Mast Therapeutics, Inc.
Form 424B3
August 05, 2013
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Filed Pursuant to Rule 424(b)(3)

Registration No. 333-188870

Prospectus Supplement No. 2

(To prospectus dated June 14, 2013)

Warrants to Purchase up to 28,097,500 Shares of Common Stock

This Prospectus Supplement No. 2 (the Prospectus Supplement) supplements our Prospectus dated June 14, 2013 and Prospectus Supplement No. 1 dated June 26, 2013 (together, the Prospectus), relating to the issuance of up to 28,097,500 shares of our common stock issuable upon exercise of outstanding warrants issued in connection with our registered offering which closed on June 19, 2013. We cannot predict when or if the warrants will be exercised, and it is possible that the warrants may expire and never be exercised.

Recent Developments

This Prospectus Supplement is being filed to update and supplement the information in the Prospectus with the information contained in our Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 5, 2013 (the Quarterly Report). Accordingly, we have attached the Quarterly Report to this Prospectus Supplement. Any statement contained in the Prospectus shall be deemed to be modified or superseded to the extent that information in this Prospectus Supplement modifies or supersedes such statement. Any statement that is modified or superseded shall not be deemed to constitute a part of the Prospectus except as modified or superseded by this Prospectus Supplement.

This Prospectus Supplement should be read in conjunction with, and may not be delivered or utilized without, the Prospectus.

In reviewing this Prospectus Supplement, you should carefully consider the matters described under the caption Risk Factors beginning on page 4 of the Prospectus.

Neither the U.S. Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this Prospectus Supplement is truthful or complete. Any representation to the contrary is a criminal offense.

This Prospectus Supplement does not constitute an offer to sell or the solicitation of an offer to buy any securities.

The date of this Prospectus Supplement is August 5, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from _____ to _____

Commission File Number 001-32157

Mast Therapeutics, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**84-1318182**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

12390 El Camino Real, Suite 150, San Diego, CA	**92130**
(Address of principal executive offices)	**(Zip Code)**

(858) 552-0866

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

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

The number of shares outstanding of the registrant s common stock, $0.001 par value per share, as of August 1, 2013 was 102,710,286.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Mast Therapeutics, Inc. and Subsidiaries

(A Development Stage Enterprise)

Condensed Consolidated Balance Sheets

(Unaudited)

	June 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 44,972,236	$ 22,500,440
Short-term investments	8,450,318	14,010,962
Interest and other receivables	9,659	15,689
Prepaid expenses	684,126	646,571
Total current assets	54,116,339	37,173,662
Property and equipment, net	119,951	198,358
In-process research and development	6,549,000	6,549,000
Goodwill	3,006,883	3,006,883
Other assets	43,912	43,912
Total assets	$ 63,836,085	$ 46,971,815
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 950,805	$ 698,838
Accrued liabilities	1,579,423	1,283,976
Accrued compensation and payroll taxes	799,061	445,352
Contingent liability		142,500
Total current liabilities	3,329,289	2,570,666
Deferred income tax liability	2,608,755	2,608,755
Total liabilities	5,938,044	5,179,421
Stockholders equity:		
Common stock, $0.001 par value; 500,000,000 shares authorized; 102,710,286 and 47,719,365 shares issued at June 30, 2013 and December 31, 2012, respectively; 102,710,286 and 46,265,286 shares outstanding at June 30, 2013 and December 31, 2012, respectively	102,710	47,720
Treasury stock, at cost 0 and 1,454,079 shares at June 30, 2013 and December 31, 2012, respectively		(1,454)
Additional paid-in capital	253,274,749	226,696,863
Accumulated other comprehensive loss	(8,838)	(2,194)
Deficit accumulated during the development stage	(195,470,580)	(184,948,541)
Total stockholders equity	57,898,041	41,792,394

Total liabilities and stockholders equity	$ 63,836,085	$ 46,971,815

See accompanying notes to unaudited condensed consolidated financial statements.

