

INOVIO BIOMEDICAL CORP  
Form 10-Q  
August 08, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**Form 10-Q**

**x**

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

**For the Quarterly Period Ended June 30, 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 No. 001-14888**

**INOVIO BIOMEDICAL CORPORATION**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**33-0969592**  
(I.R.S. Employer  
Identification No.)

**11494 SORRENTO VALLEY ROAD**

**SAN DIEGO, CALIFORNIA 92121-1318**

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)(ZIP CODE)

**(858) 597-6006**

(COMPANY'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **x** No **o**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer as defined in Rule 12b-2 of the Exchange Act.

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Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

The number of shares outstanding of the registrant's Common Stock, par value \$ 0.001 per share, was 30,906,711 as of August 4, 2006.

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INOVIO BIOMEDICAL CORPORATION

FORM 10-Q

For the Quarterly Period Ended June 30, 2006

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## Part I. Financial Information

## Item 1. Financial Statements

## INOVIO BIOMEDICAL CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

|   | June 30,<br>2006<br>(Unaudited) | December 31,<br>2005 |
|---|---------------------------------|----------------------|
| <b>ASSETS</b>                                     |                                 |                      |
| Cash and cash equivalents                         | \$ 1,873,116                    | \$ 17,166,567        |
| Short-term investments                            | 9,000,000                       |                      |
| Accounts receivable                               | 385,228                         | 284,171              |
| Prepaid expenses and other current assets         | 880,267                         | 870,169              |
| <b>Total current assets</b>                       | <b>12,138,611</b>               | <b>18,320,907</b>    |
| Fixed assets, net                                 | 471,068                         | 375,613              |
| Patents and other assets, net                     | 2,393,692                       | 2,148,090            |
| Goodwill  | 4,290,594                       | 4,290,594            |
| Intangible assets, net                            | 3,731,250                       | 3,843,750            |
| <b>Total assets</b>                               | <b>\$ 23,025,215</b>            | <b>\$ 28,978,954</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>       |                                 |                      |
| Accounts payable and accrued expenses             | \$ 1,430,129                    | \$ 1,864,935         |
| Accrued clinical trial expenses                   | 504,058                         | 1,064,497            |
| Deferred revenue                                  | 923,381                         | 1,206,443            |
| <b>Total current liabilities</b>                  | <b>2,857,568</b>                | <b>4,135,875</b>     |
| Deferred rent                                     | 263,213                         | 285,875              |
| Deferred tax liabilities                          | 1,044,750                       | 1,076,250            |
| Long-term liabilities                             |                                 | 10,206               |
| <b>Total liabilities</b>                          | <b>4,165,531</b>                | <b>5,508,206</b>     |
| <b>Stockholders' equity:</b>                      |                                 |                      |
| Preferred stock                                   | 1,028                           | 1,562                |
| Common stock                                      | 30,869                          | 29,469               |
| Additional paid-in capital                        | 138,934,399                     | 137,739,954          |
| Shareholder note receivable                       | (50,000)                        | )                    |
| Accumulated deficit                               | (120,059,360)                   | (114,269,942)        |
| Other comprehensive income (loss)                 | 2,748                           | (30,295)             |
| <b>Total stockholders' equity</b>                 | <b>18,859,684</b>               | <b>23,470,748</b>    |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 23,025,215</b>            | <b>\$ 28,978,954</b> |

See accompanying notes.



## INOVIO BIOMEDICAL CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

|   | Three Months Ended June 30, |                 | Six Months Ended June 30, |                  |
|---|-----------------------------|-----------------|---------------------------|------------------|
|   | 2006                        | 2005            | 2006                      | 2005             |
| <b>Revenue:</b>   |                             |                 |                           |                  |
| License fee and milestone payments                                | \$ 171,062                  | \$ 2,133,282    | \$ 322,116                | \$ 2,233,121     |
| Revenue under collaborative research and development arrangements | 232,351                     | 523,419         | 508,581                   | 1,029,031        |
| Grant and miscellaneous revenue                                   | 259,277                     | 294,915         | 529,986                   | 651,385          |
| <b>Total revenue</b>  | 662,690                     | 2,951,616       | 1,360,683                 | 3,913,537        |
| <b>Operating expenses:</b>  |                             |                 |                           |                  |
| Research and development  | 1,981,895                   | 3,519,623       | 3,622,320                 | 6,860,004        |
| General and administrative  | 1,827,271                   | 1,560,985       | 3,641,571                 | 3,033,722        |
| Amortization of intangible assets                                 | 56,250                      | 56,250          | 112,500                   | 93,750           |
| Charge for acquired in-process research and development           |                             |                 |                           | 3,332,000        |
| <b>Total operating expenses</b>                                   | 3,865,416                   | 5,136,858       | 7,376,391                 | 13,319,476       |
| <b>Loss from operations</b>                                       | (3,202,726 )                | (2,185,242 )    | (6,015,708 )              | (9,405,939 )     |
| Interest and other income   | 153,956                     | 54,237          | 333,078                   | 135,135          |
| <b>Net loss</b>   | (3,048,770 )                | (2,131,005 )    | (5,682,630 )              | (9,270,804 )     |
| Imputed and declared dividends on preferred stock                 | 34,423                      | 197,628         | 106,788                   | 2,343,119        |
| <b>Net loss attributable to common stockholders</b>               | \$ (3,083,193 )             | \$ (2,328,633 ) | \$ (5,789,418 )           | \$ (11,613,923 ) |
| <b>Amounts per common share basic and diluted:</b>                |                             |                 |                           |                  |
| Net loss  | \$ (0.10 )                  | \$ (0.11 )      | \$ (0.19 )                | \$ (0.49 )       |
| Imputed and declared dividends on preferred stock                 | (0.00 )                     | (0.01 )         | (0.00 )                   | (0.12 )          |
| <b>Net loss per share attributable to common stockholders</b>     | \$ (0.10 )                  | \$ (0.12 )      | \$ (0.19 )                | \$ (0.61 )       |
| <b>Weighted average number of common shares basic and diluted</b> | 30,568,369                  | 19,022,474      | 30,097,487                | 18,826,449       |

See accompanying notes.

## INOVIO BIOMEDICAL CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

|   | Six Months<br>Ended June 30,<br>2006 | Six Months<br>Ended June 30,<br>2005 |
|---|--------------------------------------|--------------------------------------|
| <b>Cash flows from operating activities:</b>                                |                                      |                                      |
| Net loss  | \$ (5,682,630 )                      | \$ (9,270,804 )                      |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                      |                                      |
| Depreciation and amortization   | 379,189                              | 312,665                              |
| Amortization of intangible assets   | 112,500                              | 93,750                               |
| Compensation for services paid in stock options                             | 934,229                              | 95,267                               |
| Amortization of deferred tax liabilities                                    | (31,500 )                            |                                      |
| Charge for acquired in-process research and development                     |                                      | 3,332,000                            |
| Deferred rent   | (22,662 )                            | (10,599 )                            |
| Revenue from conversion of note payable                                     | (10,742 )                            |                                      |
| Changes in operating assets and liabilities:                                |                                      |                                      |
| Accounts receivable   | (101,434 )                           | (2,087,838 )                         |
| Prepaid expenses and other current assets                                   | (162,370 )                           | (273,468 )                           |
| Accounts payable and accrued expenses                                       | (997,793 )                           | (856,308 )                           |
| Deferred revenue  | (292,664 )                           | 430,554                              |
| <b>Net cash used in operating activities</b>                                | <b>(5,875,877 )</b>                  | <b>(8,234,781 )</b>                  |
| <b>Cash flows from investing activities:</b>                                |                                      |                                      |
| Purchases of available-for-sale securities                                  | (13,500,000 )                        |                                      |
| Proceeds from sales of available-for-sale securities                        | 4,500,000                            |                                      |
| Purchases of capital assets   | (37,126 )                            | (235,234 )                           |
| Capitalization of patents and other assets                                  | (378,331 )                           | (177,758 )                           |
| Acquisition of business, net of cash acquired                               |                                      | (2,341,028 )                         |
| <b>Net cash used in investing activities</b>                                | <b>(9,415,457 )</b>                  | <b>(2,754,020 )</b>                  |
| <b>Cash flows from financing activities:</b>                                |                                      |                                      |
| Proceeds from issuance of common stock, net of issuance costs               | 74,467                               | 288,765                              |
| Payment of preferred stock cash dividend                                    | (99,095 )                            | (281,035 )                           |
| <b>Net cash (used in) provided by financing activities</b>                  | <b>(24,628 )</b>                     | <b>7,730</b>                         |
| Effect of exchange rate changes on cash                                     | 22,511                               |                                      |
| <b>Decrease in cash and cash equivalents</b>                                | <b>(15,293,451 )</b>                 | <b>(10,981,071 )</b>                 |
| Cash and cash equivalents, beginning of period                              | 17,166,567                           | 17,889,797                           |
| <b>Cash and cash equivalents, end of period</b>                             | <b>\$ 1,873,116</b>                  | <b>\$ 6,908,726</b>                  |

See accompanying notes.

**INOVIO BIOMEDICAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of Inovio Biomedical Corporation (the Company, we or us) have been prepared in accordance with United States generally accepted accounting principles for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. The condensed consolidated balance sheet as of June 30, 2006, condensed consolidated statements of operations for the three and six months ended June 30, 2006 and 2005, and the condensed consolidated statements of cash flows for the six months ended June 30, 2006 and 2005, are unaudited, but include all adjustments (consisting of normal recurring adjustments) that we consider necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. The results of operations for the three and six months ended June 30, 2006, shown herein are not necessarily indicative of the results that may be expected for the year ended December 31, 2006, or for any other period. These financial statements, and notes thereto, should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2005, included in our Form 10-K filed with the Securities and Exchange Commission (SEC) on March 16, 2006.

On January 25, 2005, we consummated the acquisition of Inovio AS, a Norwegian company. On June 30, 2005, we changed our corporate name from Genetronics Biomedical Corporation to Inovio Biomedical Corporation by filing a Certificate of Amendment to our Certificate of Incorporation with the State of Delaware. We also amended our Bylaws to reflect the name change. Effective April 4, 2005, our American Stock Exchange ticker symbol changed from GEB to INO. We conduct our business through our U.S. wholly-owned subsidiaries, Genetronics, Inc., which was incorporated in California on June 29, 1983, and Inovio AS, a company incorporated in Norway.

We are a San Diego-based biomedical company whose technology platform is based on medical devices that use Electroporation Therapy to deliver drugs and genes into cells. We are developing and seeking to commercialize medical therapies to address a number of diseases with critical unmet treatment needs using Electroporation Therapy. Our Selective Electrochemical Tumor Ablation (SECTA) therapy is in Phase III clinical trials, consisting of sites in the United States and Europe, for the treatment of recurrent head and neck cancer. In addition, we are currently conducting pre-marketing studies to support the commercialization of the SECTA System in Europe. Our system delivers electrical pulses to tumors injected with the generic drug bleomycin. The distinctive feature of the system, which uses a generator together with disposable needle applicators, is the preservation of healthy tissue at the margins of the tumor.

We incurred a net loss attributable to common stockholders of \$3,083,193 and \$5,789,418 for the three and six months ended June 30, 2006, respectively, and had working capital of \$9,281,043 and an accumulated deficit of \$120,059,360 as of June 30, 2006. Our ability to continue as a going concern is dependent upon our ability to obtain additional capital and eventually achieve profitable operations. We will continue to rely on outside sources of financing to meet our capital needs. The outcome of these matters cannot be predicted at this time. Further, there can be no assurance, assuming we successfully raise additional funds, that we will achieve positive cash flow. If we are not able to secure additional funding, we will be required to scale back our research and development programs, preclinical studies and clinical trials, and general and administrative activities and may not be able to continue in business. These unaudited condensed consolidated financial statements do not include any adjustments to the specific amounts and classifications of assets and liabilities, which might be necessary should we be unable to continue in business. Our unaudited condensed consolidated financial statements as of and for the period ended June 30, 2006 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business for the foreseeable future.

Certain reclassifications have been made to the financial statements for the three and six months ended June 30, 2005 to conform to the three and six months ended June 30, 2006 presentation.



## 2. Principles of Consolidation

These unaudited condensed consolidated financial statements include the accounts of Inovio Biomedical Corporation and its wholly owned subsidiaries, Genetronics, Inc. and Inovio AS. All material intercompany accounts and transactions have been eliminated.

## 3. Stockholders Equity

The following is a summary of our authorized and issued common and preferred stock as of June 30, 2006:

|                         |   |
|-------------------------|---|
| Authorized:             | 300,000,000 shares of common stock with a par value of \$0.001 per share and 10,000,000 shares of preferred stock with a par value of \$0.001 per share |
| Issued and Outstanding: | 2 and 52 shares of Series A Preferred Stock, par value of \$0.001 per share, as of June 30, 2006 and December 31, 2005, respectively.                   |
|                         | 0 and 100 shares of Series B Preferred Stock, par value of \$0.001 per share, as of June 30, 2006 and December 31, 2005, respectively.                  |
|                         | 228 and 337 shares of Series C Preferred Stock, par value of \$0.001 per share, as of June 30, 2006 and December 31, 2005, respectively.                |
|                         | 1,027,967 and 1,561,935 shares of Series D Preferred Stock, par value of \$0.001 per share, as of June 30, 2006 and December 31, 2005, respectively.    |
|                         | 30,869,211 and 29,468,756 shares of common stock, par value of \$0.001 per share, as of June 30, 2006 and December 31, 2005, respectively.              |

### *Preferred Stock*

In January 2005, we consummated the acquisition of Inovio AS, a Norwegian company. As part of this acquisition, we issued 1,966,292 shares of Series D Preferred Stock. See note 6 to these unaudited condensed consolidated financial statements for further discussion of this acquisition.

