

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1996-11-14** | Period of Report: **1996-09-30**
SEC Accession No. **0000950123-96-006627**

([HTML Version](#) on [secdatabase.com](#))

FILER

PATHOGENESIS CORP

CIK: **1001186** | IRS No.: **911542150** | State of Incorporation: **DE** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **000-27150** | Film No.: **96665045**
SIC: **2834** Pharmaceutical preparations

Mailing Address
201 ELLIOT AVENUE WEST
SEATTLE WA 98119

Business Address
201 ELLIOT AVE WEST
SEATTLE WA 98119
2064678100

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period ended September 30, 1996

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 0-27150

PATHOGENESIS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

91-1542150
(I.R.S. Employer Identification No.)

201 Elliott Avenue West
Seattle, Washington
(Address of principal executive offices)

98119
(Zip Code)

Registrant's telephone number including area code: (206) 467-8100

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$.001 per share
(Title of class)

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

At November 11, 1996, the number of shares outstanding of the registrant's Common Stock, par value \$.001 per share, was 13,897,057 shares.

PATHOGENESIS CORPORATION
(A DEVELOPMENT STAGE ENTERPRISE)
BALANCE SHEETS

<TABLE>
<CAPTION>

	September 30, 1996	December 31, 1995
	-----	-----
<S>	<C>	<C>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 23,142,320	\$ 575,297
Investment securities	43,136,632	36,871,537
Interest receivable	336,100	765,216
Grants and royalties receivable	142,683	0
Prepaid expenses	298,016	671,711
	-----	-----

Total current assets	67,055,751	38,883,761
Property and equipment, at cost:		
Leasehold improvements	6,567,451	6,435,336
Furniture and equipment	5,718,984	5,338,435
	12,286,435	11,773,771
Less accumulated depreciation and amortization	4,903,684	3,702,152
Net property and equipment	7,382,751	8,071,619
Other assets, net	4,145	7,758
Total assets	\$ 74,442,647	\$ 46,963,138
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 616,081	\$ 1,635,711
Compensation and benefits	443,129	859,462
Clinical development costs	984,157	876,132
Other accrued expenses	152,791	81,473
Total current liabilities	2,196,158	3,452,778
Long-term liability	171,978	461,986
Stockholders' equity:		
Preferred stock \$.01 par value. Authorized 1,000,000 shares; issued and outstanding none	--	--
Common stock \$.001 par value. Authorized 20,000,000 shares; issued and outstanding 13,770,182 shares	13,770	10,898
Additional paid-in capital	133,442,030	89,520,221
Unrealized gain (loss) on investment securities	(94,502)	38,458
Deficit accumulated during the development stage	(61,286,787)	(46,521,203)
Total stockholders' equity	72,074,511	43,048,374
Total liabilities and stockholders' equity	\$ 74,442,647	\$ 46,963,138

</TABLE>

3

PATHOGENESIS CORPORATION
(A DEVELOPMENT STAGE ENTERPRISE)
STATEMENTS OF OPERATIONS

<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,		December 10, 1991 (Incorporation) Through September 30,
	1996	1995	1996	1995	1996
<S>	<C>	<C>	<C>	<C>	<C>
Revenue:					
Grants and Royalties	\$ 160,539	\$ --	\$ 282,843	\$ --	\$ 282,843
Operating expenses:					
Research and development	4,940,519	3,557,859	14,437,674	11,266,394	51,866,163
General and administrative	995,666	896,795	2,919,173	2,804,169	16,055,359
Total operating expenses	5,936,185	4,454,654	17,356,847	14,070,563	67,921,522
Operating Loss	(5,775,646)	(4,454,654)	(17,074,004)	(14,070,563)	(67,638,679)
Other income (expense):					
Investment income, net	1,012,981	321,199	2,360,209	955,349	6,541,474
Other income (expense)	(24,547)	(11,018)	(51,789)	(31,056)	(189,582)
Net other income	988,434	310,181	2,308,420	924,293	6,351,892

Net loss	\$ (4,787,212)	\$ (4,144,473)	\$ (14,765,584)	\$ (13,146,270)	\$ (61,286,787)
Net loss per common share	\$ (0.35)	\$ (0.52)	\$ (1.18)	\$ (1.67)	
Weighted average common shares outstanding	13,759,209	7,897,706	12,468,547	7,886,191	

