CYTRX CORP
Form 10-Q/A
April 02, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q/A
Amendment No. 1

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

For the quarterly period ended June 30, 2006

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 0-15327

CYTRX CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	**58-1642740**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11726 San Vicente Blvd. Suite 650 Los Angeles, CA	**90049**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(310) 826-5648**

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 þ No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

There were 76,788,694 shares of CytRx Corporation Common Stock, $.001 par value, issued and outstanding as of March 23, 2007, exclusive of treasury shares.

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EXPLANATORY NOTE

CytRx Corporation (the Company) is amending in certain respects its Quarterly Report on Form 10-Q for the quarter year ended June 30, 2006, which we sometimes refer to in this amendment as our original Form 10-Q. The purpose of this amendment is to restate our condensed consolidated financial statements for the quarter ended June 30, 2006 as described below.

The restatement of our condensed consolidated financial statements is related to a reclassification of certain expenses related to the operations of our Massachusetts laboratory. The restatement also includes a correction of the accounting for historical anti-dilution adjustments in certain of our outstanding warrants in the quarters ended June 30, 2006 and 2005, respectively.

On March 30, 2007, the Audit Committee of our Board of Directors approved management s recommendation to restate our condensed consolidated financial statements for the quarter ended June 30, 2006 to reflect the expense reclassification and the correction of the accounting for historical anti-dilution adjustments in certain of our outstanding warrants.

The following Items and Exhibits of our original Form 10-Q are amended by this amendment:

Part I Item 1. Financial Statements (unaudited)

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

Part I Item 4. Controls and Procedures

Part II Item 6. Exhibits

Exhibit 31.1 Certification of Chief Executive Officer

Exhibit 31.2 Certification of Chief Financial Officer

Except for the foregoing Items and Exhibits, this amendment does not modify any disclosures contained in our original Form 10-Q. Additionally, the text of this amendment, except for the restatement information, speaks as of the filing date of the original Form 10-Q and does not attempt to update the disclosures in our original Form 10-Q or to discuss any developments subsequent to the date of the original filing. In accordance with the rules and regulations of the Securities and Exchange Commission, the information contained in the original Form 10-Q and this amendment is subject to updated or supplemental information contained in reports filed by us with the Securities and Exchange Commission subsequent to the filing dates of the original Form 10-Q and this amendment.

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Part I FINANCIAL INFORMATION

Item 1. Financial Statements

CYTRX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,243,535	$ 8,299,390
Accounts receivable		172,860
Prepaid compensation, current portion		27,813
Prepaid and other current assets	176,731	287,793
Total current assets	13,420,266	8,787,856
Equipment and furnishings, net	285,714	352,641
Molecular library, net	328,216	372,973
Prepaid insurance and other assets	402,532	425,440
Total assets	$ 14,436,728	$ 9,938,910
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,510,039	$ 815,626
Accrued expenses and other current liabilities	1,432,395	1,639,922
Total current liabilities	2,942,434	2,455,548
Deferred revenue	275,000	275,000
Total liabilities	3,217,434	2,730,548
Stockholders equity:		
Preferred Stock, $.01 par value, 5,000,000 shares authorized, including 5,000 shares of Series A Junior Participating Preferred Stock; no shares issued and outstanding		
Common stock, $.001 par value, 125,000,000 shares authorized; 70,619,000 and 59,284,000 shares issued at June 30, 2006 and December 31, 2005, respectively	70,619	59,284
Additional paid-in capital	145,910,693	131,790,932
Treasury stock, at cost (633,816 shares held at June 30, 2006 and December 31, 2005, respectively)	(2,279,238)	(2,279,238)
Accumulated deficit	(132,482,780)	(122,362,616)
Total stockholders equity	11,219,294	7,208,362
Total liabilities and stockholders equity	$ 14,436,728	$ 9,938,910

