

CYTRX CORP  
Form 10-Q  
May 19, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

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

**For the quarterly period ended March 31, 2008**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-15327**

**CytRx Corporation**

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or  
organization)

**58-1642740**

(I.R.S. Employer Identification No.)

**11726 San Vicente Blvd., Suite 650**

**Los Angeles, CA**

(Address of principal executive offices)

**90049**

(Zip Code)

**(310) 826-5648**

(Registrant'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  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. (Check one):

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

(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12(b)-2 of the Exchange Act).

Yes  No

Number of shares of CytRx Corporation Common Stock, \$.001 par value, issued and outstanding as of May 16, 2008: 90,770,453, exclusive of treasury shares.

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CONDENSED CONSOLIDATED BALANCE SHEETS**

|                                                                                                                                                                           | <b>March 31,<br/>2008<br/>(Unaudited)</b> | <b>December 31,<br/>2007</b> |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------|
| <b>ASSETS</b>                                                                                                                                                             |                                           |                              |
| Current assets:                                                                                                                                                           |                                           |                              |
| Cash and cash equivalents                                                                                                                                                 | \$ 43,538,946                             | \$ 50,498,261                |
| Short-term investments, at amortized cost                                                                                                                                 |                                           | 9,951,548                    |
| Accounts receivable                                                                                                                                                       |                                           | 101,217                      |
| Prepaid expense and other current assets                                                                                                                                  | 1,101,651                                 | 930,596                      |
| Total current assets                                                                                                                                                      | 44,640,597                                | 61,481,622                   |
| Equipment and furnishings, net                                                                                                                                            | 1,349,548                                 | 1,573,290                    |
| Molecular library, net                                                                                                                                                    | 182,017                                   | 193,946                      |
| Investment in unconsolidated subsidiary                                                                                                                                   | 3,536,614                                 |                              |
| Goodwill                                                                                                                                                                  | 183,780                                   | 183,780                      |
| Other assets                                                                                                                                                              | 647,055                                   | 713,398                      |
| Total assets                                                                                                                                                              | \$ 50,539,611                             | \$ 64,146,036                |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                                                                                                                                |                                           |                              |
| Current liabilities:                                                                                                                                                      |                                           |                              |
| Accounts payable                                                                                                                                                          | \$ 721,093                                | \$ 1,946,215                 |
| Accrued expenses and other current liabilities                                                                                                                            | 2,699,777                                 | 3,700,866                    |
| Income taxes payable                                                                                                                                                      | 342,000                                   |                              |
| Deferred revenue, current portion                                                                                                                                         | 8,207,492                                 | 8,399,167                    |
| Total current liabilities                                                                                                                                                 | 11,970,362                                | 14,046,248                   |
| Deferred revenue, non-current portion                                                                                                                                     | 5,177,967                                 | 7,167,381                    |
| Total liabilities                                                                                                                                                         | 17,148,329                                | 21,213,629                   |
| Minority interest                                                                                                                                                         |                                           | 2,708,368                    |
| Commitments and Contingencies                                                                                                                                             |                                           |                              |
| Stockholders equity:                                                                                                                                                      |                                           |                              |
| Preferred Stock, \$.01 par value, 5,000,000 shares authorized, including 15,000 shares of Series A Junior Participating Preferred Stock; no shares issued and outstanding | 91,374                                    | 90,398                       |

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Common stock, \$.001 par value, 150,000,000 shares authorized; 91,374,269 and 90,397,867 shares issued at March 31, 2008 and December 31, 2007, respectively

|                                                                                                     |               |               |
|-----------------------------------------------------------------------------------------------------|---------------|---------------|
| Additional paid-in capital                                                                          | 206,089,009   | 203,905,691   |
| Treasury stock, at cost (633,816 shares held at March 31, 2008 and December 31, 2007, respectively) | (2,279,238)   | (2,279,238)   |
| Accumulated deficit                                                                                 | (170,509,863) | (161,492,812) |
| Total stockholders' equity                                                                          | 33,391,282    | 40,224,039    |
| Total liabilities and stockholders' equity                                                          | \$ 50,539,611 | \$ 64,146,036 |

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

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**CYTRX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

|                                                                     | <b>Three Months Ended</b> |                |
|---------------------------------------------------------------------|---------------------------|----------------|
|                                                                     | <b>March 31,</b>          |                |
|                                                                     | <b>2008</b>               | <b>2007</b>    |
| Revenue:                                                            |                           |                |
| Service revenue                                                     | \$ 2,181,088              | \$ 1,446,993   |
| Grant revenue                                                       |                           | 116,070        |
|                                                                     | 2,181,088                 | 1,563,063      |
| Expenses:                                                           |                           |                |
| Research and development                                            | 3,191,713                 | 4,008,374      |
| General and administrative                                          | 4,473,149                 | 2,485,085      |
|                                                                     | 7,664,862                 | 6,493,459      |
| Loss before other income                                            | (5,483,774)               | (4,930,396)    |
| Other income:                                                       |                           |                |
| Interest income                                                     | 524,271                   | 382,614        |
| Other income, net                                                   | 218,229                   |                |
| Equity in loss of unconsolidated subsidiary                         | (378,898)                 |                |
| Minority interest in losses of subsidiary                           | 88,374                    | 2,000          |
| Net loss before income taxes                                        | (5,031,798)               | (4,545,782)    |
| Provision for income taxes                                          | (342,000)                 |                |
| Net loss                                                            | (5,373,798)               | (4,545,782)    |
| Deemed dividend for anti-dilution adjustment made to stock warrants | (756,954)                 |                |
| Net loss applicable to common stockholders                          | \$ (6,130,752)            | \$ (4,545,782) |
| Basic and diluted loss per share                                    | \$ (0.07)                 | \$ (0.06)      |
| Weighted average shares outstanding                                 | 90,280,449                | 73,273,746     |

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

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**CYTRX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

|                                                                        | <b>Three Months Ended March 31,</b> |                |
|------------------------------------------------------------------------|-------------------------------------|----------------|
|                                                                        | <b>2008</b>                         | <b>2007</b>    |
| <b>Cash flows from operating activities:</b>                           |                                     |                |
| Net loss                                                               | \$ (5,373,798)                      | \$ (4,545,782) |
| Adjustments to reconcile net loss to net used in operating activities: |                                     |                |
| Depreciation and amortization                                          | 133,052                             | 71,353         |
| Equity in loss of unconsolidated subsidiary                            | 378,898                             |                |
| Minority interest in losses of subsidiary                              | (88,374)                            | (2,000)        |
| RXi common stock transferred for services                              | 244,860                             |                |
| Non-cash earned on short-term investments                              | (48,452)                            |                |
| Non-cash gain on transfer of RXi common stock                          | (226,579)                           |                |
| Common stock, stock options and warrants issued for services           |                                     | 975,545        |
| Expense related to employee stock options                              | 555,093                             | 148,812        |
| Net change in operating assets and liabilities                         | (2,898,342)                         | (1,741,723)    |
| <br>                                                                   |                                     |                |
| Total adjustments                                                      | (1,949,844)                         | (548,013)      |
| <br>                                                                   |                                     |                |
| Net cash used in operating activities                                  | (7,323,642)                         | (5,093,795)    |
| <br>                                                                   |                                     |                |
| <b>Cash flows from investing activities:</b>                           |                                     |                |
| Purchases of equipment and furnishings                                 | (223,203)                           | (2,501)        |
| Deconsolidation of subsidiary, RXi Pharmaceutical Corporation          | (10,359,278)                        |                |
| Proceeds from sale of short-term investments                           | 10,000,000                          |                |
| <br>                                                                   |                                     |                |
| Net cash used in investing activities                                  | (582,481)                           | (2,501)        |
| <br>                                                                   |                                     |                |
| <b>Cash flows from financing activities:</b>                           |                                     |                |
| Proceeds from exercise of stock options and warrants                   | 946,808                             | 11,064,892     |
| Net proceeds from issuances of common stock in subsidiary              |                                     | 2,000          |
| <br>                                                                   |                                     |                |
| Net cash provided by financing activities                              | 946,808                             | 11,066,892     |
| <br>                                                                   |                                     |                |
| Net increase (decrease) in cash and cash equivalents                   | (6,959,315)                         | 5,970,596      |
| Cash and cash equivalents at beginning of period                       | 50,498,261                          | 30,381,393     |
| <br>                                                                   |                                     |                |
| Cash and cash equivalents at end of period                             | \$ 43,538,946                       | \$ 36,351,989  |
| <br>                                                                   |                                     |                |
| <b>Supplemental disclosure of cash flow information:</b>               |                                     |                |
| Cash received during the period as interest income                     | \$ 524,271                          | \$ 382,614     |