In May 2004, we closed a private preferred share placement and raised an aggregate of \$10,901,333 through the sale of our Series C Preferred Stock to institutional and accredited investors. The Series C Preferred Stock is convertible into our common stock at a conversion price of \$6.80 per share. The Series C Preferred Stock outstanding as of June 30, 2006 is convertible into 335,461 shares of our common stock. The holders of our Series C Preferred Stock are entitled to receive an annual dividend at a rate of 6%, in shares of common stock or cash, payable quarterly through June 30, 2007. As part of this dividend, we paid cash of \$34,124 on June 30, 2006, to holders of our Series C Preferred Stock.

Each holder of Series C Preferred Stock received 35% warrant coverage at an exercise price of \$8.80 per share exercisable through May 10, 2009. Warrants granted to holders of our Series C Preferred Stock entitle these investors the right to acquire 561,084 shares of our common stock as of June 30, 2006. The placement agents for the Series C Preferred Stock were also granted warrants entitling the agents to acquire 152,519 shares of our common stock as of June 30, 2006. Each placement agents' warrant entitles the holder to acquire one share of common stock at a price of \$6.80 per share, exercisable through May 10, 2009. As of June 30, 2006, no warrants issued as part of this Series C Preferred Stock offering had been exercised.

On July 16, 2003, we closed a preferred share private placement and raised an aggregate of \$15,670,000, through the sale of \$8,170,000 of our Series A Preferred Stock and \$7,500,000 of our Series B Preferred Stock to institutional and accredited investors. The Series A Preferred Stock is convertible into our common stock at a conversion price of \$2.40 per share. The Series B Preferred Stock was convertible into our common stock at a conversion price of \$2.80 per share. The Series A Preferred Stock outstanding as of June 30, 2006 is convertible into a total of 8,333 shares of our common stock. There were no shares of Series B Preferred Stock outstanding at June 30, 2006. The holders of our Series A Preferred Stock receive an annual dividend at a rate of 6%, in shares of common stock or cash, payable quarterly. Holders of Series A Preferred Stock are entitled to receive this quarterly dividend through September 30, 2006. As part of this dividend, on June 30, 2006 we paid cash of \$299 to holders of our Series A Preferred Stock.

Each holder of our Series A and B Preferred Stock received 40% warrant coverage at an exercise price of \$3.00 per share exercisable through July 13, 2008. Warrants granted to holders of our Series A and B Preferred Stock entitle these investors the right to acquire 2,433,073 shares of our common stock. The placement agents for the Series A and B Preferred Stock were also granted warrants entitling the agents to acquire 477,060 shares of our common stock. Each placement agent's warrant entitles the holder to acquire one share of common stock at a price between \$2.40 and \$2.80 per share, exercisable through July 13, 2008. As of June 30, 2006, warrants to purchase 547,920 shares issued as part of this offering had been exercised, resulting in \$1,436,460 of gross proceeds.

#### *Common Stock*

In January 2005, we completed a private placement to accredited investors whereby we sold 1,540,123 shares of our common stock at a purchase price of \$4.05 per share and issued warrants to purchase 508,240 shares of our common stock at an exercise price of \$5.50 per share, which resulted in aggregate cash proceeds of \$3,037,500. As of June 30, 2006, no warrants issued as part of this private placement had been exercised.

A portion of this private placement involved investors who converted \$3,200,000 of their previous investment in our Series C Preferred Stock into 790,123 shares of the common stock issued with no associated cash proceeds to us. We recorded an imputed dividend charge of \$1,942,773 in January 2005, related to these investors.

In September 2005, one investor converted \$160,000 of its previous investment in our Series C Preferred Stock into 39,506 shares of our common stock as part of this private placement.

On December 30, 2005, we completed a private placement resulting in \$15,795,080 in gross cash proceeds through the sale of our common stock to institutional and accredited investors that included Merck & Co. Inc. and Vical Inc., two of our strategic partners. At the closing, we issued to the investors an aggregate of 9,892,735 shares of common stock and warrants to purchase an aggregate of 3,462,451 shares of common stock, and received in exchange (1) gross cash proceeds of \$15,795,080 (2) an aggregate of 734 shares of outstanding Series A, B and C Cumulative Convertible Preferred Stock; and (3) 1,142,593 shares of our outstanding common stock. In addition, we issued to the investors five-year warrants to purchase 35% of the number of shares of common stock they acquired in the offering at an exercise price of approximately \$2.93 per share. As a result of the use by these existing holders of our Preferred Stock and Common Stock to acquire our shares and warrants in this private placement, we recorded a non-cash imputed dividend charge of \$8,329,112 in our consolidated statement of operations for the year ended December 31, 2005.

In June 2006, we issued 86,956 common shares to a licensing company in exchange for various patents and other assets and a \$50,000 shareholder note receivable.

## Warrants

In addition to warrants granted in connection with our preferred stock offerings, as discussed above, we have issued the following warrants that were outstanding as of June 30, 2006.

In connection with the leasing of our new corporate headquarters, we issued a warrant to purchase 50,000 shares of our common stock at \$5.00 per share to the landlord of this leased facility in December 2004. This warrant is exercisable through December 6, 2009. This warrant was valued on the date of issuance using the Black-Scholes pricing model. The fair value of this warrant, \$120,913, is being recognized ratably over the five-year term of the lease as rent expense.

On September 15, 2000, we entered into an exclusive license agreement with the University of South Florida Research Foundation, Inc. ( USF ), whereby USF granted us an exclusive, worldwide license to USF's rights in patents and patent applications generally related to needle electrodes (the License Agreement ). Pursuant to the License Agreement, we granted USF and its designees a warrant to acquire 150,000 common shares for \$9.00 per share. This warrant expires on September 14, 2010. 75,000 shares underlying the warrant vested at the date of grant and the remaining shares will vest upon the achievement of certain milestones. The 75,000 non-forfeitable vested shares underlying the warrant were valued at \$553,950 using the Black-Scholes pricing model and were recorded as capitalized license fees in other assets with a credit to additional paid-in capital. The remaining 75,000 shares underlying the warrant are forfeitable and will be valued at the fair value on the date of vesting using the Black-Scholes pricing model.

In June 2002 we granted warrants to a placement agent to acquire 166,250 shares of common stock for \$1.88 per share. In September 2003, warrants to purchase 30,000 shares of common stock were exercised totaling \$56,400 in gross proceeds. In March 2005, warrants to purchase 136,250 shares of common stock were exercised totaling \$256,150 in gross proceeds.

## Stock Options

We have one stock option plan pursuant to which we grant stock options to executive officers, directors, employees and consultants. This is our 2000 Stock Option Plan (the 2000 Plan ), adopted on July 31, 2000, approved by the stockholders on August 7, 2000 and approved by the stockholders as amended through May 5, 2006. As so amended, the 2000 Plan covers 4,750,000 common shares for issuance upon exercise of options granted and to be granted. Under the 2000 Plan, we had 872,994 shares of common stock available for future grants and options to purchase 2,906,152 shares outstanding at June 30, 2006. The options granted and available for future grant under the 2000 Plan generally have a term of ten years and vest over a period of three years. The 2000 Plan terminates by its terms on July 30, 2010.

The 2000 Plan supersedes all of our previous stock option plans, which include our 1995 Stock Option Plan, under which we had options to purchase 7,500 shares outstanding at June 30, 2006 and our 1997 Stock Option Plan, under which we had options to purchase 70,498 shares outstanding on June 30, 2006.

We account for options granted to non-employees in accordance with Emerging Issues Task Force ( EITF ) No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, and Statement of Financial Accounting Standard ( SFAS ) No. 123(R), *Share-Based Payment*. The fair value of these options at the measurement dates was estimated using the Black-Scholes pricing model. Total stock-based compensation for options granted to non-employees for the three and six months ended June 30, 2006, was \$23,229 and \$96,284, respectively. Total stock-based compensation for options granted to non-employees for the three and six months ended June 30, 2005, was \$26,326 and \$95,267, respectively.

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The following table summarizes the stock options outstanding at June 30, 2006:

| Options outstanding |                     |  | Options exercisable             |                     |                                 |
|---------------------|---------------------|--|---------------------------------|---------------------|---------------------------------|
| Exercise price      | Options outstanding | Weighted-average remaining contractual life (in years) | Weighted-average exercise price | Options exercisable | Weighted-average exercise price |
| \$1.00-\$2.00       | 582,563             | 5.86   | \$ 1.48                         | 582,563             | \$ 1.48                         |
| \$2.01-\$4.00       | 1,696,090           | 8.42   | \$ 2.77                         | 811,267             | \$ 2.75                         |
| \$4.01-\$6.00       | 512,499             | 7.21   | \$ 4.89                         | 380,309             | \$ 4.95                         |
| \$6.01-\$8.00       | 117,500             | 6.66   | \$ 6.32                         | 108,125             | \$ 6.31                         |
| \$8.01-\$22.00      | 75,498              | 2.24   | \$ 12.18                        | 75,498              | \$ 12.18                        |
|                     | 2,984,150           | 7.48   | \$ 3.26                         | 1,957,762           | \$ 3.36                         |

At June 30, 2006, the aggregate intrinsic value of options outstanding was \$340,905, the aggregate intrinsic value of options exercisable was \$340,905 and the weighted average remaining contractual term of options exercisable was 6.66 years.

Stock option activity under our stock option plans was as follows:

|                            | Number of shares | Weighted-average exercise price |
|----------------------------|------------------|---------------------------------|
| Balance, December 31, 2005 | 2,383,888        | \$ 3.55                         |
| Granted                    | 796,750          | 2.56                            |
| Exercised                  | (50,878)         | 1.46                            |
| Cancelled                  | (145,610)        | 4.78                            |
| Balance, June 30, 2006     | 2,984,150        | \$ 3.26                         |

The weighted average exercise price was \$5.37 for the 89,062 options which expired during the six months ended June 30, 2006.

The weighted average grant date fair value per share was \$1.88 and \$2.17 for options granted during the three and six months ended June 30, 2006, respectively, and 2.62 and \$3.08 for options granted during the three and six months ended June 30, 2005, respectively.

The aggregate intrinsic value of options exercised was \$8,156 and \$55,774 during the three and six months ended June 30, 2006, respectively, and \$0 and \$18,664 during the three and six months ended June 30, 2005, respectively.

#### 4. Net Loss Per Share

Net loss per share is calculated in accordance with SFAS No. 128, *Earnings Per Share*. Basic loss per share is computed by dividing the net loss for the year by the weighted average number of common shares outstanding during the year. Diluted loss per share is calculated in accordance with the treasury stock method and reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted to common stock. Since the effect of the assumed exercise of common stock options and other convertible securities was anti-dilutive for all periods presented, basic and diluted loss per share are the same.

#### 5. Share-Based Compensation

Effective January 1, 2006 we adopted SFAS No. 123(R) using the modified prospective application method. Accordingly, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period. Because we elected to use the modified prospective application method, results for prior periods have not been restated. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 107, which provides supplemental implementation guidance for SFAS No. 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS No. 123(R).



We estimate the fair value of stock options granted using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility and expected option life. We amortize the fair value of the awards on a straight-line basis. All options grants are amortized over the requisite service period of the awards. Expected volatility is based on historical volatility. The expected life of options granted is calculated using the simplified method based on the terms and conditions of the options as provided in Securities and Exchange Commission Staff Accounting Bulletin No. 107. The risk-free interest rate is based on the U.S. Treasury yield in effect at the time of grant. The forfeiture rate is based on historical data and we record share-based compensation expense only for those awards that are expected to vest.

For the purpose of calculating pro-forma information under SFAS No. 123 for periods prior to January 1, 2006, we accounted for forfeitures as they occurred. Assumptions used in the Black-Scholes model are presented below:

|                         | <b>Six Months<br/>Ended June 30,<br/>2006</b> |    | <b>2005</b> |   |
|-------------------------|---|----|-------------|---|
| Risk-free interest rate | 4.74% - 4.9                                   | 6% | 3.97        | % |
| Expected volatility     | 109   | %  | 104         | % |
| Expected life in years  | 6   |    | 6           |   |
| Dividend yield          |   |    |             |   |

Total compensation cost for our stock plans for the three and six months ended June 30, 2006 was \$346,174 and \$837,945, respectively, of which \$82,195 and \$208,851 was included in research and development expenses and \$263,979 and \$629,094 was included in general and administrative expenses, respectively. As a result of adopting SFAS No. 123(R), the Company's loss from operations and net loss for the three and six months ended June 30, 2006 is approximately \$346,174 and \$837,945 lower, respectively, than if the Company had continued to account for share-based compensation under Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Basic and diluted net loss per share for the three and six months ended June 30, 2006 are \$(0.01) and \$(0.03) lower, respectively, than if the Company had continued to account for share-based compensation under APB 25.