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Mast Therapeutics, Inc. and Subsidiaries

(A Development Stage Enterprise)

Condensed Consolidated Statements of Operations and Comprehensive Income/(Loss)

(Unaudited)

	Three months ended June 30,		Six months ended June 30,		Inception (June 12, 1996) through
	2013	2012	2013	2012	June 30, 2013
Revenues:					
Net sales	$	$	$	$	$ 174,830
Licensing revenue					1,300,000
Grant revenue					618,692
Total net revenues					2,093,522
Cost of goods sold					51,094
Gross margin					2,042,428
Operating expenses:					
Research and development	2,836,935	2,107,861	6,279,847	4,318,315	92,337,303
Selling, general and administrative	2,099,925	1,871,059	4,212,631	3,916,297	71,879,343
Transaction-related expenses	7,500	205,899	35,000	91,511	706,652
Depreciation and amortization	8,879	36,739	18,674	66,931	11,043,909
Write-off of in-process research and development					10,422,130
Goodwill impairment					5,702,130
Equity in loss of investee					178,936
Total operating expenses	4,953,239	4,221,558	10,546,152	8,393,054	192,270,403
Loss from operations	(4,953,239)	(4,221,558)	(10,546,152)	(8,393,054)	(190,227,975)
Reduction of fair value of warrants					(12,239,688)
Interest income	10,895	19,285	25,311	37,953	4,857,519
Interest expense					(191,729)
Other income (expense), net	1,172	(8,890)	(1,198)	(8,579)	128,507
Loss before cumulative effect of change in accounting principle	(4,941,172)	(4,211,163)	(10,522,039)	(8,363,680)	(197,673,366)
Cumulative effect of change in accounting principle					(25,821)
Net loss	(4,941,172)	(4,211,163)	(10,522,039)	(8,363,680)	(197,699,187)
Preferred stock dividends					(621,240)
Deemed dividends on preferred stock					(10,506,683)
Net loss applicable to common stock	$ (4,941,172)	$ (4,211,163)	$ (10,522,039)	$ (8,363,680)	$ (208,827,110)
Net loss per common share basic and diluted	$ (0.09)	$ (0.09)	$ (0.21)	$ (0.18)	

Weighted average shares outstanding	basic and diluted	53,749,791	47,715,709	50,028,214	47,715,709	
Comprehensive Income/(Loss):						
Net loss		$ (4,941,172)	$ (4,211,163)	$ (10,522,039)	$ (8,363,680)	$ (197,699,187)
Other comprehensive gains (losses)		1,804	(136)	(6,644)	3	(8,838)
Comprehensive loss		$ (4,939,368)	$ (4,211,299)	$ (10,528,683)	$ (8,363,677)	$ (197,708,025)

See accompanying notes to unaudited condensed consolidated financial statements.

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Mast Therapeutics, Inc. and Subsidiaries

(A Development Stage Enterprise)