**Supplemental schedule of non-cash investing and financing activities:**

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As the result of the stock dividend on March 6, 2008, the Company deconsolidated its previously majority-owned subsidiary. As part of the transaction, the Company deconsolidated \$3.7 million of total assets and \$4.6 million of total liabilities.

In connection with the Company's adjustment to the terms of certain outstanding warrants on March 6, 2008, the Company recorded a deemed dividend of approximately \$757,000 in the three months ended March 31, 2008. The deemed dividend was recorded as a charge to accumulated deficit and a corresponding credit to additional paid-in capital.

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



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**CYTRX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2008**  
**(Unaudited)**

**1. Description of Company and Basis of Presentation**

CytRx Corporation ( CytRx, the Company, we, us or our ) is a clinical-stage biopharmaceutical company engaged in developing human therapeutic products based primarily upon its small-molecule molecular chaperone amplification technology. Molecular chaperone proteins occur normally in human cells and are key components of the body's defenses against potentially toxic mis-folded cellular proteins. Since these toxic proteins called aggregates are thought to play a role in many diseases, the Company believes that amplification of molecular chaperone proteins could have therapeutic efficacy for a broad range of indications. Currently, the Company is using its chaperone amplification technology to discover and develop potential treatments for a number of indications, including neurodegenerative disorders and diabetic complications.

Through February 2008, the Company owned a majority of the outstanding shares of common stock of RXi Pharmaceuticals Corporation, or RXi, which was founded in April 2006 by the Company and four researchers in the field of RNAi, including Dr. Craig Mello, recipient of the 2006 Nobel Prize for Medicine for his co-discovery of RNAi. RNAi is a naturally occurring mechanism for the regulation of gene expression that has the potential to selectively inhibit the activity of any human gene. RXi is focused solely on developing and commercializing therapeutic products based upon RNAi technologies for the treatment of human diseases, including neurodegenerative diseases, cancer, type 2 diabetes and obesity. While RXi was majority-owned, the Company's consolidated financial statements reflected 100% of the assets and liabilities and results of operations of RXi, with the interests of the minority shareholders of RXi recorded as minority interests. In March 2008, the Company distributed to its stockholders approximately 36% of RXi's outstanding shares, which reduced CytRx's ownership to less than 50% of RXi. As a result of the reduced ownership, CytRx began to account for its investment in RXi using the equity method, under which CytRx records only its pro-rata share of the financial results of RXi against its historical basis investment in RXi. The investment in RXi is shown as investment in unconsolidated subsidiary on the consolidated balance sheet and the related earnings are shown as equity in loss of unconsolidated subsidiary on the consolidated statements of operations. Because only a portion of RXi's financial results for March 2008 were recorded by CytRx under the equity method, the Company's results of operations for the first quarter of 2008 are not directly comparable to results of operations for the same period in 2007. The future results of operations of the Company also will not be directly comparable to corresponding periods in prior years during which our financial statements reflected the consolidation of RXi.

To date, the Company has relied primarily upon sales of its equity securities and upon proceeds received upon the exercise of options and warrants and, to a much lesser extent, upon payments from its strategic partners and licensees, to generate funds needed to finance its business and operations. See Note 6 Liquidity and Capital Resources.

In August 2006, the Company received approximately \$24.3 million in proceeds from the privately-funded ALS Charitable Remainder Trust ( ALSCRT ) in exchange for the commitment to continue research and development of arimoclomol and other potential treatments for ALS and a one percent royalty in the worldwide sales of arimoclomol. Under the arrangement, the Company retains the rights to any developments funded by the arrangement and the proceeds of the transaction are non-refundable. Further, the ALS Charitable Remainder Trust has no obligation to provide any further funding to the Company. Management has concluded that due to the research and development components of the transaction that it is properly accounted for under SFAS No. 68, *Research and Development Arrangements* ( SFAS No. 68 ). Accordingly, the Company has recorded the value received under the arrangement as deferred revenue and will recognize service revenue using the proportional performance method of revenue recognition, meaning that service revenue is recognized on a dollar-for-dollar basis for each dollar of expense incurred for the research and development of arimoclomol and other potential ALS treatments.

The accompanying condensed consolidated financial statements at March 31, 2008 and for the three-month periods ended March 31, 2008 and 2007 are unaudited, but include all adjustments, consisting of normal recurring entries, which management believes to be necessary for a fair presentation of the periods presented. Interim results are not

necessarily indicative of results for a full year. Balance sheet amounts as of December 31, 2007 have been derived from the Company's audited financial statements as of that date.

The consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial

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statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The financial statements should be read in conjunction with the Company's audited consolidated financial statements in its Form 10-K for the year ended December 31, 2007. The Company's operating results will fluctuate for the foreseeable future. Therefore, period-to-period comparisons should not be relied upon as predictive of the results in future periods.

**2. Recent Accounting Pronouncements**

In September 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not expand the use of fair value in any new circumstances. In February 2008, the FASB issued Staff Position No. FAS 157-1, which amended SFAS No. 157 to exclude SFAS No. 13, *Accounting for Leases*, and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination. Also in February 2008, the FASB issued Staff Position No. FAS 157-2, which delayed the effective date of SFAS No. 157 for non-financial assets and liabilities, except those items recognized at fair value on an annual or more frequently recurring basis to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company adopted SFAS No. 157 with no material impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS No. 159 ). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 with no material impact on the Company's consolidated financial statements.

In June 2007, the FASB ratified the consensus on Emerging Issues Task Force ( EITF ) Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* ( EITF 06-11 ). EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for non-vested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007. The Company adopted EITF 06-11 with no material impact on the Company's consolidated financial statements.

In June 2007, the FASB ratified the consensus reached on EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* ( EITF 07-3 ), which requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and amortized over the period that the goods are delivered or the related services are performed, subject to an assessment of recoverability. EITF 07-3 will be effective for fiscal years beginning after December 15, 2007. The Company adopted EITF 07-3 with no material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ( SFAS No. 160 ) and a revision to SFAS No. 141, *Business Combinations* ( SFAS No. 141R ). SFAS No. 160 modifies the accounting for noncontrolling interest in a subsidiary and the deconsolidation of a subsidiary. SFAS No. 141R establishes the measurements in a business combination of the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree. Both of these related statements are effective for fiscal years beginning after December 15, 2008. The Company has not determined the impact that the adoption of these two statements will have on the consolidated financial statements.