At June 30, 2006, there was \$1,883,017 of total unrecognized compensation cost, related to nonvested stock options, which is expected to be recognized over a weighted-average period of 1.1 years.

Prior to January 1, 2006, we accounted for employee stock options under the measurement and recognition provisions of APB No. 25. Accordingly, we recorded no share-based compensation expense for employee stock options grants as all options granted had exercises prices not less than the fair market value of the underlying stock on the date of grant. In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation*, we provided pro forma net loss and net loss per share disclosures for each period prior to the adoption of SFAS No. 123(R) as if we had applied the fair value-based method in measuring compensation expense for our share-based compensation plans. The following table illustrates the effect on net loss attributable to common stockholders as if the fair value-based method had been applied to all outstanding and unvested awards during the three and six months ended June 30, 2005:

|   | <b>Three Months<br/>Ended<br/>June 30,<br/>2005</b> | <b>Six Months<br/>Ended<br/>June 30,<br/>2005</b> |
|---|---|---|
| Net loss attributable to common stockholders, as reported   | \$ (2,328,633 )                                     | \$ (11,613,923 )                                  |
| Deduct: Stock-based employee compensation expense determined under fair value method for all awards | (401,676 )  | (947,867 )  |
| Pro forma net loss attributable to common stockholders  | \$ (2,730,309 )                                     | \$ (12,561,790 )                                  |
| Basic and diluted net loss attributable to common stockholders per share, as reported               | \$ (0.12 )  | \$ (0.61 )  |
| Basic and diluted pro forma net loss attributable to common stockholders per share                  | \$ (0.14 )  | \$ (0.67 )  |



## 6. Inovio AS Acquisition

On January 25, 2005, we consummated the acquisition of Inovio AS, a Norwegian company (the *Acquisition*). The Acquisition expands our intellectual property in electroporation, expands the number of agreements with major pharmaceutical companies, and provides for the near-term initiation of a Phase I/II DNA vaccine clinical trial. Inovio AS is a complement to our existing electroporation therapy program. Under the terms of the transaction, we acquired the entire share capital of Inovio AS for an aggregate purchase price of \$10,904,494; \$3,000,000 of the purchase price consisted of cash and \$7,904,494 consisted of shares of our Series D Convertible Preferred Stock, par value \$0.001 per share, net of transaction costs. We issued 1,966,292 shares of the Series D Preferred Stock in the transaction, based on the average closing price of our common stock as reported on the American Stock Exchange during the 30 trading day period immediately preceding the closing. As of June 30, 2006, 938,325 shares of the Series D Preferred Stock had been converted into 938,325 shares of our common stock.

When valuing the Series D Preferred Stock issued as part of the Acquisition for accounting purposes, we followed guidance set forth in SFAS No. 141, *Business Combinations*. Under SFAS No. 141, the fair value of securities issued as part of an acquisition should be valued based on the market price of those securities for a reasonable period before and after the date that the terms of the acquisition are agreed to and announced. For purposes of valuing the Series D Preferred Stock issued as part of the Acquisition, we used an average fair value of \$4.02 per share of Series D Preferred Stock. This average was based on the closing prices of our common stock on each of the three days prior to the Acquisition, the day of Acquisition and the three days following the Acquisition.

Those shareholders of Inovio AS who received shares of Series D Preferred Stock in the transaction (the *Series D Holders*) will also be entitled to additional issuances of Series D Preferred Stock in the event we achieve certain strategic and commercial milestones, as set forth in the Stock Purchase Agreement and summarized below. These milestones are as follows:

- In the event we receive payment commitments of at least \$8,000,000, of which at least \$1,000,000 must be in the form of upfront payments, through the signing of contracts involving Inovio AS technology through September 30, 2006, we must issue an additional \$2,000,000 of Series D Preferred Stock to the shareholders of Inovio AS (the *Second Payment*). The value of each share of Series D Preferred Stock issued in connection with the Second Payment shall equal the average of the closing price of our common stock as reported on the American Stock Exchange during the 30 day trading period immediately preceding the Second Payment date.
- In the event we receive payment commitments of at least \$16,000,000 (including the \$8,000,000 in payment commitments noted above), of which at least \$2,000,000 (including the \$1,000,000 in upfront payments noted above) must be in the form of upfront payments, through the signing of contracts involving Inovio AS technology through September 30, 2006, we must issue an additional \$1,000,000 of Series D Preferred Stock to the shareholders of Inovio AS (the *Third Payment*). The value of each share of Series D Preferred Stock issued in connection with the Third Payment shall equal the average of the closing price of our common stock as reported on the American Stock Exchange during the 30 day trading period immediately preceding the Third Payment date.

None of these milestones have been met as of June 30, 2006.



Under the purchase method of accounting, the total consideration as shown in the table below was allocated to Inovio AS tangible and intangible assets and liabilities based on their estimated fair values as of the date of the completion of the Acquisition. The total consideration was as follows:

|   |               |
|---|---------------|
| Fair value of Series D Preferred Stock issued | \$ 7,904,494  |
| Cash  | 3,000,000     |
| Transaction costs                             | 121,517       |
| Total consideration                           | \$ 11,026,011 |

The allocation of the above purchase price is as follows:

|  |               |
|--|---------------|
| Fair value of net tangible assets acquired and liabilities assumed | \$ 487,417    |
| Fair value of identifiable intangible assets acquired              | 7,382,000     |
| Deferred tax liabilities   | (1,134,000 )  |
| Goodwill   | 4,290,594     |
| Total purchase price allocation                                    | \$ 11,026,011 |

Inovio AS results of operations for the period from the date of acquisition (January 25, 2005) through June 30, 2005, were included in our condensed consolidated statement of operations for the period ended June 30, 2005. Identifiable acquired intangible assets include in-process research and development of \$3,332,000, and an intangible asset related to acquired contracts and intellectual property of approximately \$4,050,000. The \$3,332,000 assigned to acquired in-process research and development was recorded as an expense in the condensed consolidated statement of operations for the six months ended June 30, 2005.

The following unaudited pro forma financial information combines the results of operations of Inovio Biomedical Corporation and Inovio AS assuming the Acquisition was consummated on January 1, 2005. The pro forma results are not necessarily indicative of what would have occurred if the Acquisition had been in effect for the periods presented. In addition, they are not intended to be a projection of future results and do not reflect any synergies that might be achieved from combined operations.

|  | Six Months Ended<br>June 30,<br>2006 | 2005 (1)         |
|--|--------------------------------------|------------------|
| Revenue  | \$ 1,360,683                         | \$ 3,926,291     |
| Net loss attributable to common stockholders           | \$ (5,789,418 )                      | \$ (11,858,256 ) |
| Net loss per share attributable to common stockholders | \$ (0.19 )                           | \$ (0.63 )       |

(1) Includes the effect of the \$3,332,000 charge for acquired in-process research and development.

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**Supplemental Disclosures of Cash Flow Information**

|  | <b>Six Months Ended<br/>June 30,</b> |              |
|--|--------------------------------------|--------------|
|  | <b>2006</b>                          | <b>2005</b>  |
| Supplemental schedule of financing activities:                               |                                      |              |
| Imputed dividends on preferred stock   | \$                                   | \$ 1,942,773 |
| Issuance of preferred stock for acquisition                                  |                                      | 7,904,494    |
| Common stock issued in connection with declared dividends on preferred stock | 7,693                                | 119,311      |
| Cashless exercise of warrants  |                                      | 43           |
| Conversions of preferred stock to common stock                               | 1,260                                | 242          |
| Issuance of common stock for patents and other assets                        | 128,922                              |              |
| Issuance of common stock in exchange for shareholder note receivable         | 50,000                               |              |
| Leasehold improvements financed by landlord                                  | 172,054                              |              |

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

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and notes thereto appearing elsewhere in this report.

This Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements with regards to our revenue, spending, cash flow, products, actions, plans, strategies and objectives. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or simply state future results, performance or achievements, and may contain the words believe, anticipate, expect, estimate, intend, plan, will be, will continue, will result, could, may, or other words of such words with similar meanings. Any such statements are subject to risks and uncertainties that could cause our actual results to differ materially from those which are management's current expectations or forecasts. Such information is subject to the risk that such expectations or forecasts, or the assumptions underlying such expectations or forecasts, become inaccurate.

The risks and uncertainties are disclosed from time to time in our reports filed with the SEC, including Forms 8-K, 10-Q, and 10-K and such risks and uncertainties are discussed in this Report under the headings "Certain Factors That Could Affect Our Future Results" later in this Management's Discussion and Analysis of Financial Condition and Results of Operations and in "Risk Factors" located Part II Item 1A. The risks included in this Report are not exhaustive. Other sections of this report may include additional factors that could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and we cannot predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. Investors should also be aware that while we do, from time to time, communicate with securities analysts, we do not disclose any material non-public information or other confidential commercial information to them. Accordingly, individuals should not assume that we agree with any statement or report issued by any analyst, regardless of the content of the report. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not our responsibility.

### General

We are a San Diego-based biomedical company whose technology platform is based on medical devices that use Electroporation Therapy to deliver drugs and genes into cells. We are developing and seeking to commercialize medical therapies to address a number of diseases with critical unmet treatment needs using Electroporation Therapy. Our Selective Electrochemical Tumor Ablation (SECTA) therapy is in Phase III clinical trials, consisting of sites in the United States and Europe, for the treatment of recurrent head and neck cancer. In addition, we are currently conducting pre-marketing studies to support the commercialization of the SECTA System in Europe. Our system delivers electrical pulses to tumors injected with the generic drug bleomycin. The distinctive feature of the system, which uses a generator together with disposable needle applicators, is the preservation of healthy tissue at the margins of the tumor.

Since we have been enrolling patients in a Phase I study to treat locally recurrent breast cancer after a mastectomy or partial mastectomy using our SECTA therapy. In addition, in 2005, we initiated a Phase I pancreatic cancer study. Although we still believe that a potential pancreatic disease indication for SECTA would be attractive commercially due to the unmet clinical need for improved local control, the pancreatic trial was terminated to maintain a focused and more manageable clinical program. As a result we have taken steps to terminate the study during the 2nd quarter of 2006.

In addition, as part of our MedPulser® product line, we have been developing devices for the delivery of DNA for vaccinations and gene therapy. The flagship of our development efforts involve licensing agreements with Merck & Co., Inc. and Vical, Inc. in which these companies are supporting the development and registration of the therapies using Inovio devices. Most recently, we executed a collaborative commercialization agreement with Tripep AS to co-develop a Hepatitis C therapeutic vaccine (HCV). Other activities include Phase I trials at the H. Lee Moffitt Cancer Center and at the University of Southampton. As a result of our partnerships in this area, our DNA Electroporation Delivery Technology is currently being evaluated in four separate Phase I clinical trials.

We will continue to seek new strategic licensing partners for the use of electroporation for the delivery of drugs in the treatment of cancer and delivery of genes into cells. We will not receive any additional milestone or licensing payments for development or sale of our products until a new strategic alliance is in place or we achieve the milestones specified in our existing agreements, or product sales commence under our existing agreements. There can be no assurance that we will be able to contract with such a partner or that we can achieve the milestones set out in our agreements.

Until the commercialization of human-use clinical products currently in the clinic, we expect revenues and other income to continue to be attributable to collaborative research arrangements, licensing fees, grants and interest income.

Due to the amount of expenses incurred in the development of the oncology and gene delivery systems, we have been unprofitable since 1994. As of June 30, 2006, we had an accumulated deficit of \$120,059,360. We expect to continue to incur substantial operating losses in the future due to our commitment to our research and development programs, the funding of preclinical studies, clinical trials and regulatory activities and the costs of general and administrative activities.

### **Critical Accounting Policies**

The SEC defines critical accounting policies as those that are, in management's view, important to the portrayal of our financial condition and results of operations and demanding of management's judgment. Our discussion and analysis of our financial condition and results of operations is based on our unaudited condensed consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. We base our estimates on experience and on various assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Our critical accounting policies include:

*Revenue Recognition.* We have adopted a strategy of co-developing or licensing our gene delivery technology for specific genes or specific medical indications. Accordingly, we have entered into collaborative research and development agreements and have received funding for pre-clinical research and clinical trials. Payments under these agreements, which are non-refundable, are recorded as revenue as the related research expenditures are incurred pursuant to the terms of the agreements and provided collectibility is reasonably assured.

License fees comprise initial fees and milestone payments derived from collaborative licensing arrangements. Non-refundable milestone payments continue to be recognized upon the achievement of specified milestones when we have earned the milestone payment, provided the milestone payment is substantive in nature and the achievement of the milestone was not reasonably assured at the inception of the agreement (We defer payments for milestone events which are reasonably assured and recognize them ratably over the minimum remaining period of our performance obligations.). Payments for milestones which are not reasonably assured are treated as the culmination of a separate earnings process and are recognized as revenue when the milestones are achieved.

We receive non-refundable grants under available government programs. Government grants towards current expenditures are recorded as revenue when there is reasonable assurance that we have complied with all conditions necessary to receive the grants, collectibility is reasonably assured, and as the expenditures are incurred.



*Patent and License Costs.* Patents are recorded at cost and amortized using the straight-line method over the expected useful lives of the patents or 17 years, whichever is less. Cost is comprised of the consideration paid for patents and related legal costs. If management determines that development of products to which patent costs relate is not reasonably certain or that costs exceed recoverable value, such costs are charged to operations.

