulation of the antibiotic tobramycin.

Research and development revenues can be expected to vary from period to period based on the activities requested by partner companies in any particular period, and therefore are not predictable. Based on agreements we currently have in place, we expect research and development revenues for 2002 to be lower than those for 2001.

Product sales revenues for the three and six months ended June 30, 2002 were \$112,000, compared with none for the same periods of 2001. Our second product, the Aeroneb® Professional Nebulizer System ("Aeroneb Pro") was launched in June 2002. Our first product, the Aeroneb® Portable Nebulizer System, was launched in June 2001. Due to manufacturing issues, which have been resolved and were not fundamental to our aerosol generator technology, no product was shipped, and therefore no product sales revenues were recorded in the first quarter of 2002. No revenue was recorded in the quarter or six months ended June 30, 2001 due to rights of return granted on initial product shipments.

Royalty, fee and other revenues were \$62,500 and \$125,000, for the three and six month periods ended June 30, for both 2002 and 2001. Royalties represent a minimum royalty obligation associated with licensing our aerosol generator technology to a consumer product company for limited usage outside the medical field.

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Cost of products sold and manufacturing start-up costs

Cost of products sold and manufacturing start-up costs for three and six months ended June 30, 2002 were \$0.2 million and \$0.5 million, respectively, compared with none for the same periods of 2001. Costs of product sold for the three and six months, ended June 30, 2002 include costs associated with the production of the Aeroneb Pro in preparation for its launch at the end of the quarter. Effective April 2002, we implemented a price reduction on the Aeroneb® Portable Nebulizer System to enhance our competitive position in the home nebulizer market. The cost of products sold and manufacturing start-up costs for the six months ending June 30, 2002 includes a \$0.2 million charge to reduce inventories to estimated market value and accrue future losses on purchase commitments based on the reduced selling price.

Research and development expenses

Research and development expenses for the three and six months ended June 30, 2002 were \$4.9 million and \$10.0 million, respectively, compared with \$5.7 million and \$10.7 million for the same periods of 2001. Incremental rent and information technology expenses, primarily associated with our newly leased facility, were approximately \$0.8 million and \$1.6 for the three and six months, respectively, ending June 30, 2002. We maintained our approximately 38,000 square foot Sunnyvale facility through April 30, 2002, at which time we reduced our space there to approximately 10,000 square feet of manufacturing and research labs. We completed our move to the Mountain View facility and vacated the Sunnyvale facility in June 2002. In the three and six months ended June 30, 2002, non-payroll related expenses, associated with our inhaled insulin product design and clinical trials, decreased by \$0.6 million and \$1.0 million, respectively; non-payroll related expenses associated with our respiratory products decreased by \$0.5 million and \$0.9 million, respectively; payroll related expenses for both insulin and respiratory products decreased by \$0.4 million and \$0.2 million, respectively; and deferred stock-based compensation decreased by \$0.1 million and \$0.2 million, respectively, in comparison with the same periods in the prior year.

Research and development expenses represent expenses related to our own research and development projects, as well as the costs related to research and development activities for our partners. Research and development expenses for partner activities approximate our revenues

from those partners. Research and development expenses include salaries and benefits for scientific and development personnel, laboratory supplies, consulting services, clinical expenses and the expenses associated with the development of manufacturing processes, including related overhead. Research and development spending may increase significantly over the next several years as we increase clinical trials, expand our research and development activities to support our products and those which we develop in our collaborations. Future research and development and clinical expenditures cannot be predicted reliably, as they depend in part upon our success in continuing existing development collaborations, entering into new partnering agreements, and the level of internally funded research and development efforts.

Selling, general and administrative expenses

Selling, general and administrative expenses for the three and six months ended June 30, 2002 were \$2.2 million and \$4.3 million, respectively, compared with \$2.2 million and \$3.7 million for the same periods of 2001. The increase for the six months ended June 30, 2002 was primarily due to \$0.4 million of incremental rent and information technology expense, primarily associated with our newly leased facility, an increased deferred compensation costs of \$0.3 million; and an increase in payroll related expense of \$0.3 million; partially offset by decreases in professional services and the cessation of goodwill amortization of \$0.4 million. We expect that our selling, general and administrative expenses will increase as we continue to commercialize existing and new products.