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six months ended June 30,		Inception (June 12, 1996) through
	2013	2012	June 30, 2013
Cash flows from operating activities:			
Net loss	$ (10,522,039)	$ (8,363,680)	$ (197,699,187)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	18,674	66,931	10,593,911
Loss on disposals of equipment	99,875	4,503	161,190
Loss on fair value of warrants			12,239,688
Loss/(gain) on change in fair value of contingent consideration	35,000	91,511	(1,493,907)
Amortization of debt discount			450,000
Forgiveness of employee receivable			30,036
Impairment loss write-off of goodwill			5,702,130
Share-based compensation expense related to employee stock options and restricted stock issued	716,693	714,329	12,266,017
Expenses related to options issued to non-employees			204,664
Expenses paid by issuance of common stock			1,341,372
Expenses paid by issuance of warrants			573,357
Expenses paid by issuance of preferred stock			142,501
Expenses related to stock warrants issued			612,000
Equity in loss of investee			178,936
In-process research and development			10,422,130
Write-off of license agreement			152,866
Impairment of equipment		300,114	510,739
Cumulative effect of change in accounting principle			25,821
Amortization of premium / (accretion of discount) on investments in securities		18,883	(1,571,502)
Changes in assets and liabilities, net of effect of acquisitions:			
Increase in prepaid expenses and other assets	(31,526)	(283,368)	(987,385)
Increase in accounts payable and accrued liabilities	523,693	46,610	2,818,871
Net cash used in operating activities	(9,159,630)	(7,404,167)	(143,325,752)
Cash flows from investing activities:			
Purchases of certificates of deposit	(3,984,000)	(8,859,000)	(27,967,179)
Proceeds from maturities of certificates of deposit	9,538,000	2,856,000	18,981,330
Proceeds from sale of certificate of deposit			248,000
Purchases of other short-term investments			(111,183,884)
Proceeds from maturities and sales of other short-term investments			113,036,378
Purchases of property and equipment	(17,176)	(205,916)	(1,753,980)
Proceeds from sale of property and equipment			66,920
Cash paid for acquisitions, net of cash acquired			32,395
Payment on obligation under license agreement			(106,250)
Issuance of note receivable related party			(35,000)

Payments on note receivable			405,993
Advance to investee			(90,475)
Cash transferred in rescission of acquisition			(19,475)
Cash received in rescission of acquisition			230,000
Net cash provided by/(used in) investing activities	5,536,824	(6,208,916)	(8,155,227)

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Cash flows from financing activities:			
Proceeds from sale of common stock	28,097,500		151,756,371
Proceeds from exercise of stock options			714,561
Proceeds from sale or exercise of warrants			14,714,258
Proceeds from sale of preferred stock			44,474,720
Repurchase of Subject to Vesting Shares			(1,454)
Repurchase of warrants			(55,279)
Payments for financing and offering costs	(2,001,599)		(15,898,966)
Payments on notes payable and long-term debt			(605,909)
Proceeds from issuance of notes payable and detachable warrants			1,344,718
Cash paid in lieu of fractional shares for reverse stock split			(146)
Net cash provided by financing activities	26,095,901		196,442,874
Effect of exchange rate changes on cash	(1,299)		10,341
Net increase/(decrease) in cash and cash equivalents	22,471,796	(13,613,083)	44,972,236
Cash and cash equivalents at beginning of period	22,500,440	43,569,947	
Cash and cash equivalents at end of period	$ 44,972,236	$ 29,956,864	$ 44,972,236

See accompanying notes to unaudited condensed consolidated financial statements.

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Mast Therapeutics, Inc. and Subsidiaries

(A Development Stage Enterprise)

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

Mast Therapeutics, Inc., a Delaware corporation (Mast Therapeutics, we or our company), prepared the unaudited interim condensed consolidated financial statements included in this report in accordance with United States generally accepted accounting principles (U.S. GAAP) for interim financial information and the rules and regulations of the Securities and Exchange Commission (SEC) related to quarterly reports on Form 10-Q. Accordingly, they do not include all of the information and disclosures required by U.S. GAAP for annual audited financial statements and should be read in conjunction with our audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the SEC on March 19, 2013 (2012 Annual Report). The condensed consolidated balance sheet as of December 31, 2012 included in this report has been derived from the audited consolidated financial statements included in the 2012 Annual Report. In the opinion of management, these condensed consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows for the periods presented. The results of operations for the interim periods shown in this report are not necessarily indicative of the results that may be expected for any future period, including the full year.

We are a biopharmaceutical company focused on developing therapies for serious or life-threatening diseases. We have devoted substantially all of our resources to research and development (R&D), and acquisition of our product candidates. We have not yet marketed or sold any products or generated any significant revenue. Through our acquisition of SynthRx, Inc. in 2011, we acquired our Membrane Adhesion & Sealant Technology (MAST) platform, which includes proprietary poloxamer-related data and know-how derived from over two decades of clinical, nonclinical and manufacturing experience, and we are leveraging the MAST platform to develop MST-188 for diseases and conditions characterized by microcirculatory insufficiency.