In December 2007, the SEC issued Staff Accounting Bulletin 110 ( SAB 110 ), which expresses the views of the Staff regarding use of a simplified method, as discussed in SAB 107, in developing an estimate of expected term of plain vanilla share options in accordance with Statement of Financial Accounting Standards No. 123. SAB 110 will allow, under certain circumstances, the use of the simplified method beyond December 31, 2007 when a Company is unable to rely on the historical exercise data. The Company adopted SAB 110 with no material impact on its financial statements.



**Table of Contents****3. Short-term Investments**

RXi had zero coupon U.S Treasury Bills that were purchased at a discount and matured within twelve months. They were classified as held-to-maturity and under Statement of Financial Accounting Standards No. 115, *Investments in Debt Securities*, were measured at amortized cost since RXi had the intent and ability to hold these securities to maturity. The interest income had been amortized at the effective interest rate.

**4. Basic and Diluted Loss Per Common Share**

Basic and diluted loss per common share are computed based on the weighted average number of common shares outstanding. Common share equivalents (which consist of options and warrants) are excluded from the computation of diluted loss per share since the effect would be antidilutive. Common share equivalents which could potentially dilute basic earnings per share in the future, and which were excluded from the computation of diluted loss per share, totaled approximately 16.2 million and 22.7 million shares at March 31, 2008 and 2007, respectively.

In connection with the Company's adjustment to the exercise terms of certain outstanding warrants to purchase common stock on March 11, 2008, the Company recorded a deemed dividend of approximately \$757,000. The deemed dividend is reflected as an adjustment to net loss for the first quarter of 2008, to arrive at net loss applicable to common stockholders on the Condensed Consolidated Statement of Operations and for purposes of calculating basic and diluted loss per share.

**5. Stock Based Compensation****CytRx Corporation**

The Company has a stock option plan, the 2000 Stock Option Incentive Plan, under which, as of March 31, 2008, an aggregate of 10,000,000 shares of common stock were reserved for issuance, including approximately 5,889,756 shares subject to outstanding stock options and approximately 2,257,032 million shares available for future grant. Additionally, the Company has two other plans, the 1994 Stock Option Plan and the 1998 Long Term Incentive Plan, which include 9,167 and 100,041 shares subject to outstanding stock options. As the terms of the plans provide that no options may be issued after 10 years, no options are available under the 1994 Plan. Under the 1998 Long Term Incentive Plan, 29,517 shares are available for future grant. Options granted under these plans generally vest and become exercisable as to 33% of the option grants on each anniversary of the grant date until fully vested. The options expire, unless previously exercised, not later than ten years from the grant date.

The Company's stock-based employee compensation plans are described in Note 12 to its financial statements contained in its Annual Report on Form 10-K filed for the year ended December 31, 2007.

The Company adopted the provisions of SFAS No. 123(R), *Share-Based Payment* ( SFAS 123(R) ), which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and non-employee directors.

For stock options paid in consideration of services rendered by non-employees, the Company recognizes compensation expense in accordance with the requirements of SFAS No. 123(R), Emerging Issues Task Force Issue No. 96-18 ( EITF 96-18 ), *Accounting for Equity Instruments that are Issued to other than Employees for Acquiring, or in Conjunction with Selling Goods or Services* and EITF 00-18, *Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees*, as amended.

Non-employee option grants that do not vest immediately upon grant are recorded as an expense over the performance period. At the end of each financial reporting period prior to performance, the value of these options, as calculated using the Black-Scholes option pricing model, will be determined, and compensation expense recognized or recovered during the period will be adjusted accordingly. Since the fair market value of options granted to non-employees is subject to change in the future, the amount of the future compensation expense is subject to adjustment until the common stock options are fully vested.

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The following table sets forth the total stock-based compensation expense (recovery) resulting from stock options included in the Company's unaudited interim consolidated statements of operations:

|                                                    | <b>Three Months Ended March<br/>31,</b> |                   |
|----------------------------------------------------|-----------------------------------------|-------------------|
|                                                    | <b>2008</b>                             | <b>2007</b>       |
| Research and development employee                  | \$ 171,000                              | \$ 37,000         |
| General and administrative employee                | 291,000                                 | 112,000           |
| <b>Total employee stock-based compensation</b>     | <b>\$ 462,000</b>                       | <b>\$ 149,000</b> |
| Research and development non-employee              | \$ (422,000)                            | \$ 695,000        |
| General and administrative non-employee            |                                         |                   |
| <b>Total non-employee stock-based compensation</b> | <b>\$ (422,000)</b>                     | <b>\$ 695,000</b> |

During the first three months of 2008, the Company issued stock options to purchase 86,000 shares of its common stock. The fair value of the stock options granted in the three-month period listed in the table below was estimated using the Black-Scholes option-pricing model, based on the following assumptions:

|                         | <b>Three Months Ended March 31,</b> |             |
|-------------------------|-------------------------------------|-------------|
|                         | <b>2008</b>                         | <b>2007</b> |
| Risk-free interest rate | 2.84%                               | 4.41%-4.89% |
| Expected volatility     | 93.8%-96.2%                         | 116.8%      |
| Expected lives (years)  | 6                                   | 6           |
| Expected dividend yield | 0.00%                               | 0.00%       |

The Company's computation of expected volatility is based on the historical daily volatility of its publicly traded stock. For option grants issued during the three-month periods ended March 31, 2008 and 2007, the Company used a calculated volatility for each grant. The Company's computation of expected life were estimated using the simplified method provided for under Staff Accounting Bulletin 107, *Share-Based Payment* (SAB 107), which averages the contractual term of the Company's options of ten years with the average vesting term of three years for an average of six years. The dividend yield assumption of zero is based upon the fact the Company has never paid cash dividends and presently has no intention of paying cash dividends. The risk-free interest rate used for each grant is equal to the U.S. Treasury rates in effect at the time of the grant for instruments with a similar expected life. Based on historical experience, for the three-month periods ended March 31, 2008 and 2007, the Company has estimated an annualized forfeiture rate of 10% and 5%, respectively, for options granted to its employees and 1% for each period for options granted to senior management and directors. Compensation costs will be adjusted for future changes in estimated forfeitures. The Company will record additional expense if the actual forfeitures are lower than estimated and will record a recovery of prior expense if the actual forfeiture rates are higher than estimated. No amounts relating to employee stock-based compensation have been capitalized.

At March 31, 2008, there remained approximately \$3.6 million of unrecognized compensation expense related to unvested stock options granted to employees, directors, scientific advisory board members and consultants, to be recognized as expense over a weighted-average period of 1.55 years. Presented below is the Company's stock option activity:

|                              | <b>Three Months Ended March 31, 2008</b> |                         |  |                             |
|------------------------------|------------------------------------------|-------------------------|--|-----------------------------|
| <b>Number of<br/>Options</b> | <b>Number of<br/>Options</b>             | <b>Total<br/>Number</b> |  | <b>Weighted<br/>Average</b> |

|                                       | <b>(Employees)</b> | <b>(Non-Employees)</b> | <b>of Options</b> | <b>Exercise Price</b> |
|---------------------------------------|--------------------|------------------------|-------------------|-----------------------|
| Outstanding at January 1, 2008        | 4,594,000          | 1,397,000              | 5,991,000         | \$ 2.29               |
| Granted                               | 86,000             |                        | 86,000            | \$ 1.93               |
| Exercised                             | (25,000)           |                        | (25,000)          | \$ 0.83               |
| Forfeited                             | (162,000)          |                        | (162,000)         | \$ 2.92               |
| Outstanding at March 31, 2008         | 4,493,000          | 1,397,000              | 5,890,000         | \$ 2.27               |
| Options exercisable at March 31, 2008 | 2,944,000          | 1,147,000              | 4,091,000         | \$ 1.89               |