License costs are recorded based on the fair value of consideration paid and amortized using the straight-line method over the shorter of the expected useful life of the underlying patents or the term of the related license agreement.

*Long-lived Assets.* We assess the recoverability of long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, we reduce the carrying value of the asset to fair value. While our current and historical operating and cash flow losses are potential indicators of impairment, we believe the future cash flows to be received from the long-lived assets will exceed the assets' carrying value, and accordingly, we have not recognized any impairment losses through June 30, 2006.

*Research and Development Expenses.* Since our inception, virtually all of our activities have consisted of research and development efforts related to developing our electroporation technologies. We expense all such expenditures in the period incurred. Our expenses related to clinical trials are based on services received and efforts expended pursuant to contracts with multiple research institutions and clinical research organizations that conduct and manage clinical trials on our behalf. The financial terms of these agreements are subject to negotiation and vary from contract to contract and may result in uneven payment flows. Generally, these agreements set forth the scope of work to be performed at a fixed fee or unit price. Payments under the contracts depend on factors such as the successful enrollment of patients or the completion of clinical trial milestones. Expenses related to clinical trials generally are accrued based on contracted amounts applied to the level of patient enrollment and activity according to the protocol. If timelines or contracts are modified based upon changes in the clinical trial protocol or scope of work to be performed, we modify our estimates accordingly on a prospective basis.

*Valuation of Goodwill and Intangible Assets.* Our business acquisitions typically result in goodwill and other intangible assets, and the recorded values of those assets may become impaired in the future. As of June 30, 2006, our goodwill and intangible assets, net of accumulated amortization, totaled \$8,021,844. The determination of the value of such intangible assets requires management to make estimates and assumptions that affect our condensed consolidated financial statements. We assess potential impairments to intangible assets when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recovered. Our judgments regarding the existence of impairment indicators and future cash flows related to intangible assets are based on operational performance of our acquired businesses, market conditions and other factors. Although there are inherent uncertainties in this assessment process, the estimates and assumptions we use are consistent with our internal planning. If these estimates or their related assumptions change in the future, we may be required to record an impairment charge on all or a portion of our goodwill and intangible assets. Furthermore, we cannot predict the occurrence of future impairment-triggering events nor the impact such events might have on our reported asset values. Future events could cause us to conclude that impairment indicators exist and that goodwill or other intangible assets associated with our acquired businesses are impaired. Any resulting impairment loss could have an adverse impact on our results of operations.

*Share-Based Compensation.* Effective January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective application method and began accounting for its stock-based compensation using a fair-value based recognition method. Under the provisions of SFAS No. 123(R), stock-based compensation cost is estimated at the grant date based on the fair-value of the award and is recognized as expense ratably over the requisite service period of the award. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates. We develop our estimates based on historical data. If factors change and we employ different assumptions in future periods, the compensation expense that we record under SFAS No. 123(R) may differ significantly from what we have recorded in the current period. A small change in the estimates used may have a relatively large change in the estimated valuation.

We use the Black-Scholes option valuation model to value employee stock awards. We recognize compensation expense using the straight-line amortization method.

### **Recent Accounting Pronouncements**

In February 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. As of June 30, 2006, the Company did not have any hybrid financial instruments subject to the fair value election under SFAS No. 155. The Company is required to adopt SFAS No. 155 effective January 1, 2007.

### **Results of Operations**

*Revenue.* We had total revenue of \$662,690 and \$1,360,683, respectively, for the three and six months ended June 30, 2006, compared to \$2,951,616 and \$3,913,537, respectively, for the three and six months ended June 30, 2005. During the three and six months ended June 30, 2006, we recognized revenue of \$38,267 and \$155,293, respectively, attributable to the operations of Inovio AS, a Norwegian company we acquired in January 2005. During the three and six months ended June 30, 2005, we recognized revenue of \$273,815 and \$606,378, respectively, attributable to the operations of Inovio AS. Revenue primarily consists of license fees, milestone payments and amounts received from collaborative research and development agreements and grants.

Revenue under license fees and milestone payments was \$171,062 and \$322,116, respectively, for the three and six months ended June 30, 2006, as compared to \$2,133,282 and \$2,233,121, respectively, for the three and six months ended June 30, 2005. The decrease in revenue under license fees and milestone payments fees for the three and six month period ended June 30, 2006, as compared to the comparable periods in 2005, was mainly due to the recognition of a \$2,000,000 milestone payment during the three months ended June 30, 2005, resulting from the achievement of a clinical milestone by Merck for a plasmid-based vaccine using our MedPulser® DNA Delivery System. Under the Merck agreement, we may receive additional future milestone payments linked to the successful development of a product if achieved. Also, an additional \$500,000 license fee payment was received from Merck in June 2005 from the Merck Agreement, under which the parties seek to develop and commercialize our MedPulser® DNA Delivery System for use with certain of Merck's DNA vaccine programs. The license payments received from Merck in prior years are being amortized over the remaining minimum term of the agreement. Royalties are payable on sales of a product utilizing the device developed under the Merck Agreement. As of June 30, 2006, no royalties have been paid.

During the three and six months ended June 30, 2006, we recorded revenue under collaborative research and development arrangements of \$232,351 and \$508,581, respectively, as compared to \$523,419 and \$1,029,031, respectively, for the three and six months ended June 30, 2005. This decrease in revenue was primarily due to less collaborative research and development revenue recognized from the Merck Agreement. Billings from research and development work performed pursuant to the Merck Agreement are recorded as revenue as the related research expenditures are incurred pursuant to the terms of the agreement.

Grant and miscellaneous revenue was \$259,277 and \$529,986, respectively, for the three and six months ended June 30, 2006, as compared to \$294,915 and \$651,385 for the three and six months ended June 30, 2005. The decrease in grant and miscellaneous revenue for the three and six months ended June 30, 2006, as compared to the comparable periods in 2005, was mainly due to less revenue recognized from our European Union and U.S. Army grants received from the acquisition of Inovio AS due to timing of the work performed.

*Research and Development Expenses.* Research and development expenses, which include clinical trial costs, for the three and six months ended June 30, 2006, were \$1,981,895 and \$3,622,320, respectively, as compared to \$3,519,623 and \$6,860,004 for the three and six months ended June 30, 2005, respectively. The decrease in research and development expenses for the three and six months ended June 30, 2006, as compared to the comparable periods in 2005, was primarily due to a decrease in clinical trial expenses. Historically, clinical expenses have included costs related to the use of an outside Clinical Research Organization ( CRO ). Throughout the six months ended June 30, 2006, we increased the use of internal resources to more cost effectively fulfill those activities formerly undertaken by this CRO. The remainder of the decrease was mainly due to lower cost of manufacturing products to support these clinical trials and research collaborations, decreased external research expenses and other expenses associated with our clinical trials and lower outside regulatory consulting costs associated with our clinical trials. These were offset by an increase in share-based compensation expense of \$82,195 and \$208,851 for the three and six months ended June 30, 2006, respectively, related to options issued to employees. During the three and six months ended June 30, 2006, research and development expenses also included \$37,265 and \$185,693, respectively, in research and development costs attributable to Inovio AS, as compared to \$359,729 and \$633,114 for the three and six months ended June 30, 2005, respectively.

*General and Administrative Expenses.* General and administrative expenses, which include business development expenses, for the three and six months ended June 30, 2006, were \$1,827,271 and \$3,641,571, respectively, as compared to \$1,560,985 and \$3,033,722 for the three and six months ended June 30, 2005, respectively. The increase in general and administrative expenses for the three and six months ended June 30, 2006, as compared to the comparable periods in 2005, was mainly due to share-based compensation expense of \$263,979 and \$629,094, respectively, related to options issued to employees. General and administrative costs attributable to Inovio AS were insignificant for the three and six months ended June 30, 2006.

*Share-Based Compensation.* Prior to January 1, 2006, we accounted for our stock plans using the intrinsic value method under APB No. 25. Effective January 1, 2006, we adopted SFAS No. 123(R), and elected to adopt the modified prospective application method. SFAS No. 123(R) requires us to use a fair-value based method to account for stock-based compensation. Accordingly, stock-based compensation cost is measured at the grant date, based on the fair value of the award reduced by estimated forfeitures, and is recognized as expense over the employee's requisite service period. Total compensation cost for our stock plans for the three and six months ended June 30, 2006 was \$346,174 and \$837,945, respectively.

*Amortization of Intangible Assets.* Amortization of intangible assets was \$56,250 and \$112,500 during the three and six months ended June 30, 2006, respectively, as compared to \$56,250 and \$93,750 for the three and six months ended June 30, 2005, related to an intangible asset associated with contracts and intellectual property acquired as part of our purchase of Inovio AS in January 2005.

*Charge for Acquired In-Process Research and Development.* Operating results for the six months ended June 30, 2005 included a \$3,332,000 non-cash charge related to the write-off of acquired in-process research and development ( IPR&D )



resulting from the Inovio AS acquisition in January 2005. The amount expended for IPR&D represents the estimated fair value of purchased in-process technology for projects that, as of the acquisition date, had not reached technological feasibility and had no alternative future use. There were no such charges resulting from any acquisitions during the same period in 2006.

*Interest and Other Income.* Interest and other income for the three and six months ended June 30, 2006, was \$153,956 and \$333,078, respectively, as compared to \$54,237 and \$135,135 for the three and six months ended June 30, 2005. The increase in interest and other income for the three and six months ended June 30, 2006 was primarily due to a larger cash and investments balance and higher average interest rate.

*Imputed and Declared Dividends on Preferred Stock.* Our Series A and B Preferred Stock requires payment of an annual dividend at a rate of 6%, in shares of common stock or cash, payable quarterly. Holders of these shares of Series A and B are entitled to receive this quarterly dividend through September 30, 2006. As part of this dividend, on March 31, 2006 we issued a total of 2,871 common shares valued at \$7,693 to holders of our Series A Preferred Stock, and paid \$14,795 in cash to the former holders of our Series B Preferred Stock, who converted them during the quarter ended March 31, 2006, based on the number of days in 2006 prior to the conversion that they had held their Series B Preferred Stock. On June 30, 2006 we paid cash of \$299 to holders of our Series A Preferred Stock. There were no shares of Series B Preferred Stock outstanding on June 30, 2006. We issued a total of 13,888 common shares valued at \$59,326 on March 31, 2005 to holders of Series A and B Preferred Stock, and issued 19,789 common shares valued at \$59,985 on June 30, 2005.

*The holders of Series C Preferred Stock receive an annual dividend rate of 6%, in shares of common stock or cash, payable quarterly through June 30, 2007. As part of this dividend, we paid cash of \$49,877 and \$34,124, respectively, on March 31, 2006 and June 30, 2006, to holders of our Series C Preferred Stock. We paid cash of \$143,392 and \$137,643, respectively, on March 31, 2005 and June 30, 2005, to holders of our Series C Preferred Stock.*

We recorded an imputed dividend charge of \$1,942,773 during the six months ended June 30, 2005, related to investors who converted \$3,200,000 of their previous Series C Preferred Stock investment into 790,123 shares of our common stock as part of our January 2005 private placement.

#### **Liquidity and Capital Resources**

During the last six years, our primary uses of cash have been to finance research and development activities and clinical trial activities in the Oncology and Gene Delivery Division. Since inception, we have satisfied our cash requirements principally from proceeds from the sale of equity securities.

In January 2005, we completed a private placement to accredited investors whereby we sold 1,540,123 shares of our common stock at a purchase price of \$4.05 per share and issued warrants to purchase 508,240 shares of our common stock at an exercise price of \$5.50 per share, which resulted in aggregate cash proceeds of \$3,037,500. A portion of this private placement involved investors who converted \$3,200,000 of their previous investment in our Series C Preferred Stock into 790,123 shares of the common stock issued as part of this private placement with no associated cash proceeds to us.

On January 25, 2005, we consummated the acquisition of Inovio AS. We acquired the entire share capital of Inovio AS for an aggregate purchase price of \$10,904,494, which consisted of \$3,000,000 in cash and \$7,904,494 in the issuance of shares of our Series D Convertible Preferred Stock.

On December 30, 2005, we completed a private placement of an aggregate of \$15,795,080 in gross cash proceeds through the sale of our common stock to institutional and accredited investors that included Merck & Co. Inc. and Vical Inc., two of our strategic partners. At the closing, we issued investors an aggregate of 9,892,735 shares of common stock and warrants to purchase an aggregate of 3,462,451 shares of common stock, and received in exchange (1) gross cash proceeds of \$15,795,080; (2) an aggregate of 734 shares of outstanding Series A, B and C Cumulative Convertible Preferred Stock; and (3) 1,142,593 shares of its outstanding common stock. In addition, we issued to the investors five-year warrants to purchase 35% of the number of shares of common stock they acquired in the offering at an exercise price of approximately \$2.93 per share.

As of June 30, 2006, we had working capital of \$9,281,043, as compared to \$14,185,032 as of December 31, 2005. The decrease in working capital during the six months ended June 30, 2006 was primarily due to expenditures related to our research and development and clinical trial activities, as well as various general and administrative expenses related to legal, corporate development, investor relations and financing activities.