In prior years, we were developing Exelbine and ANX-514, both of which are investigational oncology programs, but, beginning in 2012, we have focused our resources almost exclusively on development of MST-188.

In March 2013, we merged our wholly-owned subsidiary, Mast Therapeutics, Inc., with and into us and changed our name from ADVENTRX Pharmaceuticals, Inc. to Mast Therapeutics, Inc. The merger had no effect on our financial statements.

Certain prior year amounts have been reclassified in the condensed consolidated financial statements to conform to the current year presentation. These reclassifications were not material and had no effect on previously reported results of operations.

2. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates, including estimates related to R&D expenses and share-based compensation expenses. We base our estimates on historical experience and various other relevant assumptions we believe to be reasonable under the circumstances. Actual results may differ from these estimates.

3. Acquisition of SynthRx

On February 12, 2011, we entered into an agreement and plan of merger (the Merger Agreement) to acquire SynthRx, Inc. (SynthRx), a privately-held Delaware corporation, in exchange for shares of our common stock as described below. The transaction was completed on April 8, 2011 and SynthRx became a wholly-owned subsidiary of Mast Therapeutics. As consideration for the transaction, all shares of SynthRx common stock outstanding immediately prior to the effective time of the merger were cancelled and automatically converted into the right to receive shares of our common stock, in the aggregate, as follows:

(i) 862,078 shares of our common stock, which were issued on April 8, 2011 (the Fully Vested Shares) and represent 1,000,000 shares less 137,922 shares that were deducted as a result of certain expenses of SynthRx;

(ii) up to 1,938,773 shares of our common stock (the Subject to Vesting Shares, and together with the Fully Vested Shares, the Closing Shares), which were issued on April 8, 2011 subject to various repurchase rights by us that were triggered based on the timing and circumstances of achievement of the First Milestone (defined below);

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(iii) up to 1,000,000 shares of our common stock (the First Milestone Shares) issuable upon achievement of the First Milestone;

(iv) 3,839,400 shares of our common stock (the Second Milestone Shares) issuable upon achievement of the Second Milestone (defined below); and

(v) 8,638,650 shares of our common stock (the Third Milestone Shares, and together with the First Milestone Shares and the Second Milestone Shares, the Milestone Shares) issuable upon achievement of the Third Milestone (defined below).

The First Milestone was defined in the Merger Agreement as the dosing of the first patient in a phase 3 clinical study carried out pursuant to a protocol that is mutually agreed to by SynthRx and Mast Therapeutics; provided, however, that the number of evaluable patients planned to target statistical significance with a p value of 0.01 in the primary endpoint shall not exceed 250 unless otherwise mutually agreed (the First Protocol). If the U.S. Food and Drug Administration (FDA) indicates that a single phase 3 clinical study will not be adequate to support approval of a new drug application covering the use of purified poloxamer 188 for the treatment of sickle cell crisis in children (the 188 NDA), First Milestone shall mean the dosing of the first patient in a phase 3 clinical study carried out pursuant to a protocol that (a) is mutually agreed to by SynthRx and Mast Therapeutics as such and (b) describes a phase 3 clinical study that the FDA has indicated may be sufficient, with the phase 3 clinical study described in the First Protocol, to support approval of the 188 NDA. We considered the dosing of the first patient in the EPIC (Evaluation of Purified 188 In Children) study, our phase 3 study of MST-188 in sickle cell disease, to be the First Milestone.

The Subject to Vesting Shares were issued subject to a repurchase option that provided us the right to repurchase up to approximately 75% of the Subject to Vesting Shares, or 1,454,079 shares, for $0.001 per share based on the timing of achievement of the First Milestone and whether and the extent to which the number of evaluable patients planned to target statistical significance with a p value of 0.01 in the primary endpoint exceeds 250 patients, unless otherwise agreed.