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A summary of the activity for non-vested stock options as of March 31, 2008 is presented below:

|                               | <b>Number of<br/>Options<br/>(Employees)</b> | <b>Number of<br/>Options<br/>(Non-Employees)</b> | <b>Total Number<br/>of<br/>Options</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair<br/>Value per<br/>Share</b> |
|-------------------------------|----------------------------------------------|--------------------------------------------------|----------------------------------------|-----------------------------------------------------------------------------|
| Non-vested at January 1, 2008 | 1,734,000                                    | 250,000                                          | 1,984,000                              | \$ 2.91                                                                     |
| Granted                       | 86,000                                       |                                                  | 86,000                                 | \$ 1.50                                                                     |
| Forfeited                     | (162,000)                                    |                                                  | (162,000)                              | \$ 2.46                                                                     |
| Vested                        | (84,000)                                     |                                                  | (84,000)                               | \$ 2.74                                                                     |
| Non-vested at March 31, 2008  | 1,574,000                                    | 250,000                                          | 1,824,000                              | \$ 2.92                                                                     |

The following table summarizes significant ranges of outstanding stock options under the Company's plans at March 31, 2008:

| <b>Range of<br/>Exercise Prices</b> | <b>Number of<br/>Options</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Life<br/>(years)</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Number of<br/>Options<br/>Exercisable</b> | <b>Weighted<br/>Average<br/>Contractual<br/>Life</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> |
|-------------------------------------|------------------------------|--------------------------------------------------------------------------------|----------------------------------------------------|----------------------------------------------|------------------------------------------------------|----------------------------------------------------|
| \$0.71 - 1.00                       | 790,000                      | 6.49                                                                           | \$ 0.81                                            | 730,000                                      | 6.49                                                 | \$ 0.81                                            |
| \$1.01 - 2.00                       | 2,362,000                    | 6.97                                                                           | \$ 1.48                                            | 1,863,000                                    | 6.97                                                 | \$ 1.52                                            |
| \$2.01 - 3.00                       | 1,130,000                    | 5.32                                                                           | \$ 2.46                                            | 1,112,000                                    | 5.32                                                 | \$ 2.46                                            |
| \$3.01 - 4.00                       | 623,000                      | 9.47                                                                           | \$ 3.42                                            | 150,000                                      | 9.47                                                 | \$ 3.34                                            |
| \$4.01 - 4.65                       | 985,000                      | 9.10                                                                           | \$ 4.42                                            | 236,000                                      | 9.10                                                 | \$ 4.45                                            |
|                                     | 5,890,000                    | 7.21                                                                           | \$ 2.27                                            | 4,091,000                                    | 7.19                                                 | \$ 1.89                                            |

The aggregate intrinsic value of outstanding options as of March 31, 2008 was approximately \$300,000, of which approximately \$270,000 was related to exercisable options. The aggregate intrinsic value was calculated based on the positive difference between the closing fair market value of the Company's common stock on March 31, 2008 (\$1.15) and the exercise price of the underlying options. The intrinsic value of options exercised was \$8,000 for the three-month period ended March 31, 2008, and the intrinsic value of options that vested was approximately \$11,000 for the same period.

**RXi Pharmaceuticals**

RXi has its own stock option plan named the RXi Pharmaceuticals Corporation 2007 Incentive Plan. They account for stock option expense in the same manner as CytRx, which is described above.

The following table sets forth the total stock-based compensation expense for January and February 2008, resulting from stock options, that is included in the Company's unaudited condensed consolidated statements of operations:

|                                   | <b>Three Months Ended March<br/>31,</b> |             |
|-----------------------------------|-----------------------------------------|-------------|
|                                   | <b>2008</b>                             | <b>2007</b> |
| Research and development employee | \$ 28,000                               | \$          |



|                                             |            |    |
|---------------------------------------------|------------|----|
| General and administrative employee         | 369,000    |    |
| Total employee stock-based compensation     | \$ 397,000 | \$ |
| Research and development non-employee       | \$ 121,000 | \$ |
| General and administrative non-employee     |            |    |
| Total non-employee stock-based compensation | \$ 121,000 | \$ |

## 6. Liquidity and Capital Resources

At March 31, 2008, the Company had cash and cash equivalents of \$43.5 million. Management believes that the Company has adequate financial resources to support its currently planned level of operations into the second half of 2009, based, in part, upon projected expenditures for the remainder of 2008 and the first three months of 2009 of \$31.0 million, including \$6.2 million for the Company's planned clinical program for arimoclomol for ALS and related studies, \$6.3 million for its other ongoing and planned clinical programs, including a planned Phase II clinical trial of arimoclomol in stroke patients and a planned Phase II clinical trial of irovanadine for diabetic ulcers, \$9.9 million for the operations of the Company's research laboratory in San Diego and \$8.6 million for other general and administrative expenses. Management's projected expenditures assume the prompt resumption of the Company's Phase II clinical program for arimoclomol for ALS, which has been placed on clinical hold by the U.S. Food and Drug Administration, or FDA. If the Company is required to conduct additional toxicology or human studies prior to or in parallel with the

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resumption of that clinical trial, alter the design of that trial, including by potentially reducing the dosage of arimoclomol, or is prohibited by the FDA from resuming the current planned clinical trial or initiating any other clinical trial of arimoclomol for the treatment of ALS or stroke recovery at the desired dose, or at all, due to safety concerns, then the Company's actual expenditures will vary, perhaps significantly from management's current projections. The Company will be required to obtain additional funding in order to execute its long-term business plans, although it does not currently have commitments from any third parties to provide it with capital. The Company cannot assure that additional funding will be available on favorable terms, or at all. If the Company fails to obtain additional funding when needed, it may not be able to execute its business plans and its business may suffer, which would have a material adverse effect on its financial position, results of operations and cash flows.

**7. Equity Transactions**

On March 11, 2008, the Company paid a dividend to its stockholders of approximately 36% of the outstanding shares of RXi common stock. In connection with that distribution, the Company adjusted the price of warrants to purchase approximately 10.6 million shares that had been issued in prior equity financings in October 2004, January 2005 and March 2006. The adjustment was made as a result of anti-dilution provisions in those warrants that were triggered by the Company's distribution of a portion of its assets to its stockholders. The Company accounted for the anti-dilution adjustments as deemed dividends analogous with the guidance in Emerging Issues Task Force Issue (EITF) No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, and EITF 00-27, *Application of 98-5 to Certain Convertible Instruments*, and recorded an approximate \$757,000 charge to accumulated deficit and a corresponding credit to additional paid-in capital.

On April 19, 2007, the Company completed a \$37.0 million private equity financing in which it issued approximately 8.6 million shares of its common stock at a price of \$4.30 per share. Net of investment banking commissions, legal, accounting and other expenses related to the transaction, the Company received proceeds of approximately \$34.2 million. On April 30, 2007, the Company contributed \$15.0 million, net of reimbursed expenses estimated at \$2.0 million paid by RXi to the Company, in exchange for equity in RXi, to satisfy the initial funding requirements under its agreements with the University of Massachusetts Medical School (UMMS). In September 2007, the actual reimbursed expenses paid by RXi to the Company were finally determined to be approximately \$3.0 million, and on September 25, 2007, RXi issued to CytRx additional equity as reimbursement of the excess expenses. Following those transactions, CytRx owned approximately 85% of the outstanding capital stock of RXi, of which approximately 36% was paid as a dividend to CytRx stockholders on March 11, 2008.