As of June 30, 2006, we had an accumulated deficit of \$120,059,360. We have operated at a loss since 1994, and we expect this to continue for some time. The amount of the accumulated deficit will continue to increase, as it will be expensive to continue clinical, research and development efforts. If these activities are successful and if we receive approval from the FDA to market equipment, then even more funding will be required to market and sell the equipment. We are evaluating potential partnerships as an additional way to fund operations. We will continue to rely on outside sources of financing to meet our capital needs beyond next year. The outcome of these matters cannot be predicted at this time.



Further, there can be no assurance, assuming we successfully raise additional funds, that we will achieve positive cash flow. If we are not able to secure additional funding, we will be required to further scale back our research and development programs, preclinical studies and clinical trials, general, and administrative activities and may not be able to continue in business. We expect we will fund our operations through the beginning of the second quarter of 2007 with our current working capital.

Our long-term capital requirements will depend on numerous factors including:

- The progress and magnitude of the research and development programs, including preclinical and clinical trials;
- The time involved in obtaining regulatory approvals;
- The cost involved in filing and maintaining patent claims;
- Competitor and market conditions;
- The ability to establish and maintain collaborative arrangements;
- The ability to obtain grants to finance research and development projects; and
- The cost of manufacturing scale-up and the cost of commercialization activities and arrangements.

The ability to generate substantial funding to continue research and development activities, preclinical and clinical studies and clinical trials and manufacturing, scale-up, and selling, general, and administrative activities is subject to a number of risks and uncertainties and will depend on numerous factors including:

- The ability to raise funds in the future through public or private financings, collaborative arrangements, grant awards or from other sources;
- Our potential to obtain equity investments, collaborative arrangements, license agreements or development or other funding programs in exchange for manufacturing, marketing, distribution or other rights to products developed by us; and
- The ability to maintain existing collaborative arrangements.

We cannot guarantee that additional funding will be available when needed or on favorable terms. If it is not, we will be required to scale back our research and development programs, preclinical studies and clinical trials, and selling, general, and administrative activities, or otherwise reduce or cease operations and our business and financial results and condition would be materially adversely affected.

### **Certain Factors That Could Affect Our Future Results**

All of the information in this Form 10-Q, including the factors listed below should be carefully considered and evaluated. These factors are not the only concerns or uncertainties facing our company. Additional matters not now known to us or that we may currently deem immaterial could also impair our ability to conduct business in the future.

If any of the circumstances among the following or others factors actually occur or occur again, our ability to commercialize our technology and the therapies we believe are derivable therefrom could be compromised and the trading price of our common stock could decline.

***If We Are Unable To Develop Commercially Successful Products, Including Our Medpulser Electroporation Therapy System In Various Markets For Multiple Indications, Particularly For The Treatment Of Head And Neck Cancer, Our Business Will Be Harmed And We May Be Forced To Curtail Or Cease Operations.*** Our ability to achieve and sustain operating profitability depends on our ability to successfully commercialize our MedPulser Electroporation Therapy System in Europe and the US for use in treating solid tumors, particularly for the treatment of head and neck cancer, and other indications. This will depend in large part on our ability to commence, execute and complete clinical programs and obtain regulatory approvals for our MedPulser Electroporation Therapy System. We have received various regulatory approvals, which apply to Europe for our MedPulser Electroporation Therapy System for use in treating solid tumors; the products related to such regulatory approval have not yet been commercialized. The FDA has been notified that most of our study population will be from non-English speaking sites in Eastern Europe whose outcome data may be considered to be unlike the United States, Canada and Western Europe. Further clinical trials are still necessary before we can seek regulatory approval to sell our products in the United States for treating solid tumors. We cannot assure you we will receive approval for our MedPulser Electroporation Therapy System for the treatment of head and neck cancer or other types of cancer or indications in the United States or in other countries or, if approved, that we will achieve significant level of sales. If we fail to commercialize our products, we may be forced to curtail or cease operations.

We have commenced additional clinical studies in different indications, such as breast, and are also in the pre-clinical stages of research and development with other new product candidates using our electroporation technology. These new indications and product candidates will require significant costs to advance through the development stages. If such product candidates are advanced through clinical trials, the results of such trials may not gain FDA approval. Even if approved, our products may not be commercially successful. If we fail to develop and commercialize our products, we may be forced to curtail or cease operations.

We cannot assure you that we will successfully develop any products. If we fail to develop or successfully commercialize any products, we may be forced to curtail or cease operations. Additionally, much of the commercialization efforts for our products must be carried forward by a licensing partner. We may not be able to obtain such a partner.

***The Market For Our Stock Is Volatile, Which Could Adversely Affect An Investment In Our Stock.*** Our share price and volume are highly volatile. This is not unusual for biomedical companies of our size, age, and with a discrete market niche. It also is common for the trading volume and price of biotechnology stocks to be unrelated to a company's operations, i.e. to go up or down on positive or no news. Our stock has exhibited this type of behavior in the past, and may well exhibit it in the future. The historically low trading volume of our stock, in relation to many other biomedical companies of our size, makes it more likely that a severe fluctuation in volume, either up or down, will affect the stock price.

Some factors that we would expect to depress the price of our stock include:

- Adverse clinical trial results;

- Our inability to obtain additional capital;
- Announcement that the FDA denied our request to approve our human-use product for commercialization in the United States, or similar denial by other regulatory bodies which make independent decisions outside the United States. To date, the EU is the only foreign jurisdiction in which we have sought approval for commercialization;
- Announcement of legal actions brought by or filed against us for patent or other matters, especially if we do not win such actions;
- Cancellation of important corporate partnerships or agreements;
- Public concern as to the safety or efficacy of our human-use products including public perceptions regarding gene therapy in general;
- Stockholders' decisions, for whatever reasons, to sell large amounts of our stock;
- Adverse research and development results;
- Declining working capital to fund operations, or other signs of apparent financial uncertainty; and
- Significant advances made by competitors that are perceived to limit our market position.

Additionally, our clinical trials are open-ended and, therefore, there is the possibility that information regarding the success (or setbacks) of our clinical trials maybe be obtained by the public prior to a formal announcement by us. These factors, as well as the other factors described in this Report, could significantly affect the price of our stock.

***If We Do Not Have Enough Capital To Fund Operations, Then We Will Have To Cut Costs.*** If we are not able to raise needed money under acceptable terms, then we will have to take measures to cut costs, such as:

- Delay, scale back or discontinue one or more of our oncology or gene delivery programs or other aspects of operations, including laying off some personnel or stopping or delaying clinical trials;
- Sell or license some of our technologies that we would not otherwise give up if we were in a better financial position;
- Sell or license some of our technologies under terms that are less favorable than they otherwise might have been if we were in a better financial position; and
- Consider merging with another company or positioning ourselves to be acquired by another company.

If it became necessary to take one or more of the above-listed actions, then we may have a lower valuation, which may be reflected in our stock price.

***Pre-Clinical And Clinical Trials Of Human-Use Equipment Are Unpredictable. If We Experience Unsuccessful Trial Results, Our Business Will Suffer.*** Before any of our human-use equipment can be sold, the FDA or applicable foreign regulatory authorities must determine that the equipment meets specified criteria for use in the indications for which approval is requested,

including obtaining appropriate regulatory approvals. Satisfaction of regulatory requirements typically takes many years, and involves compliance with requirements covering research and development, testing, manufacturing, quality control, labeling and promotion of drugs for human use. To obtain regulatory approvals, we must, among other requirements, complete clinical trials demonstrating our product candidates are safe and effective for a particular cancer type or other disease. Regulatory approval of a new drug is never guaranteed. The FDA will make this determination based on the results from our pre-clinical testing and clinical trials and has substantial discretion in the approval process. Despite the time and experience exerted, failure can occur at any stage, and we could encounter problems causing us to abandon clinical trials.

We have completed Phase II clinical trials and are conducting two Phase III clinical trials of our lead product candidate, the MedPulser® Electroporation Therapy System, for the treatment of recurrent and second primary head and neck cancers. In addition, we are conducting two Phase IV (or Pre-Marketing) clinical trials of our MedPulser® Electroporation Therapy System for the treatment of new and recurrent head and neck cancers and new and recurrent primary skin cancers, and have started a Phase I clinical trial of our MedPulser® Electroporation Therapy System for the treatment of breast cancer. Current or future clinical trials may demonstrate the MedPulser® Electroporation Therapy System is neither safe nor effective.

Any delays or difficulties we encounter in our pre-clinical research and clinical trials, in particular the Phase III clinical trials of our MedPulser® Electroporation Therapy System for the treatment of recurrent head and neck cancer, may delay or preclude regulatory approval. Our product development costs will increase if we experience delays in testing or regulatory approvals or if we need to perform more or larger clinical trials than planned. Any such events could also delay or preclude the commercialization of our MedPulser® Electroporation Therapy System or any other product candidates.

Clinical trials are unpredictable, especially human-use trials. Results achieved in early stage clinical trials may not be repeated in later stage trials, or in trials with more patients. When early positive results were not repeated in later stage trials, pharmaceutical and biotechnology companies have suffered significant setbacks. Not only are commercialization timelines pushed back, but some companies, particularly smaller biotechnology companies with limited cash reserves, have gone out of business after releasing news of unsuccessful clinical trial results.

We cannot be certain the results we observed in our pre-clinical testing will be confirmed in clinical trials or the results of any of our clinical trials will support FDA approval. If we experience unexpected, inconsistent or disappointing results in connection with a clinical or pre-clinical trial our business will suffer.

The patients admitted to our oncology clinical trials conducted in the United States and Europe are experiencing late stage cancer and are in a diminished physical state prior to entering our studies and thus these patients can experience serious adverse events (SAEs) whether due to our technology or other procedures. To date, there have been seven SAEs that were at least possibly related to our technology that resulted in death, a life-threatening experience, or hospitalization or prolongation of existing hospitalization. All seven SAEs were reported to the FDA. The SAEs were excessive bleeding in the tumor bed, edema of larynx, sudden death (suspected heart failure), weight loss, sudden death (cause unknown), obstruction of the airway, and death (suspected internal bleeding). The safety issues will have to be well-managed as bleeding is a potential SAE that can occur anytime until the wound is healed. Because our studies are controlled and ongoing, we cannot assure you that these or other SAEs will not delay or prevent approval of our product by the FDA.

In addition, any of our clinical trials for our treatment may be delayed or halted at any time for various reasons, including:

- The electroporation-mediated delivery of drugs or other agents may be found to be ineffective or to cause harmful side effects, including death;
- Our clinical trials may take longer than anticipated, for any of a number of reasons including a scarcity of subjects that meet the physiological or pathological criteria for entry into the study and a scarcity of subjects that are willing to participate through the end of the trial, or follow-up visits;
- The reported clinical data may change over time as a result of the continuing evaluation of patients or the current assembly and review of existing clinical and pre-clinical information;
- Data from various sites participating in the clinical trials may be incomplete or unreliable, which could result in the need to repeat the trial or abandon the project; and
- Pre-clinical and clinical data can be interpreted in many different ways, and the FDA and other regulatory authorities may interpret our data differently than we do, which could halt or delay our clinical trials or prevent regulatory approval.

If any of the above events arise during our clinical trials or data review, then we would expect this to have a serious negative effect on our company and your investment.



Despite the FDA's designation of our MedPulser® Electroporation Therapy System as a Fast Track product, such FDA designation is independent of the FDA's Priority Review and Accelerated Approval designations

and we may encounter delays in the regulatory approval process due to additional information requirements from the FDA, unintentional omissions in our PMA for our MedPulser® Electroporation Therapy System, or other delays in the FDA's review process. We may encounter delays or rejections in the regulatory approval process because of additional government regulation from future legislation or administrative action or changes in FDA policy during the period of product development, clinical trials and FDA regulatory review.

A majority of our operating expenses relate to our clinical trials. A delay in our trials, for whatever reason, will probably require us to spend additional funds to keep the product(s) moving through the regulatory process. If we do not have or cannot raise the needed funds, then the testing of our human-use products could be shelved. In the event the clinical trials are not successful, we will have to determine whether to put more money into the program to address its deficiencies or whether to abandon the clinical development programs for the products in the tested indications. Loss of the human-use product line would be a significant setback for our company.

Because there are so many variables inherent in clinical trials, we cannot predict whether any of our future regulatory applications to conduct clinical trials will be approved by the FDA or other regulatory authorities, whether our clinical trials will commence or proceed as planned, and whether the trials will ultimately be deemed to be successful. To date, our experience has been that submission and approval of clinical protocols has taken longer than desired or expected.

***Our Business Is Highly Dependent On Receiving Approvals From Various United States And International Government Agencies And Will Be Dramatically Affected If Approval To Manufacture And Sell Our Human-Use Equipment Is Not Granted Or Is Not Granted In A Timely Manner.*** The production and marketing of our human-use equipment and the ongoing research, development, pre-clinical testing, and clinical trial activities are subject to extensive regulation. Numerous governmental agencies in the U.S. and internationally, including the FDA, must review our applications and decide whether to grant approval. All of our human-use equipment must go through an approval process, in some instances for each indication for which we want to label it for use (such as use for dermatology, use for transfer of a certain gene to a certain tissue, or use for administering a certain drug to a certain tumor type in a patient having certain characteristics). These regulatory processes are extensive and involve substantial costs and time.

We have limited experience in, and limited resources available for, regulatory activities. Failure to comply with applicable regulations can, among other things, result in non-approval, suspensions of regulatory approvals, fines, product seizures and recalls, operating restrictions, injunctions and criminal prosecution.