Under the Merger Agreement, the number of shares issuable upon achievement of the First Milestone was subject to reduction by up to 75%, or 750,000 shares, based on the timing of achievement of the First Milestone and whether and the extent to which the number of evaluable patients planned to target statistical significance with a p value of 0.01 in the primary endpoint exceeded 250 patients, unless otherwise agreed.

The Second Milestone means the FDA s acceptance of the 188 NDA for review, and the Third Milestone means the approval by the FDA of the 188 NDA. Although issuance of the Second Milestone Shares and the Third Milestone Shares is contingent upon achievement of the Second Milestone and Third Milestone, respectively, the number of shares issuable upon achievement of each of those milestones is fixed.

Based on the estimated fair value of the Closing Shares and the Milestone Shares as of April 8, 2011, the acquisition date, the total purchase price was approximately $6.7 million.

Acquired In-Process Research and Development

Our acquired IPR&D was the estimated fair value as of the acquisition date of MST-188, which was SynthRx s lead product candidate. We determined that the estimated fair value of the MST-188 program was $6.5 million as of the acquisition date using the Multi-Period Excess Earnings Method, or MPEEM, which is a form of the income approach. Under the MPEEM, the fair value of an intangible asset is equal to the present value of the asset s incremental after-tax cash flows (excess earnings) remaining after deducting the market rates of return on the estimated value of contributory assets (contributory charge) over its remaining useful life.

To calculate fair value of the MST-188 program under the MPEEM, we used probability-weighted cash flows discounted at a rate considered appropriate given the significant inherent risks associated with drug development by development-stage companies. Cash flows were calculated based on estimated projections of revenues and expenses related to MST-188 in sickle cell disease and then reduced by a contributory charge on requisite assets employed. Contributory assets included debt-free working capital, net fixed assets and assembled workforce. Rates of return on the contributory assets were based on rates used for comparable market participants. Cash flows were assumed to extend through the market exclusivity period estimated to be provided by orphan drug designation. The resultant cash flows were then discounted to present value using a weighted-average cost of equity capital for companies with profiles substantially similar to that of SynthRx, which we believe represents the rate that market participants would use to value the assets. We compensated for the phase of development of this program by applying a probability factor to our estimation of the expected future cash flows. The projected cash flows were based on significant assumptions, such as the time and resources needed to complete the development and approval of MST-188 in sickle cell disease, estimates of revenue and operating profit related to the program considering its stage of development, the life of the potential commercialized product and associated risks, including the inherent difficulties and uncertainties in drug development, such as obtaining marketing approval from the FDA and other regulatory agencies, and risks related to the viability of and potential alternative treatments in any future target markets.

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We test our acquired IPR&D for impairment annually (and between annual tests if we become aware of an event or a change in circumstances that would indicate the carrying amount may be impaired) in accordance with Accounting Standards Codification (ASC) Topic 350, *Intangibles Goodwill and Other* and Accounting Standards Update (ASU) No. 2012-02, *Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. We perform our annual indefinite-lived intangible assets impairment testing as of September 30 of each year. As of September 30, 2012, no impairment was noted. There were no events or changes in circumstances during the three months ended June 30, 2013 that we considered indications of impairment of our acquired IPR&D.

Goodwill

A value of $3.0 million, representing the difference between the total purchase price and the aggregate fair values of tangible and intangible assets acquired, less liabilities assumed, was recorded as goodwill. We acquired SynthRx to expand our product pipeline, enter into new therapeutic areas and address unmet market needs. These are among the factors that contributed to a purchase price for the SynthRx acquisition that resulted in the recognition of goodwill.