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

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CYTRX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006 (restated)	**2005**	**2006** (restated)	**2005** (restated)
Revenue:				
Service revenue	$	$	$ 60,830	$
License fees				1,500
			60,830	1,500
Expenses:				
Research and development (includes $61,000 and $105,000 of non-cash stock-based compensation given to consultants for the three and six-month periods ended June 30, 2006 and $38,000 and $90,000 of non-cash stock-based compensation given to consultants for the three and six-month periods ended June 30, 2005, respectively)	3,096,293	2,915,969	5,269,941	4,829,989
Depreciation and amortization	80,010	62,288	138,941	100,412
General and administrative (includes $58,000 and $125,000 of non-cash stock-based compensation given to consultants for the three and six-month periods ended June 30, 2006 and $77,000 and $316,000 of non-cash stock-based compensation given to consultants for the three and six-month periods ended June 30, 2005)	2,114,776	1,614,695	3,871,705	3,271,907
Expense related to employee stock options	351,209		696,378	
	5,642,288	4,592,952	9,976,965	8,202,308
Loss before other income	(5,642,288)	(4,592,952)	(9,916,135)	(8,200,808)
Other income:				
Interest income	176,908	41,066	284,398	83,730
Minority interest in losses of subsidiary		42,753		81,452
Net loss	$ (5,465,380)	$ (4,509,133)	$ (9,631,737)	$ (8,035,626)
Deemed dividend for anti-dilution adjustments made to outstanding common stock warrants			(488,429)	(1,075,568)

Net loss applicable to common stockholders	$ (5,465,380)	$ (4,509,133)	$ (10,120,166)	$ (9,111,194)
Basic and diluted loss per share, as originally stated	$ (0.08)	$ (0.08)	$ (0.15)	$ (0.14)
Basic and diluted loss per share, as restated	$ (0.08)	$ (0.08)	$ (0.15)	$ (0.16)
Weighted average shares outstanding	69,977,876	57,542,340	66,181,900	55,509,421

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

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CYTRX CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2006	**2005**
Cash flows from operating activities:		
Net loss	$ (9,631,737)	$ (8,035,626)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	138,941	100,412
Minority interest in losses of subsidiary		(81,452)
Common stock, stock options and warrants issued for services	230,547	406,483
Expense related to employee stock options	696,378	
Net change in operating assets and liabilities	788,796	575,956
Total adjustments	1,854,662	1,001,399
Net cash used in operating activities	(7,777,075)	(7,034,227)
Cash flows from investing activities:		
Purchases of property and equipment	(22,335)	(34,489)
Net cash used in investing activities	(22,335)	(34,489)
Cash flows from financing activities:		
Net proceeds from exercise of stock options and warrants	339,194	251,619
Net proceeds from issuances of common stock	12,404,360	19,590,446
Net cash provided by financing activities	12,743,554	19,842,065
Net increase in cash and cash equivalents	4,944,144	12,773,349
Cash and cash equivalents at beginning of period	8,299,390	2,999,409
Cash and cash equivalents at end of period	$ 13,243,534	$ 15,772,758

Non-Cash Financing Activities:

In connection with the Company s adjustment to the terms of certain outstanding warrants on January 20, 2005 and March 2, 2006, the Company recorded deemed dividends of $1,075,568 and $488,429, respectively, which were recorded as charges to retained earnings with a corresponding credit to additional paid-in capital.

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

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CYTRX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006
(Unaudited)

1. Description of Company and Basis of Presentation

CytRx Corporation (CytRx or the Company) is a biopharmaceutical research and development company, based in Los Angeles, California, with an obesity and type 2 diabetes research laboratory in Worcester, Massachusetts (see Note 11 to our financial statements for the year ended December 31, 2005). On September 30, 2005, the Company completed the merger of CytRx Laboratories, Inc., previously a wholly owned subsidiary of the Company and the owner of its Massachusetts laboratory (the Subsidiary), with and into the Company. The Company s small molecule therapeutics efforts include the clinical development of three, oral drug candidates that it acquired in October 2004, as well as a drug discovery operation conducted by its laboratory in Worcester, Massachusetts. The Company owns the rights to a portfolio of technologies, including ribonueleic acid interference (RNAi or gene silencing) technology in the treatment of specified diseases, including those within the areas of amyotrophic lateral sclerosis (ALS or Lou Gehrig s disease), obesity and type 2 diabetes and human cytomegalovirus (CMV). In addition, the Company announced that a novel HIV DNA + protein boost vaccine exclusively licensed to the Company and developed by researchers at University of Massachusetts Medical School and Advanced BioScience Laboratories, and funded by the National Institutes of Health, demonstrated promising interim Phase I clinical trial results that indicate its potential to produce potent antibody responses with neutralizing activity against multiple HIV viral strains. The Company has entered into strategic alliances with third parties to develop several of the Company s other products.