In connection with the April 2007 private equity financing, the Company adjusted the price and number of underlying shares of warrants to purchase approximately 1.4 million shares that had been issued in prior equity financings in May and September 2003. The adjustment was made as a result of anti-dilution provisions in those warrants that were triggered by the Company's issuance of common stock in the April 2007 financing at a price below the closing market price on the date of the transaction. For the reasons described above, the Company accounted for the anti-dilution adjustments as deemed dividends. Because the fair value of the outstanding warrants decreased as a result of the anti-dilution adjustment, no deemed dividend was recorded, and thus the Company did not record a charge to retained earnings or a corresponding credit to additional paid-in capital.

In connection with the April 2007 private equity financing, the Company entered into a registration rights agreement with the purchasers of its common stock and warrants. That agreement provides, among other things, for cash penalties, up to a maximum of 16% (approximately \$5.9 million) of the purchase price paid for the securities in the event that the Company failed to initially register or maintain the effective registration of the securities until the sooner of two years or the date on which the securities could be sold pursuant to Rule 144 of the Securities Act of 1933, as amended. The Company has evaluated the penalty provisions of the April 2007 registration rights agreement in light of FASB Staff Position No. EITF 00-19-2, *Accounting for Registration Payment Arrangements*, which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*, pursuant to which a contingent obligation must be accrued only if it is reasonably estimable and probable. In management's estimation, the contingent payments related to the registration payment arrangement are not probable to occur, and thus no amount need be accrued.

During the three-month period ended March 31, 2008, the Company issued 1.0 million shares of its common stock, and received \$0.9 million, upon the exercise of stock options and warrants. During the three-month period ended March 31, 2007, the Company issued 6.9 million shares of its common stock, and received \$11.1 million, upon the exercise of stock options and warrants.

**Table of Contents****8. Minority Interest**

Through February 2008, the Company owned approximately 85% of the outstanding shares of common stock of RXi. While RXi was majority-owned, the Company's consolidated financial statements reflected 100% of the assets and liabilities and results of operations of RXi, with the interests of the minority shareholders of RXi recorded as minority interests. In March 2008, the Company distributed to its stockholders approximately 36% of RXi's outstanding shares, which reduced CytRx's ownership to less than 50% of RXi. As a result, CytRx began to account for its investment in RXi using the equity method, under which CytRx records only its pro-rata share of the financial results of RXi against its historical basis investment in RXi. Because only a portion of RXi's financial results for March 2008 were recorded by CytRx under the equity method, the Company's results of operations for the first quarter of 2008 are not directly comparable to results of operations for the same period in 2007. The future results of operations of the Company also will not be directly comparable to corresponding periods in prior years during which our financial statements reflected the consolidation of RXi.

The Company offset \$88,000 of minority interest in losses of RXi against its net loss for the months of January and February 2008, and \$2,000 of minority interest in losses of RXi against its net loss for the three-month period ended March 31, 2007.

**9. Equity Investment in RXi**

In the first quarter of 2008, the Company distributed approximately 4.5 million shares of RXi common stock to its stockholders representing approximately 36% of RXi's outstanding shares, which reduced CytRx's ownership to approximately 49% of RXi. Management determined that the distribution of the RXi common stock to stockholders of CytRx represented a partial spin-off of RXi and accounted for the distribution of the RXi common shares at cost. As a result of its reduced ownership in RXi, CytRx began to account for its investment in RXi using the equity method, under which CytRx records only its pro-rata share of the financial results of RXi against its historical basis investment in RXi. The following table presents summarized financial information for RXi for the three months ended March 31, 2008:

|                                             | <b>Three Month<br/>Period Ended<br/>March 31,<br/>2008</b> |
|---------------------------------------------|------------------------------------------------------------|
| <b>Income Statement Data (in thousands)</b> |                                                            |
| Sales                                       | \$                                                         |
| Gross profit                                |                                                            |
| Loss from continuing operations             | (2,713)                                                    |
| Loss                                        | (2,646)                                                    |
| <br>                                        |                                                            |
| <b>Balance Sheet Data (in thousands)</b>    |                                                            |
| Current assets                              | \$ 10,179                                                  |
| Noncurrent assets                           | 401                                                        |
| Current liabilities                         | 1,774                                                      |
| Stockholders' equity                        | 8,806                                                      |

At March 31, 2008, the fair value of CytRx's ownership of 6,268,881 shares of RXi's common stock was \$59,554,000 based on the closing price of RXi's common stock on that date.

**10. Income Taxes**

On March 11, 2008, the Company distributed to our stockholders approximately 4.5 million shares of RXi common stock. We will recognize approximately a \$32.9 million gain for income tax purposes on the distribution of shares of RXi common stock, which is the amount equal to the excess of the fair market value of the stock distributed over our basis. The gain will be included in determining whether we have current year earnings and profits subject to taxation. Based upon our anticipated loss from operations for 2008 and currently available loss carryforwards, we expect to pay no regular income taxes in connection with the distribution, however, we have recorded a tax provision

of \$342,000 related to the estimated Alternative Minimum Tax resulting from this gain.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition And Results of Operations*****Forward Looking Statements***

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

All statements in this Quarterly Report, including statements in this section, other than statements of historical fact are forward-looking statements for purposes of these provisions, including statements of our current views with respect to the recent developments regarding our majority-owned subsidiary, RXi Pharmaceuticals Corporation, our business strategy, business plan and research and development activities, our future financial results, and other future events. These statements include forward-looking statements both with respect to us, specifically, and the biotechnology industry, in general. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, estimates, potential or could or the negative comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct, and actual results could differ materially from those projected or assumed in the forward-looking statements.

All forward-looking statements involve inherent risks and uncertainties, and there are or will be important factors that could cause actual results to differ materially from those indicated in these statements. We believe that these factors include, but are not limited to, those factors set forth in this Quarterly Report under the captions Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations, all of which you should review carefully. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from what we anticipate. Please consider our forward-looking statements in light of those risks as you read this Quarterly Report. We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

***Overview***

CytRx Corporation (CytRx, the Company, we, us or our) is a clinical-stage biopharmaceutical company engaged in developing human therapeutic products based primarily upon its small-molecule molecular chaperone amplification technology. Molecular chaperone proteins occur normally in human cells and are key components of the body's defenses against potentially toxic mis-folded cellular proteins. Since these toxic proteins, called aggregates, are thought to play a role in many diseases, the Company believes that amplification of molecular chaperone proteins could have therapeutic efficacy for a broad range of indications. Currently, the Company is using its chaperone amplification technology to discover and develop potential treatments for a number of indications, including neurodegenerative disorders and diabetic complications.