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Interest income, net

Interest income, net for the three and six months ended June 30, 2002 was \$0.1 million and \$0.3 million, respectively, compared with \$0.6 million and \$1.5 million for the same periods of 2001. The decrease in interest income, net was primarily due to lower average cash, cash equivalents and investment balances resulting from cash used in operations and capital expenditures and, to a lesser extent, lower interest rates.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through equity financings, research and development revenues and the interest earned on these funds. We have received approximately \$98.2 million aggregate net proceeds from sales of our common and preferred stock through June 30, 2002, including approximately \$44.5 million of net proceeds from our initial public offering ("IPO").

As of June 30, 2002, we had cash, cash equivalents and available-for-sale securities of approximately \$19.5 million. Net cash used in operating activities of \$13.6 million during the six months ended June 30, 2002 resulted primarily from the net loss for the period and decreased accounts payable and accrued liabilities of \$2.2 million, partially reduced by non-cash related charges of approximately \$1.8 million and a reduction in prepaid expenses of \$0.5 million. Net cash used in operating activities of \$8.8 million during the six months ended June 30, 2001 resulted primarily from the net loss for the period, partially reduced by non-cash charges of approximately \$1.4 million, and an increase in accrued liabilities and accounts payable of \$1.1 million.

Net cash provided by investing activities of \$14.8 million for the six months ended June 30, 2002 consisted primarily of net proceeds from maturing available-for-sale securities and purchases of securities of \$18.3 million, partially offset by \$3.5 million of property and equipment acquisitions, primarily associated with leasehold improvements to our newly leased facility. Cash used in investing activities of \$0.1 million for the first six months ended June 30, 2001 consisted of equipment acquisitions of \$0.4 million, partially offset by the net proceeds from maturing securities of \$0.3 million.

Cash provided through financing activities for the first six months ending June 30, 2002 comprised \$0.2 million of proceeds from the issuance of common stock, comparable with the same period for 2001. In addition, repayment of notes receivable from stockholders provided \$0.3 million for the first six months ending June 30, 2002, compared with no repayments in the same period of 2001.

The development of our technology and products will require a commitment of substantial funds to conduct the costly and time-consuming product development and clinical trials required to develop and expand our technology and products and to bring any such products to market. Our future capital requirements and operating expenses will depend on many factors including, but not limited to, research and development activities, the timing, cost, extent and results of clinical trials, our success in licensing drugs for use in our products, regulatory approvals, the status of competitive products, marketing and manufacturing costs associated with commercialization of products, costs involved in obtaining and maintaining patents and our ability to enter into collaborative agreements.

Based upon our current plans, we believe that our cash, cash equivalents and available-for-sale securities will be sufficient to meet our capital requirements into the second quarter of 2003. We will need to raise additional funds through partner collaborations, sales of our securities or borrowing. There can be no assurance that we will be able to enter into such collaborations or raise additional funds through sales of our

securities or borrowing. Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties, and actual results could vary materially. The factors described above, as well as the risk factors discussed in the Form 10-K, will impact our future capital requirements and the adequacy of our available funds.

Recent accounting pronouncements

In April of 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 145 ("SFAS 145"), "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections," which is effective for fiscal years beginning after May 15, 2002. Under SFAS 145, gains and losses from the extinguishment of debt should be classified as extraordinary items only if they meet the criteria of Accounting Principles Board Opinion No. 30. SFAS 145 also addresses financial accounting and reporting for capital leases that are modified in such a way as to give rise to a new agreement classified as an operating lease. The Company believes that the adoption of SFAS 145 will not have a material impact on the consolidated financial position or results of the operations of the Company.