In 2004, the Company began a development program based on molecular chaperone co-induction technology through the acquisition of novel small molecules with broad therapeutic applications in neurology, type 2 diabetes, cardiology and diabetic complications. The acquired assets included three oral, clinical stage drug candidates and a library of 500 small molecule drug candidates. In September 2005, the Company entered the clinical stage of drug development with the initiation of a Phase II clinical program with its lead small molecule product candidate arimoclomol for the treatment of ALS. The Company completed dosing and patient follow-up for that clinical trial in July 2006. Arimoclomol has received Orphan Drug and Fast Track designation from the U.S. Food and Drug Administration.

To date, the Company has relied primarily upon selling equity securities and, to a much lesser extent, upon payments from its strategic partners and licensees and upon proceeds received upon the exercise of options and warrants to generate the funds needed to finance its operations. Management believes the Company s cash and cash equivalents balances are sufficient to meet projected cash requirements into the third quarter of 2007. The Company will be required to obtain significant additional funding in order to execute its long-term business plans, although it does not currently have commitments from any third parties to provide it with capital. The Company cannot assure that additional funding will be available on favorable terms, or at all. If the Company fails to obtain significant additional funding when needed, it may not be able to execute its business plans and its business may suffer, which would have a material adverse effect on its financial position, results of operations and cash flows.

The accompanying condensed consolidated financial statements at June 30, 2006 and for the three and six-month periods ended June 30, 2006 and 2005 are unaudited, but include all adjustments, consisting of normal recurring entries, which the Company s management believes to be necessary for a fair presentation of the periods presented. Interim results are not necessarily indicative of results for a full year. Balance sheet amounts as of December 31, 2005 have been derived from our audited financial statements as of that date.

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The financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to such rules and regulations. The financial statements should be read in conjunction with the Company s audited financial statements in its Form 10-K for the year ended December 31, 2005. The Company s operating 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.

The accompanying condensed financial statements have been restated to reflect a reclassification of certain expenses related to the operations of the Company s Massachusetts laboratory and a correction of the accounting for the Company s historical anti-dilution adjustments in certain of its outstanding warrants. The statement of operations was restated to include deemed dividends of $1,075,568 and $488,429 in the first quarters of 2005 and 2006, respectively, in arriving at the net loss applicable to common stockholders of $9,111,194 and $10,120,166 for the six-month periods ended June 30, 2005 and 2006, respectively. The restated net loss applicable to common stockholders resulted in an increase in net loss per share from $0.14 to $0.16 for the six-month period ended June 30, 2005, but did not change the net loss per share of $0.15 for the same period in 2006. The statement of operations was also restated to reflect $408,593 and $882,123 of expenses that were reclassified from general and administrative expense to research and development expense for the three and six-month periods ended June 30, 2006, respectively.

2. Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes* , which clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* . FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently in a loss position and does not pay income taxes; therefore the adoption of FIN 48 is not expected to have a significant impact on the Company s 2006 financial statements.

3. Loss Per Share

Basic net loss per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Dilutive potential common shares primarily consist of employee stock options and restricted common stock. Common share equivalents which potentially could dilute basic loss per share in the future, and which were excluded from the computation of diluted loss per share, as the effect would be anti-dilutive, totaled approximately 29,224,000 and 24,890,000 shares at June 30, 2006 and 2005, respectively.

Statement of Financial Accounting Standards No. 128, Earnings per Share (SFAS 128) requires that employee equity share options, nonvested shares and similar equity instruments granted by the Company be treated as potential common shares outstanding in computing diluted loss per share. As the Company recorded losses for the three and six-month periods ended June 30, 2006, all employee equity share options, nonvested shares and similar equity instruments would be anti-dilutive. In the event the Company becomes profitable, diluted shares outstanding will include the dilutive effect of in-the-money options which are calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of benefits that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares.

In connection with our adjustment to the exercise terms of certain outstanding warrants to purchase common stock on March 2, 2006 and January 20, 2005, we recorded deemed dividends of $488,000 and $1.1 million, respectively. These deemed dividends are reflected as an adjustment to net loss for the six-month periods ended June 30, 2006 and 2005, respectively, to arrive at net loss applicable to common stockholders on the condensed consolidated statement

of operations and for purposes of calculating basic and diluted loss per share.

4. Stock Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options, based on estimated fair values. SFAS 123(R) supersedes the Company s previous accounting under Accounting

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Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), employed by the Company for periods prior to fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company s Consolidated Financial Statements as of and for the three and six-month periods ended June 30, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Stock-based compensation expense recognized under SFAS 123(R) as general and administrative expense for the three and six-month periods ended June 30, 2006 were approximately $351,000 and $696,000, respectively. There was no stock-based compensation expense related to employee stock options and employee stock purchases recognized during the three and six-month periods ended June 30, 2005.