Any of the following events can occur and, if any did occur, any one could have a material adverse effect on our business, financial conditions and results of operations:

- As mentioned earlier, clinical trials may not yield sufficiently conclusive results for regulatory agencies to approve the use of our products;
- There can be delays, sometimes long, in obtaining approval for our human-use devices, and indeed, we have experienced such delays in obtaining FDA approval of our clinical protocols;
- The rules and regulations governing human-use equipment such as ours can change during the review process, which can result in the need to spend time and money for further testing or review;
- If approval for commercialization is granted, it is possible the authorized use will be more limited than we believe is necessary for commercial success, or that approval may be conditioned on completion of further clinical trials or other activities; and
- Once granted, approval can be withdrawn, or limited, if previously unknown problems arise with our human-use product or data arising from its use.

***We Could Be Substantially Damaged If Physicians And Hospitals Performing Our Clinical Trials Do Not Adhere To Protocols Or Promises Made In Clinical Trial Agreements.*** We work and have worked with a number of hospitals to perform clinical trials,

primarily in oncology. We depend on these hospitals to recruit patients for the trials, to perform the trials according to our protocols, and to report the results in a thorough, accurate and consistent fashion. Although we have agreements with these hospitals, which govern what each party is to do with

respect to the protocol, patient safety, and avoidance of conflict of interest, we cannot be sure that contracts will be followed, or that circumstances like the following will not occur:

Possible Deviations from Protocol. Proper administration of bleomycin and electroporation is critical to achieving a similar rate of recurrence to surgery. The hospitals or the physicians working at the hospitals may not perform the trial correctly. Without a similar rate of recurrence, we are not likely to have a pharmacoeconomic profile as the patient will be crossed over to surgery. If we over electroporate we may cause permanent damage to the normal tissue and create wound healing issues. Deviations from protocol may make the clinical data not useful and the trial could be essentially worthless.

Potential for Conflict of Interest. Physicians working on protocols may have an improper economic interest in our company, or other conflict of interest. When a physician has a personal stake in the success of the trial, such as can be inferred if the physician owns stock, or rights to purchase stock of the trial sponsor, it can create suspicion that the trial results were improperly influenced by the physician's interest in economic gain. Not only can this put the clinical trial results at risk, but it can also do serious damage to a company's reputation.

Patient Safety and Consent Issues. Physicians and hospitals may fail to secure formal written consent as instructed or report adverse effects that arise during the trial in the proper manner, which could put patients at unnecessary risk. Physicians and hospital staff may fail to observe proper safety measures such as the mishandling of used medical needles, which may result in the transmission of infectious and deadly diseases, such as HIV and AIDS. This increases our liability, affects the data, and can damage our reputation.

If any of these events were to occur, it could have a material adverse effect on our ability to receive regulatory authorization to sell our human-use equipment and our reputation. Negative events that arise in the performance of clinical trials sponsored by biotechnology companies of our size and with limited cash reserves similar to ours have resulted in companies going out of business.

***Even If Our Products Are Approved By Regulatory Authorities, If We Fail To Comply With On-Going Regulatory Requirements, Or If We Experience Unanticipated Problems With Our Products, These Products Could Be Subject To Restrictions Or Withdrawal From The Market.*** Any product for which we obtain marketing approval, along with the manufacturing processes, post-approval clinical data and promotional activities for such product, will be subject to continual review and periodic inspections by FDA and other regulatory bodies. Even if regulatory approval of a product is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed or to certain requirements for costly post-marketing testing and surveillance to monitor the safety or efficacy of the product. Later discovery of previously unknown problems with our products, including unanticipated adverse events of unanticipated severity or frequency, manufacturer or manufacturing processes or failure to comply with regulatory requirements, may result in restrictions on such products or manufacturing processes, withdrawal of the products from the market, voluntary or mandatory recall, fines, suspension of regulatory approvals, product seizures or detention, injunctions or the imposition of civil or criminal penalties.

***Failure To Comply With Foreign Regulatory Requirements Governing Human Clinical Trials And Marketing Approval For Our Human-Use Equipment Could Prevent Us From Selling Our Products In Foreign Markets, Which May Adversely Affect Our Operating Results And Financial Conditions.*** For marketing our MedPulser Electroporation Therapy System outside the United States, the requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary greatly from country to country and may require additional testing. The time required to obtain approvals outside the United States may differ from that required to obtain FDA approval. We may not obtain foreign regulatory approval on a timely basis, if at all. Approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other countries or by the FDA. Failure to comply with these regulatory requirements or to obtain required approvals could impair our ability to develop these markets and could have a material adverse effect on our results of operations and financial condition.

*Our Ability To Achieve Significant Revenues From Sales Or Leases Of Human-Use Products Will Depend On Establishing Effective Sales, Marketing And Distribution Capabilities Or Relationships And We Currently Lack Substantial Experience In These Areas.* To market our products, we will need to develop sales, marketing and distribution capabilities. In order to develop or otherwise obtain these capabilities, we may have to enter into marketing, distribution or other similar arrangements with third parties in order to sell, market and distribute our products successfully. To the extent we enter into any such arrangements with third parties, our product revenue is likely to be lower than if we marketed and sold our products directly, and our revenues will depend upon the efforts of such third parties.

We have limited experience in sales, marketing and distribution of clinical and human-use products and we currently have no sales, marketing or distribution capability. If we decide to market and sell our human-use products directly, we must develop a marketing and sales force. This would involve substantial costs, training, and time. We may be unable to develop sufficient sales, marketing and distribution capabilities to commercialize our products successfully. Regardless of whether we elect to use third parties or seek to develop our own marketing capability, we may not be able to successfully commercialize any product.

***We Rely On Collaborative And Licensing Relationships To Fund A Portion Of Our Research And Development Expenses. If We Are Unable To Maintain Or Expand Existing Relationships, Or Initiate New Relationships, We Will Have To Defer Or Curtail Research And Development Activities In One Or More Areas.*** Our partners and collaborators fund a portion of our research and development expenses and assist us in the research and development of our human-use equipment. These collaborations and partnerships can help pay the salaries and other overhead expenses related to research. In the past, we encountered operational difficulties after the termination of an agreement by a former partner. Because this partnership was terminated, we did not receive significant milestone payments which we had expected and were forced to delay some clinical trials as well as some product development.

Our clinical trials to date have used our equipment with the anti-cancer drug bleomycin. We do not currently intend to package bleomycin together with the equipment for sale, but if it should be necessary or desirable to do this, we would need a reliable source of the drug. At this time we do not have a fixed source of bleomycin for inclusion with equipment or alone. If it becomes necessary or desirable to include bleomycin in our package, we would have to form a relationship with another provider of this generic drug before any product could be launched.

We also rely on scientific collaborators at companies and universities to further our research and test our equipment. In most cases, we lend our equipment to a collaborator, teach him or her how to use it, and together design experiments to test the equipment in one of the collaborator's fields of expertise. We aim to secure agreements that restrict collaborators' rights to use the equipment outside of the agreed upon research, and outline the rights each of us will have in any results or inventions arising from the work.

Nevertheless, there is always potential that:

- Our equipment will be used in ways we did not authorize, which can lead to liability and unwanted competition;
- We may determine that our technology has been improperly assigned to us or a collaborator may claim rights to certain of our technology, which may require us to pay license fees or milestone payments and, if commercial sales of the underlying product is achieved, royalties;
- We may lose rights to inventions made by our collaborators in the field of our business, which can lead to expensive legal fights and unwanted competition;
- Our collaborators may not keep our confidential information to themselves, which can lead to loss of our right to seek patent protection and loss of trade secrets, and expensive legal fights; and
- Collaborative associations can damage a company's reputation if they go awry and thus, by association or otherwise, the scientific or medical community may develop a negative view of us.

We cannot guarantee that any of the results from these collaborations will be successful. We also cannot be sure that we will be able to continue to collaborate with individuals and institutions that will further our work, or that we will be able to do so under terms that are not overly restrictive. If we are not able to maintain or develop new collaborative relationships, it is likely the research pace will slow down and it will take longer to identify and commercialize new products, or new indications for our existing products.

***We Rely Heavily On Our Patents And Proprietary Rights To Attract Partnerships And Maintain Market Position.*** The strength of our patent portfolio is an important factor that will influence our success. Patents give the patent holder the right to prevent others from using its patented technology. If someone infringes upon the patented material of a patent holder, the patent holder has the right to initiate legal proceedings against that person to protect the patented material. These

proceedings, however, can be lengthy and costly. We perform an ongoing

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review of our patent portfolio to confirm that our key technologies are adequately protected. If we determine that any of our patents require either additional disclosures or revisions to existing information, we may ask that such patents be reexamined or reissued, as applicable, by the United States Patent and Trademark Office.

The patenting process, enforcement of issued patents, and defense against claims of infringement are inherently risky. Because we rely heavily on patent protection, we face the following significant risks:

Possibility of Inadequate Patent Protection for Product. The United States Patent and Trademark Office or foreign patent offices may not grant patents of meaningful scope based on the applications we have already filed and those we intend to file. If we do not have patents that adequately protect our human-use equipment and indications for its use, then we will not be competitive.

Potential That Important Patents Will Be Judged Invalid. Some of the issued patents we now own or license may be determined to be invalid. If we have to defend the validity of any of our patents, the costs of such defense could be substantial, and there is no guarantee of a successful outcome. In the event an important patent related to our drug delivery technology is found to be invalid, we may lose competitive position and may not be able to receive royalties for products covered in part or whole by that patent under license agreements.

Dangers of Being Charged With Infringement. Although we are not currently aware of any parties intending to pursue infringement claims against us, there is the possibility that we may use a patented technology owned by another person and/or be charged with infringement. Defending or indemnifying a third party against a charge of infringement can involve lengthy and costly legal actions, and there can be no guarantee of a successful outcome. Biotechnology companies comparable to us in size and financial position have gone out of business after fighting and losing an infringement battle. If we or our partners were prevented from using or selling our human-use equipment, then our business would be materially adversely affected.

Freedom to Operate Issues. We are aware that patents related to electrically-assisted drug delivery have been granted to, and patent applications filed by, our potential competitors. We or our partners have taken licenses to some of these patents, and will consider taking additional licenses in the future. Nevertheless, the competitive nature of our field of business and the fact that others have sought patent protection for technologies similar to ours make these potential issues significant.

In addition to patents, we also rely on trade secrets and proprietary know-how. We try to protect this information with appropriate confidentiality and inventions agreements with our employees, scientific advisors, consultants, and collaborators. We cannot be sure that these agreements will not be breached, that we will be able to protect ourselves if they are breached, or that our trade secrets will not otherwise become known or be independently discovered by competitors. If any of these events occurs, then we face the potential of losing control over valuable company information, which could negatively affect our competitive position.

***If We Are Not Successful In Developing Our Current Products, Our Business Model May Change As Our Priorities And Opportunities Change. Our Business May Never Develop To Be Profitable Or Sustainable.*** There are many products and programs that to us seem promising and that we could pursue. However, with limited resources, we may decide to change priorities and shift programs away from those that we had been pursuing for the purpose of exploiting our core technology of electroporation. The choices we may make will be dependent upon numerous factors, which we cannot predict. We cannot be sure that our business model, as it currently exists or as it may evolve, will enable us to become profitable or to sustain operations.

***Serious And Unexpected Side Effects Attributable To Gene Therapy May Result In Governmental Authorities Imposing Additional Regulatory Requirements Or A Negative Public Perception Of Our Products.*** The MedPulser DNA Delivery System and any of our other Gene Therapy or DNA Vaccine product candidates under development could be broadly described as gene therapies. A number of clinical trials are being conducted by other pharmaceutical companies involving gene therapy, including compounds similar to, or competitive with, our product candidates. The announcement of adverse results



from these clinical trials, such as serious unwanted and unexpected side effects attributable to treatment, or any response by the FDA to such clinical trials, may impede the timing of our clinical trials, delay or prevent us from obtaining regulatory approval or negatively influence public perception of our product candidates, which could harm our business and results of operations and depress the value of our stock.

The U.S. Senate has held hearings concerning the adequacy of regulatory oversight of gene therapy clinical trials, as well as the adequacy of research subject education and protection in clinical research in general, and to determine whether additional legislation is required to protect volunteers and patients who participate in such clinical trials. The Recombinant DNA Advisory Committee, or RAC, which acts as an advisory body to the National Institutes of Health, has expanded its public role in evaluating important public and ethical issues in gene therapy clinical trials. Implementation of any additional review and reporting procedures or other additional regulatory measures could increase the costs of or prolong our product development efforts or clinical trials.

To date, there have not been any serious adverse events in any gene therapy clinical trials in which our technology was used. In the future, if one or a series of serious adverse events were to occur during a gene therapy clinical trial in which our technology was used, we would report all such events to the FDA and other regulatory agencies as required by law. Such serious adverse events, whether treatment-related or not, could result in negative public perception of our treatments and require additional regulatory review or other measures, which could increase the cost of or prolong our gene therapy clinical trials or require us to halt the clinical trials altogether.