</TABLE>

4

PATHOGENESIS CORPORATION
(A DEVELOPMENT STAGE ENTERPRISE)
STATEMENTS OF STOCKHOLDERS' EQUITY

<TABLE>
<CAPTION>

DATE	DESCRIPTION	NUMBER OF COMMON SHARES OUTSTANDING	PRICE PER SHARE	COMMON STOCK	ADDITIONAL PAID -IN CAPITAL
----	-----	-----	-----	-----	-----
<S> Feb to Mar 1992	<C> Shares issued for cash	<C> 1,870,000	<C> \$0.08	<C> 1,870	<C> 147,730
June to Dec 1992	Shares issued for cash net of issue costs of \$744,966	4,308,500	10.00	4,309	42,335,725
November 1992	Repurchase of common stock through forgiveness of note receivable	(25,000)	10.00	(25)	(249,975)
	Repurchase of common stock for cash	(46,875)	0.08	(47)	(3,703)
	Net loss for the period ended December 31, 1992				
	Balances at December 31, 1992	6,106,625		6,107	42,229,776
October 1993	Shares issued in payment of license fees	50,000	10.00	50	499,950
	Net loss for the year ended December 31, 1993				
	Balances at December 31, 1993	6,156,625		6,157	42,729,726
March 1994	Shares issued for cash net of issue costs of \$1,251,739	1,690,677	12.00	1,690	19,093,694
	Unrealized loss on investment securities				
	Net loss for the year ended December 31, 1994				
	Balances at December 31, 1994	7,847,302		7,847	61,823,421
March 1995	Shares issued in payment of license fees	50,000	12.00	50	599,950
April to Aug 1995	Exercise of stock options for cash	413	10.00	1	4,124
November 1995	Shares issued for cash net of issue costs of \$2,904,274	3,000,000	10.00	3,000	27,092,726
	Unrealized loss on investment securities				
	Net loss for the year ended December 31, 1995				
	Balances at December 31, 1995	10,897,715		10,898	89,520,221
Jan to June 1996	Exercise of stock options	4,974	16.94	5	29,667
Jan to June 1996	Redemption of fractional shares	(45)	12.00	(0)	(540)
February 1996	Shares issued in payment of license fees	6,250	10.00	6	62,494
February 1996	Repurchase of common stock for cash	(45,000)	0.08	(45)	(3,555)
May 1996	Shares issued for cash net of issue costs of \$3,214,628	2,875,000	16.25	2,875	43,501,247
July to Sept 1996	Adjustment to issue costs				1,218
July to Sept 1996	Exercise of stock options	31,291	10.59	31	331,314
July to Sept 1996	Redemption of fractional shares	(3)	12.00	(0)	(36)
	Unrealized loss on investment securities				
	Net loss for the period ended September 30, 1996				
	Balances at September 30, 1996	13,770,182		13,770	133,442,030

</TABLE>

<TABLE>
<CAPTION>

DATE	DESCRIPTION	UNREALIZED LOSS ON INVESTMENTS	DEFICIT ACCUMULATED DURING THE DEVELOPMENT STAGE	TOTAL STOCKHOLDERS' EQUITY
<S>	<C>	<C>	<C>	<C>
Feb to Mar 1992	Shares issued for cash			149,600
June to Dec 1992	Shares issued for cash net of issue costs of \$744,966			42,340,034
November 1992	Repurchase of common stock through forgiveness of note receivable			(250,000)
	Repurchase of common stock for cash			(3,750)
	Net loss for the period ended December 31, 1992		(2,930,285)	(2,930,285)
	Balances at December 31, 1992		(2,930,285)	39,305,599
October 1993	Shares issued in payment of license fees			500,000
	Net loss for the year ended December 31, 1993		(10,804,878)	(10,804,878)
	Balances at December 31, 1993		(13,735,163)	29,000,721
March 1994	Shares issued for cash net of issue costs of \$1,251,739			19,095,384
	Unrealized loss on investment securities	(172,809)		(172,809)
	Net loss for the year ended December 31, 1994		(14,762,117)	(14,762,117)
	Balances at December 31, 1994	(172,809)	(28,497,280)	33,161,179
March 1995	Shares issued in payment of license fees			600,000
April to Aug 1995	Exercise of stock options for cash			4,125
November 1995	Shares issued for cash net of issue costs of \$2,904,274			27,095,726
	Unrealized loss on investment securities	211,267		211,267
	Net loss for the year ended December 31, 1995		(18,023,923)	(18,023,923)
	Balances at December 31, 1995	38,458	(46,521,203)	43,048,374
Jan to June 1996	Exercise of stock options			29,672
Jan to June 1996	Redemption of fractional shares			(540)
February 1996	Shares issued in payment of license fees			62,500
February 1996	Repurchase of common stock for cash			(3,600)
May 1996	Shares issued for cash net of issue costs of \$3,214,628			43,504,122
July to Sept 1996	Adjustment to issue costs			1,218
July to Sept 1996	Exercise of stock options			331,345
July to Sept 1996	Redemption of fractional shares			(36)
	Unrealized loss on investment securities	(132,960)		(132,960)
	Net loss for the period ended September 30, 1996		(14,765,584)	(14,765,584)
	Balances at September 30, 1996	(94,502)	(61,286,787)	72,074,511