As of June 30, 2006, an aggregate of 10,000,000 shares of common stock were reserved for issuance under the Company s 2000 Stock Option Incentive Plan, including 6,478,000 shares subject to outstanding stock options and 3,159,000 shares available for future grant. Additionally, the Company has two other plans, the 1994 Stock Option Plan and the 1998 Long Term Incentive Plan, which include 31,000 and 100,000 shares subject to outstanding stock options. As the terms of our plans provide that no options may be issued after 10 years, no options are available under the 1994 Plan. Under the 1998 Plan Long Term Incentive Plan, 40,000 shares are available for future grant. Options granted under these plans generally vest and become exercisable as to 33% of the option grants on each anniversary of the grant date until fully vested. The options will expire, unless previously exercised, not later than ten years from the grant date.

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Accounting Standard (SFAS) No. 123R, Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95 (SFAS 123R), that addresses the accounting for, among other things, transactions in which a company receives employee services in exchange for equity instruments of the company. The statement precludes accounting for employee share-based compensation transactions using the intrinsic method, and requires that such transactions be accounted for using a fair-value-based method and that the fair value of the transaction be recognized as expense on a straight-line basis over the vesting period. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 (SAB 107) regarding the Staff s interpretation of SFAS 123R. This interpretation provides the Staff s views regarding interactions between SFAS 123R and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company s Consolidated Statement of Operations. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123). Under the intrinsic value method, no stock-based compensation expense had been recognized in the Company s Consolidated Statement of Operations, other than as related to acquisitions and investments, because the exercise price of the Company s stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company s Consolidated Statement of Operations for the first six months of fiscal 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for the share-based payment awards granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). In conjunction with the adoption of SFAS 123(R), the Company adopted the straight-line single option method. As stock-based compensation expense

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recognized in the Consolidated Statement of Operations for the first six months of fiscal 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company s pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

Upon adoption of SFAS 123(R), the Company elected to continue to use the Black-Scholes option-pricing model (Black-Scholes model). The Company s determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company s expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions and are fully transferable. Because the Company s employee stock options have certain characteristics that are significantly different from traded options, and because changes in the subjective assumptions can materially affect the estimated value, in management s opinion, the existing valuation models may not provide an accurate measure of the fair value of the Company s employee stock options. Although the fair value of employee stock options is determined in accordance with SFAS 123(R) and SAB 107 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

Prior to January 1, 2006, the Company accounted for its stock based compensation plans under the recognition and measurement provisions of Accounting Principles Board No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations for all awards granted to employees. Under APB 25, when the exercise price of options granted to employees under these plans equals the market price of the common stock on the date of grant, no compensation expense is recorded. When the exercise price of options granted to employees under these plans is less than the market price of the common stock on the date of grant, compensation expense is recognized over the vesting period.

For stock options paid in consideration of services rendered by non-employees, the Company recognizes compensation expense in accordance with the requirements of SFAS No. 123 and EITF 96-18, as amended, and Emerging Issues Task Force Issue No. 96-18, Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services. Under SFAS No. 123, the compensation associated with stock options paid to non-employees is generally recognized in the period during which services are rendered by such non-employees. Since our adoption of SFAS 123(R), there been no change to our equity plans or modifications of our outstanding stock-based awards.

Deferred compensation for non-employee option grants that do not vest immediately upon grant are recorded as an expense over the vesting period of the underlying stock options, using the method prescribed by FASB Interpretation 28. At the end of each financial reporting period prior to vesting, the value of these options, as calculated using the Black Sholes option pricing model, will be re-measured using the fair value of the Company s common stock and deferred compensation and the non-cash compensation recognized during the period will be adjusted accordingly. Since the fair market value of options granted to non-employees is subject to change in the future, the amount of the future compensation expense is subject to adjustment until the stock options are fully vested. The Company recognized $119,000 and $231,000 of stock based compensation expense related to non-employee stock options for the three and six-month periods ended June 30, 2006, respectively.

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The following table illustrates the pro forma effect on net loss and net loss per share assuming the Company had applied the fair value recognition provisions of SFAS 123 to options granted under the Company s stock option plans for the three and six-month periods ended June 30, 2005. For purposes of this presentation, the value of the options is estimated using a Black Sholes option-pricing model and recognized as an expense on a straight-line basis over the options vesting periods.