The FDA has not approved any gene therapy product or gene-induced product for sale in the United States. The commercial success of our products will depend in part on public acceptance of the use of gene therapy products or gene-induced products, which are a new type of disease treatment for the prevention or treatment of human diseases. Public attitudes may be influenced by claims that gene therapy products or gene-induced products are unsafe, and these treatment methodologies may not gain the acceptance of the public or the medical community. Negative public reaction to gene therapy products or gene-induced products could also result in greater government regulation and stricter clinical trial oversight.

***We Cannot Predict The Safety Profile Of The Use Of Our Medpulsar Electroporation System When Used In Combination With Other Therapies.*** Our trials involve the use of our MedPulsar Electroporation System in combination with bleomycin, an anti-cancer drug. While the data we have evaluated to date suggest the MedPulsar Electroporation Therapy System does not increase the adverse effects of other therapies, we cannot predict if this outcome will continue to be true or whether possible adverse side effects not directly attributable to the other drugs will compromise the safety profile of our MedPulsar Electroporation Therapy System when used in certain combination therapies or if used off-label with other drugs by physicians.

***There Is A Possibility That Our Technology Will Become Obsolete Or Lose Its Competitive Advantage.*** The drug delivery business is very competitive, fast moving and intense, and expected to be increasingly so in the future. Other companies and research institutions are developing drug delivery systems that, if not similar in type to our systems, are designed to address the same patient or subject population. Therefore, we cannot promise you that our products will be the best, the safest, the first to market, or the most economical to make or use. If competitors' products are better than ours, for whatever reason, then we could make less money from sales and our products could become obsolete.

There are many reasons why a competitor might be more successful than us, including:

**Financial Resources.** Some competitors have greater financial resources and can afford more technical and development setbacks than we can.

**Greater Experience.** Some competitors have been in the biomedical business longer than we have. They have greater experience than us in critical areas like clinical testing, obtaining regulatory approval, and sales and marketing. This experience or their name recognition may give them a competitive advantage over us.

**Superior Patent Position.** Some competitors may have a better patent position protecting their technology than we have or will have to protect our technology. If we cannot use our patents to prevent others from copying our technology or developing similar technology, or if we cannot obtain a critical license to another's patent that we need to make and use our equipment, then we would expect our competitive position to weaken.

**Faster to Market.** Some companies with competitive technologies may move through stages of development, approval, and marketing faster than us. If a competitor receives FDA approval before us, then it will be authorized to sell its products before we can sell ours. Because the first company to market often has a significant advantage over

late-comers, a second place position could result in less than anticipated sales.

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Reimbursement Allowed. In the U.S., third party payers, such as Medicare, may reimburse physicians and hospitals for competitors' products but not for our human-use products. This would significantly affect our ability to sell our human-use products in the U.S. and would have a serious effect on revenue and our business as a whole. Outside of the U.S., reimbursement and funding policies vary widely.

***Any Acquisition We Might Make May Be Costly And Difficult To Integrate, May Divert Management Resources Or Dilute Stockholder Value.*** We have considered and made strategic acquisitions in the past, including Inovio AS in January 2005, and, in the future, may acquire or make investments in complementary companies, products or technologies. As part of our business strategy, we may acquire assets or businesses principally relating to or complementary to our current operations, and we have in the past evaluated and discussed such opportunities with interested parties. Any acquisitions we undertake will be accompanied by issues commonly encountered in business acquisitions, which could adversely affect us, including:

- Potential exposure to unknown liabilities of acquired companies;
- The difficulty and expense of assimilating the operations and personnel of acquired businesses;
- Diversion of management time and attention and other resources;
- Loss of key employees and customers as a result of changes in management;
- Incurrence of amortization expenses related to intangible assets or large impairment charges such as the charges in excess of \$3.3 million we incurred to our results of operations during 2005 related to our write-off of in-process research and development that we acquired in our acquisition of Inovio AS in January 2005; and
- Possible dilution to our stockholders.

In addition, geography may make the integration of businesses more difficult. We may not be successful in overcoming these risks or any other problems encountered in connection with any acquisitions.

***Economic, Political, Military Or Other Events In The United States Or In Other Countries Could Interfere With Our Success Or Operations And Harm Our Business.*** The September 11, 2001 terrorist attacks disrupted commerce throughout the United States and other parts of the world. The continued threat of similar attacks throughout the world and the military action taken by the United States and other nations in Iraq or other countries may cause significant disruption to commerce throughout the world. To the extent that such disruptions further slow the global economy, our business and results of operations could be materially adversely affected. We are unable to predict whether the threat of new attacks or the responses thereto will result in any long-term commercial disruptions or if such activities or responses will have a long-term material adverse effect on our business, results of operations or financial condition.

***Our Dependence Upon Non-Marketed Products, Lack Of Experience In Manufacturing And Marketing Human-Use Products, And Our Continuing Deficit May Result In Even Further Fluctuations In Our Trading Volume And Share Price.*** Successful approval, marketing, and sales of our human-use equipment are critical to the financial future of our company. Our human-use products are not yet approved for sale neither in the United States nor in other jurisdictions and we may never obtain those approvals. Even if we do obtain approvals to sell our human-use products in the United States, those sales may not be as large or timely as we expect. These uncertainties may cause our operating results to fluctuate dramatically in the next several years. We believe that quarter-to-quarter or annual comparisons of our operating results are not a good indicator of our future performance. Nevertheless,



these fluctuations may cause us to perform below the expectations of the public market analysts and investors. If this happens, the price of our common shares would likely fall.

***We Have Product Liability Issues With Human-Use Equipment.*** The testing, marketing and sale of human-use products expose us to significant and unpredictable risks of equipment product liability claims. These claims may arise from patients, clinical trial volunteers, consumers, physicians, hospitals, companies, institutions, researchers or others using, selling, or buying our equipment. Product liability losses are inherent in our business and will exist even after the products are approved for sale. If our human-use equipment is commercialized, we face the possibility that use (or misuse) of the equipment will result in personal injury. The chance of such an occurrence will increase after a product is on the market.

We possess liability insurance in connection with ongoing business and products, and we will purchase additional policies if such policies are determined by management to be necessary. The insurance we purchase may not provide adequate coverage in the event a claim is made, however, and we may be required to pay claims directly. If we did have to make payment against a claim, it would impact our financial ability to perform the research, development, and sales activities we have planned.

If and when our human-use equipment is commercialized, there is always the possibility of product defects. Product defects can lead to loss of future sales, decrease in market acceptance, damage to our brand or reputation, product returns and warranty costs, and even product withdrawal from the market. These events can occur whether the defect resides in a component we purchased from a third party or whether it was due to our design and/or manufacture. We expect that our sales agreements will contain provisions designed to limit our exposure to product liability claims. However, we do not know whether these limitations are enforceable in the countries in which the sale is made. Any product liability or other claim brought against us, if successful and of sufficient magnitude, could negatively impact our financial performance, even if we have insurance.

***We Cannot Be Certain That We Will Be Able To Manufacture Our Human-Use Equipment In Sufficient Volumes At Commercially Reasonable Rates.*** Our manufacturing facilities for human-use products will be subject to quality systems regulations, international quality standards and other regulatory requirements, including pre-approval inspection for the human-use equipment and periodic post-approval inspections for all human-use products. While we have undergone and passed a quality systems audit from an international body, we have never undergone a quality systems inspection by the FDA. We may not be able to pass an FDA inspection when it occurs. If our facilities are found not to be up to the FDA standards in sufficient time, prior to United States launch of product, then it will result in a delay or termination of our ability to produce the human-use equipment in our facility. Any delay in production will have a negative effect on our business. While there are no target dates set forth for launch of our products in the United States, we plan on launching these products once we successfully perform a Phase III clinical study, obtain the requisite regulatory approval, and engage a partner who has the financial resources and marketing capacity to bring our products to market. Our products must be manufactured in sufficient commercial quantities, in compliance with regulatory requirements, and at an acceptable cost to be attractive to purchasers. We rely on third parties to manufacture and assemble most aspects of our equipment.

Disruption of the manufacture of our products, for whatever reason, could delay or interrupt our ability to manufacture or deliver our products to customers on a timely basis. This would be expected to affect revenue and may also affect our long-term reputation. In the event we provide product of inferior quality, product liability claims and warranty obligations, could negatively affect our financial performance.

***If We Lose Key Personnel Or Are Unable To Attract And Retain Additional, Highly Skilled Personnel Required To Develop Our Products Or Obtain New Collaborations, Our Business May Suffer.*** We depend, to a significant extent, on the efforts of our key employees, including senior management and senior scientific, clinical, regulatory and other personnel. The development of new therapeutic products requires expertise from a number of different disciplines, some of which is not widely available. We depend upon our scientific staff to discover new product candidates and to develop and conduct pre-clinical studies of those new potential products. Our clinical and regulatory staff is responsible for the design and execution of clinical trials in accordance with FDA requirements and for the advancement of our product candidates toward FDA approval. Our manufacturing staff is responsible for designing and conducting our manufacturing processes in accordance with the FDA's Quality System Regulations. The quality and reputation of our scientific, clinical,

regulatory and manufacturing staff, especially the senior staff, and their success in performing their responsibilities, are significant factors in attracting potential funding sources and collaborators. In addition, our Chief Executive Officer and Chief Financial Officer and other executive officers are involved in a broad range of critical activities, including providing strategic and operational guidance. The loss

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of these individuals, or our inability to retain or recruit other key management and scientific, clinical, regulatory, manufacturing and other personnel, may delay or prevent us from achieving our business objectives. We face intense competition for personnel from other companies, universities, public and private research institutions, government entities and other organizations.

***We May Not Meet Environmental Guidelines And As A Result Could Be Subject To Civil And Criminal Penalties.*** Like all companies in our industry, we are subject to a variety of governmental regulations relating to the use, storage, discharge and disposal of hazardous substances. Our safety procedures for handling, storage and disposal of such materials are designed to comply with applicable laws and regulations. While we believe we are currently in compliance with all material applicable environmental regulations, if we are found to not comply with environmental regulations, or if we are involved with contamination or injury from these materials, then we may be subject to civil and criminal penalties. This would have a negative impact on our reputation and finances, and could result in a slowdown or even complete cessation of our business.

***Our Facilities Are Located Near Known Earthquake Fault Zones, And The Occurrence Of An Earthquake Or Other Catastrophic Disaster Could Cause Damage To Our Facilities And Equipment.*** Our facilities are located near known earthquake fault zones and are vulnerable to damage from earthquakes. We are also vulnerable to damage from other types of disasters, including fire, floods, power loss, communications failures and similar events. If any disaster were to occur, our ability to operate our business at our facilities would be seriously impaired. In addition, the unique nature of our research activities could cause significant delays in our programs and make it difficult for us to recover from a disaster. The insurance we maintain may not be adequate to cover our losses resulting from disasters or other business interruptions. Accordingly, an earthquake or other disaster could materially and adversely harm our ability to conduct business.

***Recent Legislation Requiring Companies To Evaluate Internal Controls Under Section 404 Of The Sarbanes-Oxley Act Of 2002 Have Increased Our Expenses And Could Result In Events That Adversely Affect Our Stock Price.*** As directed by Section 404 of the Sarbanes-Oxley Act of 2002 ( "Section 404" ), the Securities and Exchange Commission adopted rules requiring public companies to include a report of management on our internal controls over financial reporting in our annual reports on Form 10-K that contains an assessment by management of the effectiveness of our internal controls over financial reporting. In addition, our independent auditor must attest to and report on management's assessment of the effectiveness of our internal controls over financial reporting. This requirement first applied to our 2004 Annual Report on Form 10-K.

How companies are implementing these new requirements including internal control reforms, if any, to comply with Section 404's requirements, and how independent auditors are applying these new requirements and testing companies' internal controls, is an evolving process and remains subject to uncertainty. The requirements of Section 404 are ongoing and apply to future years. We expect that our internal controls will continue to evolve as our business activities change. During the course of management's and our independent auditor's review of our internal controls over financial reporting as of December 31, 2005, we did identify two significant control deficiencies that did not rise to the level of material weaknesses, as defined by the Public Company Accounting Oversight Board (PCAOB). Although we will continue to diligently and vigorously review our internal controls over financial reporting in order to ensure compliance with the Section 404 requirements, any control system, regardless of how well designed, operated and evaluated, can provide only reasonable, not absolute, assurance that its objectives will be met.

If, during any year, our independent auditor is not satisfied with our internal controls over financial reporting or the level at which these controls are documented, designed, operated, tested or assessed, or if the independent auditor interprets the requirements, rules or regulations differently than we do, our independent auditor may decline to attest to management's assessment or may issue a report that is qualified. This could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively impact the market price of our stock.

***Anti-Takeover Provisions In Our Charter Documents, Our Stockholder Rights Agreement And Delaware Law May Prevent Or Delay Removal Of Incumbent Management Or A Change Of Control.*** Anti-takeover provisions of our Certificate of Incorporation, our Amended and Restated Stockholders Rights Agreement and Delaware law may have the effect of deterring or delaying attempts by our stockholders to remove or replace management, engage in proxy contests and effect changes in control. The provisions of our charter documents include the ability of our board of directors to issue shares of preferred stock without approval of all our





stockholders upon the terms and conditions and with the rights, privileges and preferences as our board of directors may determine.

The Rights issued pursuant to our Stockholder Rights Agreement will become exercisable, subject to certain exceptions, after a person or group announces acquisition of 20% or more of our common stock or announces commencement of a tender or exchange offer the consummation of which would result in ownership by the person or group of 20% or more of our common stock.