</TABLE>

5

PATHOGENESIS CORPORATION
(A DEVELOPMENT STAGE ENTERPRISE)
STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

	Nine Months Ended September 30,		December 10, 1991 (Incorporation) Through September 30, 1996
	1996	1995	
<S>	<C>	<C>	<C>
Cash flows from operating activities:			
Net loss	\$ (14,765,584)	\$ (13,146,270)	\$ (61,286,787)

Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,202,884	1,170,273	5,019,465
Amortization of investment premiums	(135,877)	110,856	236,473
Common stock issued in payment of license fees	--	600,000	1,159,000
Loss on sale of furniture and equipment	315	63,174	
Change in certain assets and liabilities:			
Interest receivable	429,116	(336,100)	
Grants and royalties receivable	(142,683)	(142,683)	
Prepaid expenses	373,695	(12,543)	(298,016)
Other assets, net	3,613	(1,043)	(4,145)
Accounts payable	(1,019,630)	(160,197)	616,081
Compensation and benefits	(416,333)	(136,205)	503,129
Clinical development costs	108,025	(172,368)	984,157
Other accrued expenses	71,318	(63,689)	152,791
Long-term liability	(227,508)	507,086	234,478
Net cash used in operating activities	(14,518,649)	(11,304,100)	(53,098,983)
Cash flows from investing activities:			
Purchases of investment securities	(87,656,851)	(13,007,643)	(222,162,502)
Sales of investment securities	81,394,672	22,637,557	178,694,894
Purchases of furniture and equipment	(514,430)	(258,178)	(12,565,489)
Proceeds from sale of furniture and equipment	100	--	40,100
Issuance of note receivable	--	--	(250,000)
Net cash (used) provided in investing activities	(6,776,509)	9,371,736	(56,242,997)
Cash provided by financing activities			
net proceeds from issuance of common stock	43,862,181	4,125	132,484,300
Net increase (decrease) in cash and cash equivalents	22,567,023	(1,928,239)	23,142,320
Cash and cash equivalents at beginning of period	575,297	2,873,792	
Cash and cash equivalents at end of period	\$ 23,142,320	\$ 945,553	\$ 23,142,320
Supplemental schedule of noncash investing and financing activities:			
Stock issued to extinguish long term-liability	62,500		62,500
Repurchase of common stock through forgiveness of note receivable			250,000

</TABLE>

6

PATHOGENESIS CORPORATION
(A DEVELOPMENT STAGE ENTERPRISE)
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1995 AND 1996

(1) BASIS OF PRESENTATION

The accompanying financial statements and related notes have been prepared pursuant to Securities and Exchange Commission rules and regulations for interim financial statements. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The accompanying financial statements and related notes should be read in conjunction with the audited financial statements for the year ended December 31, 1995.

The information furnished reflects, in the opinion of management, all adjustments necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

6

7

Statements in this Quarterly Report on Form 10-Q that are not historical fact constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All such forward-looking statements involve risks and uncertainties, including, without limitation, relating to the Company's limited operating history and anticipated future losses, uncertainties relating to the Company's future profitability and ability to meet its capital needs, product development, FDA approval, government regulation, competition, market acceptance and other risks detailed in the Company's Prospectus dated April 25, 1996 filed with the Securities and Exchange Commission pursuant to Rule 424(b).

RESULTS OF OPERATIONS

Overview

The Company develops drugs for the treatment of serious human infectious diseases where there is a significant need for improved therapy. Since its incorporation in December 1991, the Company has been engaged in research and development, clinical trials and administrative activities. The Company's most advanced drug candidate, TOBI(TM) (tobramycin for inhalation), is a stable, premixed, proprietary formulation of the antibiotic tobramycin for delivery by inhalation. In October 1996, the Company completed Phase III clinical trials of TOBI for the treatment of chronic pseudomonal lung infections in patients with cystic fibrosis. The Company's second drug candidate, PA-1648, a novel derivative of the antibiotic rifampin, is being developed for the treatment of MAC, a tuberculosis-like disease, in AIDS patients, and tuberculosis. PathoGenesis is currently in Phase I clinical trials for PA-1648. The Company has also selected PA-824, a newly synthesized antibiotic, for further research as a drug candidate for tuberculosis.