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005 (restated)
Net loss allocable to common stockholders	$ (4,509)	$ (9,111)
Total stock-based employee compensation expense determined under fair-value based method for all awards	(350)	(657)
Pro forma net loss	$ (4,859)	$ (9,768)
Loss per share, as originally reported (basic and diluted)	$ (0.08)	$ (0.14)
Loss per share, as restated (basic and diluted)	$ (0.08)	$ (0.16)
Loss per share, pro forma (basic and diluted)	$ (0.08)	$ (0.18)

The fair value of stock options at the date of grant was estimated using the Black-Sholes option-pricing model, based on the following assumptions: The Company s expected stock price volatility assumption is based upon the historical daily volatility of our publicly traded stock. For option grants issued during the six-month period ended June 30, 2006 the Company used a calculated volatility for each grant. The expected life assumptions is based upon the simplified method provided for under SAB 107, which averages the contractual term of the Company s options of ten years with the average vesting term of two years for an average of six years. The dividend yield assumption is based upon the fact the Company has never paid cash dividends and presently has no intention of paying cash dividends. The risk-free interest rate used for each grant is equal to the U.S. Treasury rates in effect at the time of the grant for instruments with a similar expected life. Based on historical experience, the Company has estimated an annualized forfeiture rate of 10% for options granted to its employees and 3% for its senior management and director stock options. The Company will record additional expense if the actual forfeitures are lower than estimated and will record a recovery of prior expense if the actual forfeiture rates are higher than estimated. Under provisions of SFAS 123(R), the Company recorded $351,000 and $696,000 of stock-based compensation for the three and six-month periods ended June 30, 2006, respectively. No amounts relating to employee stock-based compensation have been capitalized.

	Six Months Ended	
	June 30, 2006	June 30, 2005
Risk-free interest rate	4.27% 5.23%	3.58% 4.33%
Expected volatility	117.0%	119.1%
Expected lives (years)	6	6
Expected dividend yield	0.00%	0.00%

At June 30, 2006, there remained approximately $3.7 million of unrecognized compensation expense related to unvested employee stock options to be recognized as expense over a weighted-average period of 8.48 years. Presented below is the Company s stock option activity:

	Stock Options

	Six Months Ended June 30, 2006	
	Number of Shares	Weighted Average Exercise Price per Share
Outstanding at beginning of year	6,205,542	$ 1.71
Granted	553,500	$ 1.36
Exercised	(62,500)	$ 0.96
Forfeited	(87,500)	$ 2.07
Outstanding at end of year	6,609,042	$ 1.69
Shares exercisable at end of period	4,016,911	$ 1.86

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A summary of the activity for nonvested stock options as of June 30, 2006 and changes during the six month period is presented below:

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Nonvested at January 1, 2006	2,767,385	$ 1.47
Granted	553,500	$ 1.36
Vested	(728,754)	$ 1.59
Nonvested at June 30, 2006	2,592,131	$ 1.42

The following table summarizes significant ranges of outstanding stock options under the three plans at June 30, 2006:

Range of Exercise Prices	Number of Options	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Contractual Life	Weighted Average Exercise Price
$0.25 1.00	1,236,043	7.92	$ 0.82	521,904	6.66	$ 0.82
$1.01 1.50	1,437,500	8.98	1.29	544,670	4.91	1.27
$1.51 2.00	2,222,500	7.55	1.86	1,454,170	6.69	1.86
$2.01 3.00	1,712,999	7.12	2.43	1,496,167	7.23	2.44
	6,609,042	7.82	$ 1.69	4,016,911	6.65	$ 1.86

The aggregate intrinsic value of outstanding options as of June 30, 2006, was $710,000 of which $84,000 is related to exercisable options. The aggregate intrinsic value was calculated based on the positive difference between the closing fair market value of the Company s common stock on June 30, 2006 ($1.32) and the exercise price of the underlying options. The intrinsic value of options exercised was $2,100 and $55,550 for the three and six month periods ended June 30, 2006 and the intrinsic value of options vested was $26,000 and $97,000 during these same periods.

5. Liquidity and Capital Resources

Based on the Company s currently planned level of expenditures, it believes that it will have adequate working capital to allow it to operate at its currently planned levels into the third quarter of 2007. The Company will be required to obtain significant additional funding in order to execute its business plans. The Company is pursuing several potential sources of capital, including potential strategic alliances, although it does not currently have commitments from any third parties to provide it with capital.