In addition, as a Delaware corporation, we are subject to Delaware law, including Section 203 of the Delaware General Corporation Law. In general, Section 203 prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder unless certain specific requirements are met as set forth in Section 203.

These provisions, alone or together, could have the effect of deterring or delaying changes in incumbent management, proxy contests or changes in control.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our exposure to market risk for changes in interest rates relates primarily to the increase or decrease in the amount of interest income that we can earn on our cash and cash equivalents and short-term investments. We are subject to interest rate risk on our cash equivalents, which, as of June 30, 2006, had an average interest rate of approximately 4.77%. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities. A hypothetical 100 basis point adverse move in interest rates along the entire interest rate yield curve would not materially affect the fair value of our interest sensitive financial instruments. Declines in interest rates over time will, however, reduce our interest income.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures, which are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, as appropriate to allow timely decisions regarding required disclosure.

Based on an evaluation carried out as of the end of the period covered by this quarterly report, under the supervision and with the participation of our management, including our CEO and CFO, our CEO and CFO have concluded that, as of the end of such period, our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective as of June 30, 2006.

#### **Changes in Internal Control Over Financial Reporting**

An evaluation was also performed under the supervision and with the participation of our management, including our CEO and CFO, of any change in our internal controls over financial reporting that occurred during our last fiscal quarter and that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

There have not been any changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that occurred during the six months ended June 30, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Part II. Other Information

### Item 1. Legal Proceedings

Not applicable

### Item 1A. Risk Factors

*You should carefully consider and evaluate all of the information in this Form 10-Q in combination with the more detailed description of our business in our annual report on Form 10-K for the year ended December 31, 2005, which we filed with the Securities and Exchange Commission on March 16, 2006, for a more complete understanding of the risks associated with an investment in our securities. There have been material changes in the Risk Factors as previously disclosed in our annual report on Form 10-K for the year ended December 31, 2005 and such changes are reflected immediately below. The following risk factors, as well those contained in our annual report on Form 10-K for the year ended December 31, 2005 and factors included elsewhere in this report are not the only factors that could potentially facing our company. Additional issues not now known to us or that we may currently deem immaterial may also impair our ability to commercialize our technology and the therapies we believe are derivable therefrom resulting in our business outlook being compromised and the trading price of our common stock declining.*

#### **WE HAVE A HISTORY OF LOSSES, WE EXPECT TO CONTINUE TO INCUR LOSSES AND WE MAY NOT ACHIEVE OR MAINTAIN PROFITABILITY**

As of June 30, 2006, we had an accumulated deficit of \$120,059,360. We have operated at a loss since 1994, and we expect this to continue for some time. The amount of the accumulated deficit will continue to increase, as it will be expensive to continue clinical, research and development efforts. If these activities are successful and if we receive approval from the FDA to market equipment, then even more funding will be required to market and sell the equipment. We are evaluating potential partnerships as an additional way to fund operations. We will continue to rely on outside sources of financing to meet our capital needs beyond next year. The outcome of these matters cannot be predicted at this time.

Further, there can be no assurance, assuming we successfully raise additional funds, that we will achieve positive cash flow. If we are not able to secure additional funding, we will be required to further scale back our research and development programs, preclinical studies and clinical trials, general, and administrative activities and may not be able to continue in business. Including the cash proceeds received from financings, various licensing payments, the exercise of employee stock options and investor warrants, we believe we have sufficient funds to fund operations through the middle of the second quarter 2007.

#### **WE WILL HAVE A NEED FOR SIGNIFICANT FUNDS IN THE FUTURE AND THERE IS NO GUARANTEE THAT WE WILL BE ABLE TO OBTAIN THE FUNDS WE NEED.**

Developing a new medical device and conducting clinical trials is expensive. Our product development efforts may not lead to commercial products, either because our product candidates fail to be found safe or effective in clinical trials or because we lack the necessary financial or other resources or relationships to pursue our programs through commercialization. Our capital and future revenue may not be sufficient to support the expenses of our operations, the development of commercial infrastructure and the conduct of our clinical trials and pre-clinical research.

Our plans for continuing clinical trials, conducting research, furthering development and, eventually, marketing our human-use equipment will involve substantial costs. The extent of our costs will depend on many factors, including some of the following:

- The progress and breadth of pre-clinical testing and the size or complexity of our clinical trials and drug delivery programs, all of which directly influence cost;
- Higher than expected costs involved in complying with the regulatory process to get our human-use products approved, including the number, size, and timing of necessary clinical trials and costs associated with the current assembly and review of existing clinical and pre-clinical information;



- Higher than expected costs involved in patenting our technologies and defending them and pursuing our intellectual property strategy;
- Changes in our existing research and development relationships and our ability to enter into new agreements;
- Changes in or terminations of our existing collaboration and licensing arrangements;
- Faster than expected rate of progress and changes in scope and cost of our research and development and clinical trial activities;
- An increase or decrease in the amount and timing of milestone payments we receive from collaborators;
- Higher than expected costs of preparing an application for FDA approval of our MedPulser® Electroporation Therapy System;
- Higher than expected costs of developing the processes and systems to support FDA approval of our MedPulser® Electroporation Therapy System;
- An increase in our timetable and costs for the development of marketing operations and other activities related to the commercialization of our MedPulser® Electroporation Therapy System and our other product candidates;
- A change in the rate of success in our Phase III clinical trial of MedPulser® Electroporation Therapy System and in our other clinical trials;
- Higher than expected costs to further develop and scale up our manufacturing capability of our human-use equipment; and
- Competition for our products and our ability, and that of our partners, to commercialize our products.

We plan to fund operations by several means. We will attempt to enter into contracts with partners that will fund either general operating expenses or specific programs or projects. Some funding also may be received through government grants. We cannot promise that we will enter into any such contracts or receive such grants or, if we do, that our partners and the grants will provide enough funding to meet our needs.

In the past, we have raised funds by public and private sale of our stock, and we are likely to do this in the future to raise needed funds. Sale of our stock to new private or public investors usually results in existing stockholders becoming diluted. The greater the number of shares sold, the greater the dilution. A high degree of dilution can, among other things, make it difficult for the price of our stock to rise rapidly. Dilution also lessens the voting power of stockholders.

We expect that our cash and cash equivalents on hand and cash available from the periodic liquidation of our short-term investments will be sufficient to fund our operations through the beginning of the second quarter of 2007. Accordingly, prior to that time we will need to raise additional capital to continue to fund operations at their current level. We cannot assure you that we will be able to raise capital needed to fund operations, or that we will be able to raise capital under terms that are favorable to us.

**A SMALL NUMBER OF LICENSING PARTNERS ACCOUNT FOR A SUBSTANTIAL PORTION OF OUR REVENUE IN EACH PERIOD AND OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION COULD SUFFER IF WE LOSE THESE LICENSING PARTNERS OR FAIL TO ADD ADDITIONAL LICENSING PARTNERS IN THE FUTURE.**

We derive a significant portion of our revenue from a limited number of licensing partners in each period. Accordingly, if we fail to sign additional future contracts with major licensing partners, if a licensing contract is delayed or deferred, or if an existing licensing contract expires or is cancelled and we fail to replace the contract with new business, our revenue could be adversely affected. Until commercialization of our Medpulsar Electroporation Therapy System, we expect that a limited number of licensing partners will continue to account for a substantial portion of our revenue in each quarter in the foreseeable future. During the three and six months ended June 30, 2006, one licensing partner, Merck, accounted for approximately 57% and 58%, respectively, of our consolidated revenue. During the three and six months ended June 30, 2005, Merck accounted for approximately 90% and 81%, respectively, of our consolidated revenue.

**IF WE CANNOT MAINTAIN OUR EXISTING CORPORATE AND ACADEMIC ARRANGEMENTS AND ENTER INTO NEW ARRANGEMENTS, WE MAY BE UNABLE TO DEVELOP PRODUCTS EFFECTIVELY, OR AT ALL.**

Our strategy for the research, development and commercialization of our product candidates may result in our entering into contractual arrangements with corporate collaborators, academic institutions and others. We have entered into sponsored research, license and/or collaborative arrangements with several entities, including Merck, Vical, Valentis, the U.S. Navy, Chiron and the University of South Florida, as well as numerous other institutions that conduct clinical trials work or perform pre-clinical research for us. Our success depends upon our collaborative partners performing their responsibilities under these arrangements and complying with the regulations and requirements governing clinical trials. We cannot control the amount and timing of resources our collaborative partners devote to our research and testing programs or product candidates, or their compliance with regulatory requirements which can vary because of factors unrelated to such programs or product candidates. These relationships may in some cases be terminated at the discretion of our collaborative partners with only limited notice to us.

Merck can terminate its May 2004 license and collaboration agreement with us at any time in its sole discretion, without cause, by giving ninety days' advance notice to us. If this agreement is terminated by Merck at any time during the first two years of the collaboration term, then Merck shall continue, for a six-month period beginning on the date of such termination, to make payments previously approved by the project's joint collaboration committee in relation to scientists and outside contractors engaged by us in connection with the agreement. During the three and six months ended June 30, 2006, Merck accounted for approximately 57% and 58%, respectively, of our consolidated revenue. During the three and six months ended June 30, 2005, Merck accounted for approximately 90% and 81%, respectively, of our consolidated revenue.

We may not be able to maintain our existing arrangements, enter into new arrangements or negotiate current or new arrangements on acceptable terms, if at all. Some of our collaborative partners may also be researching competing technologies independently from us to treat the diseases targeted by our collaborative programs.

**CHANGES IN FOREIGN EXCHANGE RATES MAY AFFECT OUR FUTURE OPERATING RESULTS.**

In January 2005, we acquired Inovio AS, a Norwegian company. During the three and six months ended June 30, 2006, Inovio AS contributed approximately \$38,267 and \$155,293 to our revenue, respectively, which amounted to approximately 6% and 11% of our total revenue. Inovio AS conducts its operations primarily in foreign currencies, including the Euro, Norwegian Kroner and Swedish Krona. Fluctuation in the values of these foreign currencies relative to the U.S. dollar will affect our financial results which are reported in US dollars and will cause U.S. dollar translation of such currencies to vary from one period to another. We cannot predict the effect of exchange rate fluctuations upon future operating results.

**Item 2. Unregistered Sale of Equity Securities and Use of Proceeds**

Not applicable.

**Item 3. Default Upon Senior Securities**

Not applicable.



**Item 4. Submission of Matters to a Vote of Security Holders**

On May 5, 2006, we held our annual meeting of stockholders. Of the 32,140,390 shares eligible to vote, 19,603,339 votes, or 61%, were returned, constituting a quorum. At the stockholders' meeting, the following matters were submitted to stockholders for vote:

- Proposal No. 1 Election of Directors;
- Proposal No. 2 Amendment of our 2000 Stock Option Plan (the "Plan") to increase the maximum number of common shares reserved for issuance under the Plan, including options currently outstanding, from 4,250,000 shares to 4,750,000 shares; and
- Proposal No. 3 Ratification of the appointment of our independent registered public accounting firm.

The results of the voting on these proposals are as follows:

1. Proposal No. 1 - Each of the individuals below were elected by the stockholders to serve until the next annual meeting of the stockholders or until his successor is duly elected or appointed, subject to earlier resignation or removal.

| Director         | Votes For  | Votes Against | Votes Withheld |
|------------------|------------|---------------|----------------|
| Avtar Dhillon    | 19,549,624 |               | 53,715         |
| James L. Heppell | 19,538,428 |               | 59,753         |
| Simon X. Benito  | 19,536,327 |               | 67,012         |
| Tazdin Esmail    | 19,564,477 |               | 38,862         |
| Felix Theeuwes   | 19,546,121 |               | 57,218         |
| Riaz Bandali     | 19,535,765 |               | 67,574         |

2. Proposal No. 2 The stockholders approved an amendment to our 2000 Stock Option Plan (the "Plan") to increase the maximum number of common shares reserved for issuance under the Plan, including options currently outstanding, from 4,250,000 shares to 4,750,000 shares. The total number of votes cast for, against, and withheld was 10,494,927, 183,477, and 6,979, respectively. The number of broker non-votes was 8,726,470. Broker non-votes count in determining if a quorum is present but do not count towards vote tabulation.

3. Proposal No. 3 - The stockholders approved the appointment of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2006. The total number of votes cast for, against, and withheld was 19,421,988, 0, and 100, respectively.

**Item 5. Other Information**

Not applicable.



**Item 6. Exhibits**

**(a) Exhibits**

**Exhibit**

| <b>Number</b> | <b>Description of Document</b>  |
|---------------|---|
| 10.1          | Amended 2000 Stock Option Plan (as amended by the Board of Directors through March 6, 2006 with approvals by stockholders through May 5, 2006) (incorporated by reference to Exhibit 4.1 of registrants Registration Statement on Form S-8 filed July 28, 2006) |
| 31.1          | Certification of Chief Executive Officer Pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2          | Certification of Chief Financial Officer Pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1          | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*   |

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\* This exhibit shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

**INOVIO BIOMEDICAL CORPORATION**

**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.

Inovio Biomedical Corporation

Date: August 7, 2006

By: /s/ Peter Kies  
Peter Kies  
Authorized Officer and Chief Financial  
Officer