Financial results for the first nine months of 1996 reflect a planned increase in operating expenses for activities related to advancing potential products through the development process. Such activities include product development and clinical trials. The Company expects to invest in additional clinical, regulatory and product development efforts over the next few years.

The Company currently has limited sources of revenue, has incurred losses since its inception and has an accumulated deficit through September 30, 1996 of \$61,286,787. The Company expects that operating losses will continue and increase for at least the next few years as total costs and expenses continue to increase due principally to the advancement of the Company's clinical development programs through various phases of clinical trials and, if successful, the cost of commercializing its first products. The Company's results of operations may vary significantly from period to period depending on several factors, such as the timing of certain expenses and the progress of the Company's research and development efforts.

In August 1996, the Company exercised its option for an additional 26,000 square feet of combined laboratory and office space contiguous to the Company's principal facility in Seattle, Washington. Approximately one-half of the additional space will be occupied by the Company and the remainder will be subleased for approximately four years. The Company is currently negotiating a lease agreement relating to an 18,000 square foot facility in Clinton, New Jersey, in which it plans to establish an operations support center.

Revenue

In April 1996, the Company was awarded a competitive grant of \$470,000 for two years by the United States Food and Drug Administration Office of Orphan Products Development to support the Company's recently completed Phase III clinical trials of TOBI for the treatment of chronic pseudomonal lung infections in cystic fibrosis patients. Revenue of \$41,039 was earned from this grant in the quarter ended September 30, 1996.

In May 1996, the Company entered into a distribution agreement with Bohdan Automation, Inc. ("Bohdan") pursuant to which Bohdan has agreed to manufacture and sell a proprietary combinatorial chemistry system invented by the Company. Revenue of \$118,000 was earned from this arrangement in the quarter ended September 30, 1996.

THREE MONTHS ENDED SEPTEMBER 30, 1996 AND 1995

Total operating expenses for the quarter ended September 30, 1996 increased by \$1,481,531 to \$5,936,185 from \$4,454,654 for the quarter ended September 30, 1995. Research and development expense for the third quarter increased by \$1,382,660 to \$4,940,519 in 1996 from \$3,557,859 for the comparable period in 1995. Such increase was due primarily to increases in clinical development activity. General and administrative expense for the third quarter increased by \$98,871 to \$995,666 in 1996 from \$896,795 for the comparable period in 1995. This increase was due to higher personnel and professional costs relating to marketing, investor relations and higher premiums for directors' and officers' liability insurance in the current quarter.

Other income primarily represents investment income from the Company's investment securities. In the third quarter of 1996, investment income, net increased by \$678,253 to \$988,434 from \$310,181 for the comparable period in 1995. Such increase was due primarily to higher average invested cash balances.

NINE MONTHS ENDED SEPTEMBER 30, 1996 AND 1995

Total operating expenses for the nine months ended September 30, 1996 increased by \$3,286,284 to \$17,356,847 from \$14,070,563 for the nine months ended September 30, 1995. Research and development expense for the nine months ended September 30, 1996 increased by \$3,171,280 to \$14,437,674 from \$11,266,394 for the comparable period in 1995. This increase resulted primarily from the planned increase in product development and clinical trials. General and administrative expense for the nine months ended September 30, 1996 increased by \$115,004 to \$2,919,173 from \$2,804,169 for the comparable period in 1995. This increase was due to higher personnel and professional costs relating to marketing and investor relations and higher premiums for directors' and officers' liability insurance in the current period.

Other income primarily represents investment income from the Company's investment securities. In the nine months ended September 30, 1996, investment income, net increased by \$1,384,127 to \$2,308,420 from \$924,293 for the comparable period in 1995. This increase was due primarily to higher average invested cash balances.

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations since inception primarily by the issuance of equity securities. Through September 30, 1996, the Company has raised \$61,331,268 from private sales of Common Stock and \$70,599,848 from two public offerings of Common Stock. Through September 30, 1996, the Company has earned net interest and investment income of \$6,351,892 from investments.

The Company's combined cash, cash equivalents and investment securities totaled \$66,278,952 at September 30, 1996, an increase of \$28,832,118 from the balance at December 31, 1995. This increase was due primarily to the net proceeds from the public offering of 2,875,000 shares of Common Stock in May 1996. The primary uses of cash during the quarter ended September 30, 1996, were to finance the Company's operations and working capital requirements. From the Company's inception through September 30, 1996, the Company purchased approximately \$12.6 million of property and equipment.

The Company plans to continue its policy of investing excess funds in government securities and investment grade, interest-bearing securities primarily with a maturity of one and one half years or less.