We test our goodwill for impairment annually (and between annual tests if we become aware of an event or a change in circumstances that would indicate the carrying amount may be impaired) in accordance with ASC Topic 350, *Intangibles Goodwill and Other*, and ASU No. 2011-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. We perform our annual goodwill impairment testing as of September 30 of each year. As of September 30, 2012, no impairment was noted. For the quarter ended December 31, 2012, we determined that the persistently low trading price of our common stock, even after announcement during that quarter of our phase 3 clinical development plans for MST-188 in sickle cell disease, may be an indicator of impairment of our goodwill and we performed an impairment test as of December 31, 2012. Through Step 1 of the two-step quantitative impairment test, we concluded that, as of December 31, 2012, our goodwill was not impaired. There were no events or changes in circumstances during the three months ended June 30, 2013 that we considered indications of impairment of our goodwill.

Deferred Income Tax Liability

The $2.6 million recorded for deferred income tax liability resulting from the acquisition reflects the tax impact of the difference between the book basis and tax basis of acquired IPR&D. Such deferred income tax liability cannot be used to offset deferred tax assets when analyzing our end of year valuation allowance as the acquired IPR&D is considered to have an indefinite life until we complete or abandon development of MST-188.

Contingent Consideration

The Milestone Shares and 1,454,079 of the Subject to Vesting Shares were considered contingent consideration at the acquisition date because our obligation to issue the Milestone Shares and our repurchase rights with respect to 1,454,079 of the Subject to Vesting Shares were contingent on future events. To determine the classification of the fair value of this contingent consideration as a liability or equity, we reviewed ASC Topic 815-40, *Derivatives and Hedging Contracts in Entity s Own Equity* (ASC 815-40), which requires that contingent consideration arrangements that include potential net cash settlements or variable provisions be classified as a liability (or an asset, as applicable). Such classification requires a fair value measurement initially and subsequently at each reporting date. Changes in the fair value of contingent consideration classified as a liability or an asset are recognized in earnings until the contingent consideration arrangement is settled. Classification as equity requires fair value measurement initially and there are no subsequent re-measurements. Settlement of equity-classified contingent consideration is accounted for within equity.

The probability-weighted fair values of the Second Milestone Shares and the Third Milestone Shares were recorded as equity as there is no net cash settlement provision and the number of shares that ultimately may be issued upon achievement of each of those milestones is fixed. However, the probability-weighted fair value of the First Milestone Shares was recorded as a contingent liability and the probability-weighted fair value of 1,454,079 of the Subject to Vesting Shares was recorded as a contingent asset because there was variability with respect to the number of shares that we ultimately would be required to issue and repurchase, respectively, based on the circumstances of achievement of the First Milestone, as described above.

The contingent asset related to the 1,454,079 Subject to Vesting Shares was eliminated, or settled, in December 2012 by our exercise in full of our repurchase option and purchase of the 1,454,079 shares from the former SynthRx stockholders for $0.001 per share.

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The contingent liability related to the First Milestone Shares was settled in May 2013 with achievement of the First Milestone and our subsequent issuance of 250,000 of the First Milestone Shares. In accordance with ASC 815-40, we remeasured the contingent liability as of its settlement date, which remeasurement resulted in $7,500 of transaction-related expenses for the three-month period ended June 30, 2013.

4. Short-Term Investments

We consider income-yielding securities that can be readily converted to cash and have original maturities of more than three months and one year or less at the date of purchase to be short-term investments. All of our short-term investments are marketable securities under the custodianship of a major financial institution and consist primarily of FDIC-insured certificates of deposit.

We account for and report our short-term investments in accordance with ASC Topic 320, *Accounting for Certain Investments in Debt and Equity Securities*. Our short-term investments are classified as available-for-sale securities and carried at fair value. Fair value for securities with short maturities and infrequent secondary market trades is typically determined by using a curve-based evaluation model that utilizes quoted prices for similar securities. The evaluation model takes into consideration the days to maturity, coupon rate and settlement date convention. Net unrealized gains or losses on these securities are included in accumulated other comprehensive loss, which is a separate component of stockholders equity. Realized gains and realized losses are included in other income/(expense), while amortization of premiums and accretion of discounts are included in interest income. Interest and dividends on available-for-sale securities are included in interest income. Marketable securities are evaluated periodically for impairment. If we determine that a decline in market value of any investment is other than temporary, then the investment basis would be written down to fair value and the decline in value would be charged to earnings.