In June of 2002, the FASB issued Statement of Financial Accounting Standards No. 146 ("SFAS 146"), "Accounting for Costs Associated with Exit or Disposal Activities," which is effective for exit or disposal activities initiated after December 31, 2002. SFAS 146 nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Under SFAS 146, a liability is required to be recognized for a cost associated with an exit or disposal activity when the liability is incurred. SFAS 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with a retirement or disposal activity covered by FASB Statements No. 143, "Accounting for Asset Retirement Obligations," and No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The Company believes that the adoption of SFAS 146 will not have a material impact on the consolidated financial position or results of the operations of the Company.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Interest rate risk

Interest rate risk represents the risk of loss that may impact our financial position, operating results or cash flows due to changes in interest rates. This exposure is directly related to our normal operating activities. We invest only in U.S. government and related agency securities and money markets. These investments are generally of a short-term nature. As a result, other than changes in interest income due to changes in interest rates, we do not believe that near-term changes in interest rates will have a material effect on our future results of operations.

Exchange rate risk

Due to our Irish operations, we have market risk exposure to adverse changes in foreign currency exchange rates. The revenues and expenses of our subsidiary, Aerogen (Ireland) Limited, are denominated in Eurodollars. At the end of each period, the revenues and expenses of our subsidiary are translated into U.S. dollars using the average currency exchange rate in effect for that period, and assets and liabilities are translated into U.S. dollars using the exchange rate in effect at the end of that period. Fluctuations in exchange rates therefore impact our financial condition and results of operations, as reported in U.S. dollars. Additionally, we occasionally have market risk exposure to adverse changes in foreign currency exchange rates associated with foreign vendors who require payment in their functional currencies. To date, we have not experienced any significant negative impact as a result of fluctuations in foreign currency markets. As a policy, we do not engage in speculative or leveraged transactions, nor do we hold financial instruments for trading purposes.

We may expand our overseas operations. As a result, our operating results may become subject to more significant fluctuations based on changes in exchange rates of foreign currencies in relation to the U.S. dollar. We will periodically analyze our exposure to currency fluctuations and we may adjust our policies to allow for financial hedging techniques to minimize exchange rate risk.

Factors that may affect future operating results

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Risk factors that may affect future operating results are described in Part I of our Form 10-K for the year ended December 31, 2001 and have not changed materially since such date. Please also see "Liquidity and Capital Resources" above.

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Part II. Other Information

Item 1. Legal Proceedings
None

Item 2. Changes in Securities and Use of Proceeds

In November 2000, the Securities Exchange Commission declared our Registration Statement on Form S-1 effective. We completed our initial public offering, including exercise of the underwriters' over-allotment option of 4,140,000 shares, at an initial public offering price of \$12.00 per share, for aggregate cash proceeds of approximately \$49.7 million. The managing underwriters of the offering were Chase Securities Inc., CIBC World Markets Corporation and SG Cowen Securities Corporation.

In connection with the offering, we paid a total of approximately \$3.5 million in underwriting discounts and commissions and \$1.7 million in other offering costs and expenses. After deducting the underwriting discounts and commissions and the offering costs and expenses, our net proceeds from the offering, including the over-allotment option, were approximately \$44.5 million.

From January 1, 2001 through June 30, 2002, the proceeds from the offering were used for research and development, clinical activities, marketing and manufacturing expenditures for existing and future products, capital expenditures and general corporate purposes. In the future we intend to use the net proceeds in a similar manner.

As of June 30, 2002, \$1.8 million of the proceeds from our IPO remained available and were primarily invested in cash equivalents and short-term available-for-sale securities.

Item 3. Defaults Upon Senior Securities
None

Item 4. Submission of Matters to a Vote of Security Holders
On May 14, 2002, at the Company's annual meeting of stockholders, the following votes were cast:

To elect as Class II Directors for a three-year term ending in 2005, as follows:

| | <u>For</u> | <u>Withheld</u> |
|---------------------|------------|-----------------|
| Mr. Tom Baruch | 14,026,082 | 12,383 |
| Jane E. Shaw, Ph.D. | 12,610,207 | 1,428,258 |

To change the spelling of the Company's name from AeroGen, Inc. to Aerogen, Inc.:

| | <u>For</u> | <u>Against</u> | <u>Abstain</u> |
|--|------------|----------------|----------------|
| | 13,734,788 | 68,877 | 234,800 |

To ratify the appointment of PricewaterhouseCoopers LLC as the Company's independent accountants for the fiscal year ending December 31, 2002:

| | <u>For</u> | <u>Against</u> | <u>Abstain</u> |
|--|------------|----------------|----------------|
| | 13,804,340 | 2,152 | 231,973 |

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