Through February 2008, we owned a majority of the outstanding shares of common stock of RXi Pharmaceuticals Corporation, or RXi, which was founded in April 2006 by the Company and four researchers in the field of RNAi, including Dr. Craig Mello, recipient of the 2006 Nobel Prize for Medicine for his co-discovery of RNAi. RNAi is a naturally occurring mechanism for the regulation of gene expression that has the potential to selectively inhibit the activity of any human gene. RXi is focused solely on developing and commercializing therapeutic products based upon RNAi technologies for the treatment of human diseases, including neurodegenerative diseases, cancer, type 2 diabetes and obesity. While RXi was majority-owned, the Company's consolidated financial statements reflected 100% of the assets and liabilities and results of operations of RXi, with the interests of the minority shareholders of RXi being recorded as minority interests. In March 2008, we distributed to our stockholders approximately 36% of RXi's outstanding shares, which reduced our ownership to less than 50% of RXi. As a result of the reduced ownership, CytRx began to account for its investment in RXi using the equity method, under which CytRx records only its pro-rata share of the financial results of RXi against its historical basis investment in RXi. The investment in RXi is

shown as investment in unconsolidated subsidiary on the consolidated balance sheet and the related earnings are shown as equity in loss of unconsolidated subsidiary on the consolidated statements of operations. Because only a portion of RXi's financial results for March 2008 were recorded by CytRx under the equity method, the Company's results of operations for the first quarter of 2008 are not directly comparable to results of operations for the same period in 2007. The future results of operations of the Company also will not be directly comparable to corresponding periods in prior years during which our financial statements reflected the consolidation of RXi.

In January 2008, the FDA placed a clinical hold on our Phase IIb clinical efficacy trial of arimoclomol for the treatment of ALS due to concerns relating to previous toxicology studies of arimoclomol in rats. Although we have submitted additional information to

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the FDA regarding these concerns, we cannot predict how long it may take to resolve them. Depending on the outcome of the FDA's review, we may be:

required to conduct additional toxicology or human studies prior to or in parallel with the resumption of our clinical trial, which would result in substantial additional expenses and possible significant delays in completing the clinical trial;

required to alter the design including reducing the dosage of arimoclomol, of the clinical trial, which could significantly delay the completion of the trial, increase the cost of the trial, adversely affect our ability to demonstrate the efficacy of arimoclomol in the trial or cause us to cancel the trial altogether due to one or more of these consideration; or

prohibited by the FDA from resuming our current planned clinical trial or initiating any other clinical trial of arimoclomol for the treatment of ALS or any other indication due to safety concerns.

We also planned to commence a Phase II clinical trial for arimoclomol for stroke recovery in the second half of 2008. In light of the FDA's concerns regarding toxicity of arimoclomol, our planned trial is subject to similar risks.

We have relied primarily upon proceeds from sales of our equity securities and the exercise of options and warrants, and to a much lesser extent upon payments from our strategic partners and licensees, to generate funds needed to finance our business and operations. At March 31, 2008, we had cash and cash equivalents of \$43.5 million. We believe that we have adequate financial resources to support our currently planned level of operations into the second half of 2009, based, in part, upon projected expenditures for the remainder of 2008 and the first three months of 2009 of \$31.0 million, including \$6.2 million for our planned clinical program for arimoclomol for ALS and related studies, \$6.3 million for our other ongoing and planned clinical programs, including a planned Phase II clinical trial of arimoclomol in stroke patients and a planned Phase II clinical trial of iroxanadine for diabetic ulcers, \$9.9 million for the operations of our research laboratory in San Diego and \$8.6 million for other general and administrative expenses. Our projected expenditures assume the prompt resumption of our Phase II clinical program for arimoclomol for ALS that currently is on clinical hold by the FDA. If we are required to conduct additional toxicology or human studies prior to or in parallel with the resumption of that clinical trial, alter the design of that trial, including by potentially reducing the dosage of arimoclomol, or are prohibited by the FDA from resuming the current planned clinical trial or initiating any other clinical trial of arimoclomol for the treatment of ALS or stroke recovery at the desired dose, or at all, due to safety concerns, then our actual expenditures will vary, perhaps significantly, from our current projections.

We will be required to obtain additional funding in order to execute our long-term business plans. We do not have commitments from any third parties to provide us with capital and we cannot assure that additional funding will be available on favorable terms, or at all. If we fail to obtain additional funding when needed, we may not be able to execute our business plans and our business may suffer, which would have a material adverse effect on our financial position, results of operations and cash flows.

### ***Critical Accounting Policies and Estimates***

Management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates, including those related to revenue recognition, impairment of long-lived assets, including finite lived intangible assets, research and development expenses and clinical trial expenses and stock-based compensation expense.

We base our estimates on historical experience and on various other assumptions that are believed to be 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 materially from these estimates under different assumptions or conditions.



Our significant accounting policies are summarized in Note 2 to our financial statements contained in our Annual Report on Form 10-K filed for the year ended December 31, 2007. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

**Table of Contents****Revenue Recognition**

Biopharmaceutical revenues consist of license fees from strategic alliances with pharmaceutical companies as well as service and grant revenues. Service revenues consist of contract research and laboratory consulting. Grant revenues consist of government and private grants.

Monies received for license fees are deferred and recognized ratably over the performance period in accordance with Staff Accounting Bulletin ( SAB ) No. 104, *Revenue Recognition*. Milestone payments will be recognized upon achievement of the milestone as long as the milestone is deemed substantive and we have no other performance obligations related to the milestone and collectability is reasonably assured, which is generally upon receipt, or recognized upon termination of the agreement and all related obligations. Deferred revenue represents amounts received prior to revenue recognition.

Revenues from contract research, government grants, and consulting fees are recognized over the respective contract periods as the services are performed, provided there is persuasive evidence or an arrangement, the fee is fixed or determinable and collection of the related receivable is reasonably assured. Once all conditions of the grant are met and no contingencies remain outstanding, the revenue is recognized as grant fee revenue and an earned but unbilled revenue receivable is recorded.

In August 2006, we received approximately \$24.3 million in proceeds from the privately-funded ALS Charitable Remainder Trust ( ALSCRT ) in exchange for the commitment to continue research and development of arimoclomol and other potential treatments for ALS and a one percent royalty in the worldwide sales of arimoclomol. Under the arrangement, we retain the rights to any products or intellectual property funded by the arrangement and the proceeds of the transaction are non-refundable. Further, the ALSCRT has no obligation to provide any further funding to us. We have concluded that due to the research and development components of the transaction that it is properly accounted for under Statement of Financial Accounting Standards No. 68, *Research and Development Arrangements*. Accordingly, we have recorded the value received under the arrangement as deferred service revenue and will recognize service revenue using the proportional performance method of revenue recognition, meaning that service revenue is recognized on a dollar-for-dollar basis for each dollar of expense incurred for the research and development of arimoclomol and other potential ALS treatments. We believe that this method best approximates the efforts expended related to the services provided. We adjust our estimates of expense incurred for this research and development on a quarterly basis. For the three-month periods ended March 31, 2008 and 2007, we recognized approximately \$2.2 million and \$1.4 million, respectively, of service revenue related to this transaction. Any significant change in ALS related research and development expense in any particular quarterly or annual period will result in a change in the recognition of revenue for that period and consequently affect the comparability of revenue from period to period.

The amount of deferred revenue, current portion is the amount of deferred revenue that is expected to be recognized in the next twelve months and is subject to fluctuation based upon management's estimates. Management's estimates include an evaluation of what pre-clinical and clinical trials are necessary, the timing of when trials will be performed and the estimated clinical trial expenses. These estimates are subject to changes and could have a significant effect on the amount and timing of when the deferred revenues are recognized.

**Research and Development Expenses**

Research and development expenses consist of costs incurred for direct and overhead-related research expenses and are expensed as incurred. Costs to acquire technologies, including licenses, that are utilized in research and development and that have no alternative future use are expensed when incurred. Technology developed for use in its products is expensed as incurred until technological feasibility has been established.