At June 30, 2013, the fair value of our short-term investments was $8,450,318. The cost basis of such investments was $8,457,000 and our unrealized losses were $6,682.

5. Fair Value of Financial Instruments

Our short-term investments are and, prior to its settlement, our contingent liability was carried at fair value. The fair value of financial assets and liabilities is measured under a framework that establishes levels which are defined as follows: (i) Level 1 fair value is determined from observable, quoted prices in active markets for identical assets or liabilities; (ii) Level 2 fair value is determined from quoted prices for similar items in active markets or quoted prices for identical or similar items in markets that are not active; and (iii) Level 3 fair value is determined using the entity s own assumptions about the inputs that market participants would use in pricing an asset or liability.

The fair value at June 30, 2013 of our short-term investments is summarized in the following table:

	June 30, 2013			
	Total Fair Value	Fair Value Determined Under: (Level 1)	(Level 2)	(Level 3)
Short-term investments	$ 8,450,318	$	$ 8,450,318	$

The contingent liability was settled in May 2013. A reconciliation of the contingent liability for the six months ended June 30, 2013 is as follows:

	Six months ended June 30, 2013
Balance at December 31, 2012	$ (142,500)
Settlements	177,500
Total net unrealized losses included in earnings	(35,000)
Balance at June 30, 2013	$ 0

The fair value of the contingent liability was measured and recorded on a recurring basis using significant unobservable inputs (Level 3). At each remeasurement date until the contingent arrangement was settled, we determined the fair value of the contingent liability based on the market price of our common stock on the measurement date and our estimate of the number of First Milestone Shares we would issue, which was based on our estimate of the probability of achievement of the First Milestone and assumptions regarding the circumstances under which it would be achieved. As discussed in Note 3, the contingent liability was settled in May 2013 and we issued 250,000 of the First Milestone Shares. The remeasurement of the fair value of the contingent liability as of its settlement date resulted in the recognition of $7,500 in transaction-related expenses for the three months ended June 30, 2013.

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6. Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Property and equipment are depreciated using the straight-line method over the estimated useful lives of the assets, which generally is three to five years. Leasehold improvements are amortized over the economic life of the asset or the lease term, whichever is shorter.

In connection with our determination in 2012 to discontinue independent development of ANX-514, we assessed the classification and recoverability, at the end of each fiscal quarter, of certain equipment held and used in research and development-related manufacturing of ANX-514 (the ANX-514 equipment) by our contract manufacturer. The original cost of the ANX-514 equipment was $0.6 million. We determined, based on an independent appraisal, that the carrying amount of the ANX-514 equipment exceeded its estimated fair value and was not recoverable. For the year ended December 31, 2012, we recorded an impairment loss of $0.4 million, which was the difference between the carrying amount and estimated fair value at December 31, 2012, as a research and development expense in our consolidated statement of operations and comprehensive income/(loss). The ANX-514 equipment was not classified separately as held for sale as of December 31, 2012 because the criteria for that classification, as set forth in ASC Topic 360-10, *Property, Plant and Equipment Overall*, were not met.

In April 2013, in connection with reaching an agreement with our contract manufacturer regarding final payment for ANX-514 research-related manufacturing activities, we agreed to assign ownership of the ANX-514 equipment to the contract manufacturer. Accordingly, we disposed of and wrote-off the carrying amount of $99,875 of the ANX-514 equipment in April 2013.

7. Accrued Liabilities

Accrued liabilities at June 30, 2013 and December 31, 2012 were as follows:

	June 30, 2013	December 31,