6. Equity Transactions

On March 2, 2006, the Company completed a $13.4 million private equity financing in which it issued 10,650,794 shares of its common stock and warrants to purchase an additional 5,325,397 shares of its common stock at an exercise price of $1.54 per share.

Net of investment banking commissions, legal, accounting and other expenses related to the transaction, we received proceeds of approximately $12.4 million.

In connection with the financing, the Company adjusted the price and number of underlying shares of warrants to purchase approximately 2.8 million shares that had been issued in prior equity financings in May and September 2003. The adjustment was made as a result of anti-dilution provisions in those warrants that were triggered by the Company s issuance of common stock in that financing at a price below the closing market price on the date of the transaction. The Company accounted for the anti-dilution adjustments as deemed dividends analgous with the guidance in Emerging Issues Task Force Issue (EITF) No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, and EITF 00-27, *Application of 98-5 to Certain Convertible Instruments*, and recorded an approximate $488,000 charge to retained earnings and a corresponding credit to additional paid-in capital.

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In connection with March equity financing, the Company entered into a registration rights agreement with the purchasers of its stock and warrants, which provides, among other things, for cash penalties in the event that the Company were unable to initially register, or maintain the effective registration of, the securities. The Company evaluated the penalty provisions in light of EITF 00-19, *Accounting for Derivative Financial Instruments Indexed To, and Potentially Settled In a Company s Own Stock*, and determined that the maximum penalty does not exceed the difference between the fair value of a registered share of CytRx common stock and unregistered share of Cytrx common stock on the date of the transaction. Further, the Company s management evaluated the other terms of the March 2006 financing with the provisions of EITF 00-19 and related accounting literature. Management concluded based upon its analysis of EITF 00-19 and related accounting literature, the common stock and related warrants sold in the March 2006 financing should be recorded as permanent equity in its financial statements.

During the three and six-month periods ended June 30, 2006, the Company issued 41,072 and 683,903 shares of its common stock, and received $4,968 and $339,193, upon the exercise of stock options and warrants. In addition to the warrants issued in the March 2006 financing described above, the Company issued 450,000 and 553,500 options and warrants in the three and six-month period ended June 30, 2006.

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

Forward Looking Statements

From time to time, we make oral and written statements that may constitute forward-looking statements (rather than historical facts) as defined in the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission, or SEC, in its rules, regulations and releases, including Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. We desire to take advantage of the safe harbor provisions in the Private Securities Litigation Reform Act of 1995 for forward-looking statements made from time to time, including, but not limited to, the forward-looking statements made in this Quarterly Report on Form 10-K, as well as those made in other filings with the SEC.

All statements in this Quarterly Report, including in Management s Discussion and Analysis of Financial Condition and Results of Operations, other than statements of historical fact are forward-looking statements for purposes of these provisions, including any projections of financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance, and any statement of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, estimates, potential or could or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein and in documents incorporated by this Quarterly Report are reasonable, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct, and actual results could differ materially from those projected or assumed in the forward-looking statements.

Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including but not limited to the risk factors set forth under the heading Risk Factors in this Quarterly Report. These risks and uncertainties include: the scope of the clinical testing that may be required by regulatory authorities for our molecular chaperone co-induction drug candidates, including with respect to arimoclomol for the treatment of amyotrophic lateral sclerosis (ALS or Lou Gehrig s disease), our HIV vaccine candidate and our other product candidates, and the outcomes of those tests; uncertainties related to the early stage of our diabetes, obesity, cytomegalovirus, or CMV, and ALS research; the need for future clinical testing of any small molecules and products based on ribonucleic acid interference, or RNAi, that may be developed by us; the significant time and expense that will be incurred in developing any of the potential commercial applications for our small molecules or RNAi technology; risks or uncertainties related to our ability to obtain capital to fund our ongoing working capital needs, including capital required to fund RNAi development activities that we plan to

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conduct through the creation of a new subsidiary; and risks relating to the enforceability of any patents covering our products and to the possible infringement of third party patents by those products.

All forward-looking statements and reasons why results may differ included in this Quarterly Report are made as of the date hereof, and we assume no obligation to update any such forward-looking statement or reason why actual results might differ.

Overview

We are a biopharmaceutical research and development company, based in Los Angeles, California, with an obesity and type 2 diabetes research laboratory in Worcester, Massachusetts. We are in the process of developing products, primarily in the areas of small molecule therapeutics and ribonucleic acid interference, or RNAi, for the human health care market. Our small molecule therapeutics efforts include clinical development of three oral drug candidates that we acquired in October&