**Clinical Trial Expenses**

Clinical trial expenses, which are included in research and development expenses, include obligations resulting from our contracts with various clinical research organizations in connection with conducting clinical trials for our product candidates. We recognize expenses for these activities based on a variety of factors, including actual and estimated labor hours, clinical site initiation activities, patient enrollment rates, estimates of external costs and other activity-based factors. We believe that this method best approximates the efforts expended on a clinical trial with the expenses we record. We adjust our rate of clinical expense recognition if actual results differ from our estimates. If

our estimates are incorrect, clinical trial expenses recorded in any particular period could vary.

**Table of Contents*****Stock-Based Compensation***

Our share-based employee compensation plans are described in Note 5 to our interim financial statements. SFAS 123(R), *Share-Based Payment*, requires the recognition of compensation expense associated with stock option grants and other equity instruments to employees in the financial statements. We adopted SFAS 123(R) using the modified-prospective method and use the Black-Scholes valuation model for valuing share-based payments. We account for transactions in which services are received in exchange for equity instruments based on the fair value of such services received from non-employees, in accordance with SFAS 123(R), Emerging Issues Task Force Issue No. 96-18 ( EITF 96-18 ), *Accounting for Equity Instruments that are Issued to other than Employees for Acquiring, or in Conjunction with Selling Goods or Services* and EITF 00-18, *Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees*, as amended.

Non-employee share-based compensation charges generally are amortized over the vesting period on a straight-line basis. In certain circumstances, option grants to non-employees are immediately vested and have no future performance requirements by the non-employee and the total share-based compensation charge is recorded in the period of the measurement date.

The fair value of each CytRx and RXi common stock option grant is estimated using the Black-Scholes option pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the common stock options and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes option pricing model, based on an expected forfeiture rate that is adjusted for actual experience. If our Black-Scholes option pricing model assumptions or our actual or estimated forfeiture rate are different in the future, that could materially affect compensation expense recorded in future periods.

***Impairment of Long-Lived Assets***

We review long-lived assets, including finite lived intangible assets, for impairment on an annual basis, as of December 31, or on an interim basis if an event occurs that might reduce the fair value of such assets below their carrying values. An impairment loss would be recognized based on the difference between the carrying value of the asset and its estimated fair value, which would be determined based on either discounted future cash flows or other appropriate fair value methods. If our estimates used in the determination of either discounted future cash flows or other appropriate fair value methods are not accurate as compared to actual future results we may be required to record an impairment charge.

***Earnings Per Share***

Basic and diluted loss per common share are computed based on the weighted-average number of common shares outstanding. Common share equivalents (which consist of options and warrants) are excluded from the computation of diluted loss per share since the effect would be anti-dilutive. Common share equivalents which could potentially dilute basic earnings per share in the future, and which were excluded from the computation of diluted loss per share, totaled approximately 16.2 million shares and 22.7 million shares at March 31, 2008 and 2007, respectively. In connection with the dividend of 36% of the outstanding shares of RXi paid to our stockholders on March 11, 2008, we recorded a deemed dividend of \$757,000. The deemed dividend was reflected as an adjustment to net loss for the first quarter of 2008, to arrive at net loss applicable to common stockholders on the consolidated statement of operations and for purposes of calculating basic and diluted loss per shares.

***Liquidity and Capital Resources***

We have relied primarily upon proceeds from sales of our equity securities and the exercise of options and warrants, and to a much lesser extent upon payments from our strategic partners and licensees, to generate funds needed to finance our business and operations. At March 31, 2008, we had cash, cash equivalents and short-term investments of \$43.5 million. We believe that we have adequate financial resources to support our currently planned level of operations into the second half of 2009, based, in part, upon projected expenditures for the remainder of 2008 and the first three months of 2009 of \$31.0 million, including \$6.2 million for our planned clinical program for arimoclomol for ALS and related studies, \$6.3 million for our other ongoing and planned clinical programs, including a planned Phase II clinical trial of arimoclomol in stroke patients and a planned Phase II clinical trial of iroxsanadine for diabetic ulcers, \$9.9 million for the operations of our research laboratory in San Diego and \$8.6 million for other general and administrative expenses. Our projected expenditures assume the prompt resumption of our Phase II

clinical program for arimoclomol for ALS that currently is on clinical hold by the FDA. If we are required to conduct additional toxicology or human studies prior to or in parallel with the resumption of that clinical trial, alter the design of that trial, including by potentially reducing the dosage of arimoclomol, or are prohibited by the FDA from resuming the current planned clinical trial or initiating any other clinical trial of arimoclomol for the treatment of ALS or stroke recovery at the desired dose, or at all, due to safety concerns, then our actual expenditures will vary, perhaps significantly from our projections.

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We have no significant revenue, and we expect to have no significant revenue and to continue to incur significant losses over the next several years. Our net losses may increase from current levels primarily due to expenses related to our ongoing and planned clinical trials, research and development programs, possible technology acquisitions, and other general corporate activities. In the event that actual costs of our ongoing and planned activities are significantly higher than our current estimates, we may be required to significantly modify our planned level of operations.

In the future, we will be dependent on obtaining financing from third parties in order to maintain our operations. We cannot assure that additional funding will be available to us on favorable terms, or at all. If we fail to obtain additional funding when needed in the future, we would be forced to scale back, or terminate, our operations, or to seek to merge with or to be acquired by another company.

Our net loss, which includes non-cash charges relating to (1) common stock, stock option and warrants issued for services and (2) expenses related to employee stock options, increased by approximately \$0.8 million from the quarter ended March 31, 2007 to the quarter ended March 31, 2008. This increase was due to several factors, including an additional \$0.9 million of professional and consulting fees associated with compliance with provisions of the Sarbanes-Oxley Act, and professional fees and other costs related to RXi's registration statement on Form S-1 to register RXi's common stock. Research and development expenses decreased by approximately \$0.5 million principally because RXi's expenses for the month of March were excluded. The Company's total expenses were offset in part by an increase of \$0.6 million in service revenue.

In the three-month period ended March 31, 2008 there was \$0.6 million of cash used in investing activities, compared to \$3,000 used in the respective 2007 period. The 2008 period included \$10.0 million of funds provided by RXi converting short-term investments to cash equivalents. However, RXi's cash of \$10.4 million (inclusive of this \$10.0 million) is no longer available due to the deconsolidation. The remainder of the investing activity for both the 2008 and 2007 periods primarily related to cash used for the purchase of equipment. We manage our cash, cash equivalents and short-term investments interchangeably and at the present time do not anticipate any significant changes to our current holdings in cash equivalents. We expect capital spending to continue due to additional laboratory equipment necessary for our new San Diego, California laboratory.

Cash provided by financing activities in the three months ended March 31, 2008 and 2007 was \$0.9 million and \$11.1 million, respectively, which consisted almost exclusively of funds received from the exercise of stock options and warrants.

We are evaluating other potential future sources of capital as we do not currently have commitments from any third parties to provide us with capital. The results of our technology licensing efforts and the actual proceeds of any fund-raising activities will determine our ongoing ability to operate as a going concern. Our ability to obtain future financings through joint ventures, product licensing arrangements, royalty sales, equity financings, gifts, and grants or otherwise is subject to market conditions and our ability to identify parties that are willing and able to enter into such arrangements on terms that are satisfactory to us. Depending upon the outcome of our fundraising efforts, the accompanying consolidated financial information may not necessarily be indicative of future operating results or future financial condition.

We expect to incur significant losses for the foreseeable future and there can be no assurance that we will become profitable. Even if we become profitable, we may not be able to sustain that profitability.

***Results of Operations***

We recorded a net loss applicable to common stockholders of approximately \$6.1 million for the three-month period ended March 31, 2008, as compared to \$4.5 million for the same period in 2007.