The Company anticipates that its existing capital resources should be sufficient to meet its capital requirements through the second quarter of 1998. Until such time as the Company can generate sufficient levels of cash from operations, the Company will have to continue to finance future cash needs through some or all of the sources previously used or through other means. The Company does not expect to generate a positive internal cash flow for at least a few years due to the expected increase of spending for research and clinical development programs and the expected cost of commercializing its first products. The Company may need to arrange additional financing for the future operation of the business, including the commercialization of its drug candidates currently under development. There can be no assurances that such additional financing can be obtained, and if obtained, at reasonable terms.

PART II - OTHER INFORMATION

Item 1.	Legal Proceedings	None.
Item 2.	Changes in Securities	None.
Item 3.	Defaults Upon Senior Securities	None.
Item 4.	Submission of Matters to a Vote of Security-Holders	

On July 10, 1996 the Company held its Annual Meeting of Stockholders. The holders of 13,735,927 shares of Common Stock of the Company were entitled to vote at the meeting and the holders of 9,989,225 shares of Common Stock, or 72.7% of shares entitled to vote at the meeting, were represented by proxy. No stockholders were present in person. The following actions took place:

1. The holders of 9,956,300 shares of Common Stock voted for the election of Alan R. Meyer to continue to serve as director of the Company and the holders of 32,925 shares of Common Stock abstained from voting. The holders of 9,954,217 shares of Common Stock voted for the election of Michael J. Montgomery to continue to serve as director of the Company and the holders of 35,008 shares of Common Stock abstained from voting. No stockholders voted against either of the nominees.

2. The stockholders approved a proposal to adopt the Company's 1996 Stock Option Plan for Non-Employee Directors. The holders of 9,677,788 shares of Common Stock voted for the proposal, the holders of 180,752 shares of Common Stock voted against the proposal and the holders of 130,685 shares of Common Stock abstained from voting.

3. Finally, the stockholders ratified the appointment of KPMG Peat Marwick LLP, as independent accountants of the Company for the fiscal year ending December 31, 1997. The holders of 9,965,897 shares of Common Stock voted for the ratification, the holders of 15,818 shares of Common Stock voted against the ratification and the holders of 7,510 shares of Common Stock abstained from voting.

Item 5. Other Information

On November 7, 1996, the Board of Directors of the Company voted to expand the numbers of members of the Board of Directors of the Company to nine members and elected Elizabeth M. Greetham as a Director of the Company. Ms. Greetham is a portfolio manager with Weiss Peck & Greer, LLC, a New York-based money management firm, having responsibilities for healthcare investments. Ms. Greetham currently serves as a director with several bio-pharmaceutical firms.

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits Exhibit 27. Financial Data Schedule.
- (b) Reports on Form 8-K None.

SIGNATURES

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

PATHOGENESIS CORPORATION

Date: November 13, 1996 By: WILBUR H. GANTZ

Wilbur H. Gantz

Date: November 13, 1996

By: ALAN R. MEYER

Alan R. Meyer
Senior Vice President and Chief
Financial Officer

<TABLE> <S> <C>

<ARTICLE> 5

<S>	<C>
<PERIOD-TYPE>	3-MOS
<FISCAL-YEAR-END>	DEC-31-1996
<PERIOD-START>	JUL-01-1996
<PERIOD-END>	SEP-30-1996
<CASH>	23,142,320
<SECURITIES>	43,136,632
<RECEIVABLES>	776,799
<ALLOWANCES>	0
<INVENTORY>	0
<CURRENT-ASSETS>	67,055,751
<PP&E>	12,286,435
<DEPRECIATION>	4,903,684
<TOTAL-ASSETS>	74,442,647
<CURRENT-LIABILITIES>	2,196,158
<BONDS>	0
<PREFERRED-MANDATORY>	0
<PREFERRED>	0
<COMMON>	13,770
<OTHER-SE>	72,060,741
<TOTAL-LIABILITY-AND-EQUITY>	74,442,647
<SALES>	0
<TOTAL-REVENUES>	160,539
<CGS>	0
<TOTAL-COSTS>	0
<OTHER-EXPENSES>	5,936,158
<LOSS-PROVISION>	0
<INTEREST-EXPENSE>	0
<INCOME-PRETAX>	0
<INCOME-TAX>	0
<INCOME-CONTINUING>	(4,787,212)
<DISCONTINUED>	0
<EXTRAORDINARY>	0
<CHANGES>	0
<NET-INCOME>	(4,787,212)
<EPS-PRIMARY>	(.35)
<EPS-DILUTED>	0

</TABLE>