We recognized \$2.2 million of revenue for the three-month period ended March 31, 2008, and \$1.6 million for the same period in 2007. We recognized \$2.2 million and \$1.4 million during those periods, respectively, from our \$24.3 million sale to the ALSCRT of a 1% royalty interest in worldwide sales of arimoclomol in August 2006. All future licensing fees under our current licensing agreements are dependent upon successful development milestones being achieved by the licensor. During 2008, we do not anticipate receiving any significant licensing fees. We will continue to recognize the balance of the deferred revenue recorded from the royalty transaction with the ALSCRT over the development period of our arimoclomol research.



**Table of Contents*****Research and Development***

|                                                       | <b>Three Month Period<br/>Ended March 31,<br/>2008                  2007<br/>(In thousands)</b> |                 |
|-------------------------------------------------------|-------------------------------------------------------------------------------------------------|-----------------|
| Research and development expense                      | \$ 3,125                                                                                        | \$ 3,209        |
| Non-cash research and development expenses (recovery) | (243)                                                                                           | 695             |
| Employee stock option expense                         | 199                                                                                             | 37              |
| Depreciation and amortization                         | 111                                                                                             | 67              |
|                                                       | <b>\$ 3,192</b>                                                                                 | <b>\$ 4,008</b> |

Research expenses are expenses incurred by us in the discovery of new information that will assist us in the creation and the development of new drugs or treatments. Development expenses are expenses incurred by us in our efforts to commercialize the findings generated through our research efforts.

Research and development expenses incurred during the first three months of 2008 and 2007 related primarily to (i) our Phase II clinical program for arimoclomol in ALS, (ii) our ongoing research and development related to other molecular chaperone amplification drug candidates, (iii) RXi's acquisition of technologies covered by the UMMS license agreements, and (iv) the small molecule drug discovery and development operations at our former Massachusetts and new California laboratory. All research and development costs related to the activities of RXi and our former laboratory were expensed.

As compensation to members of our scientific advisory board and consultants, and in connection with the acquisition of technology, we and RXi sometimes issue shares of common stock, stock options and warrants to purchase shares of common stock. For financial statement purposes, we value these shares of common stock, stock options, and warrants at the fair value of the common stock, stock options or warrants granted, or the services received, whichever is more reliably measurable. The value of the non-employee option grants are marked to market using the Black Scholes option pricing model and most of the compensation expense recognized or recovered during the period is adjusted accordingly. This resulted in a significant recovery of expenses in this quarter totaling approximately \$243,000 and an expense of approximately \$695,000 for the same period of 2007. We recorded \$199,000 of employee stock option expense during the three-month period ended March 31, 2008, as compared with \$37,000 for the related period in 2007.

Over the coming twelve months, we expect our research and development expenses to increase primarily as a result of our ongoing clinical programs for arimoclomol and irovanadine and our drug discovery efforts at our San Diego, California laboratory.

***General and Administrative Expenses***

|                                              | <b>Three Month Period<br/>Ended March 31,<br/>2008                  2007<br/>(In thousands)</b> |                 |
|----------------------------------------------|-------------------------------------------------------------------------------------------------|-----------------|
| General and administrative expenses          | \$ 3,603                                                                                        | \$ 2,369        |
| Non-cash general and administrative expenses | 189                                                                                             |                 |
| Employee stock option expense                | 659                                                                                             | 112             |
| Depreciation and amortization                | 22                                                                                              | 4               |
|                                              | <b>\$ 4,473</b>                                                                                 | <b>\$ 2,485</b> |



General and administrative expenses include all administrative salaries and general corporate expenses, including legal expenses associated with the prosecution of our intellectual property. Our general and administrative expenses, excluding stock option expense and depreciation expense, were \$3.6 million for the first three months of 2008, compared to \$2.4 million for the related period in 2007. General and administrative expenses increased by \$1.9 million in the first quarter of 2008 as compared to 2007 primarily due to increased audit, legal and consulting fees and higher employment costs. Audit fees associated with our annual audit, compliance with the internal control provisions of the Sarbanes-Oxley Act and RXi's registration statement relating to our partial spinoff of RXi increased by approximately \$550,000. Legal fees increased by approximately \$160,000 primarily related to RXi's Registration Statement, increased patent work and other legal matters, including possible financing transactions. Recruiting and consulting fees increased by approximately \$190,000 related to the recruitment of additional officers, financial and scientific personnel and the engagement of consultants to assist with the preparation of RXi's registration statement. Employment costs increased by

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approximately \$121,000 related to wages and bonuses for additional personnel for RXi and annual increases for other employees. Printing costs and other expenses relating to the filing of RXi's registration statement totaled approximately \$180,000.

Employee stock option expense relates to options granted to recruit and retain directors, officers and additional employees. We recorded approximately \$659,000 of employee stock option expense during the three-month period ended March 31, 2008 as compared to approximately \$112,000 during the three-month period ended March 31, 2007. Of this increase, approximately \$370,000 relates to RXi and \$177,000 relates to CytRx. In March 2008 we awarded RXi common stock to directors and certain employees and recorded the \$189,000 fair value as non-cash compensation expense. There were no comparable awards in the 2007 period.

***Depreciation and Amortization***

The depreciation expense reflects the depreciation of our equipment and furnishings and the amortization expenses related to our molecular library, which was placed in service in March 2005. These expenses are classified as Research and Development or General and Administrative expenses depending upon the associated business activity.

***Interest Income***

Interest income was \$0.5 million for the three months ended March 31, 2008, compared to \$0.4 million for the comparable period in 2007. The difference between periods is attributable primarily to the cash available for investment each year.

***Minority Interest in Losses of Subsidiary***

We offset \$88,000 of minority interest in losses of RXi against our net loss for the months of January and February 2008. For March 2008, we did not record a minority interest in the losses of RXi, as RXi's gain and losses were accounted for under the equity method because, following our March 11, 2008 distribution to our stockholders of RXi shares, we owned less than 50% of RXi. We offset \$2,000 of minority interest in losses of RXi against our net loss for the three-month period ended March 31, 2007.

***Income Taxes***

On March 11, 2008, the Company distributed to our stockholders approximately 4.5 million shares of RXi common stock. We will recognize approximately a \$32.9 million gain for income tax purposes on the distribution of shares of RXi common stock, which is the amount equal to the excess of the fair market value of the stock distributed over our basis. The gain will be included in determining whether we have current year earnings and profits subject to taxation.

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

Our exposure to market risk is limited primarily to interest income sensitivity, which is affected by changes in the general level of United States interest rates, particularly because a significant portion of our investments are in short-term debt securities issued by the U.S. government and institutional money market funds. The primary objective of our investment activities is to preserve principal. Due to the nature of our short-term investments, we believe that we are not subject to any material market risk exposure. We do not have any derivative financial instruments or foreign currency instruments. If interest rates had varied by 10% in the three-month period ended March 31, 2008, it would not have had a material effect on our results of operations or cash flows for that period.

**Item 4. Controls and Procedures*****Evaluation of Disclosure Controls and Procedures***

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)) as of the end of the quarterly period covered by this Quarterly Report and identified continuing deficiencies as disclosed in the Form 10-K for the period ending December 31, 2007, that it considered to be material weaknesses in the effectiveness of our internal controls over financial reporting. Pursuant to standards established by the Public Company Accounting Oversight Board, a

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Material weakness is a deficiency or combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC.

***Changes in Controls over Financial Reporting***

During the quarterly period covered by this Quarterly Report, we made changes to our internal controls designed to strengthen our financial reporting and disclosure controls and procedures in light of material weaknesses in those regards reported in our Annual Report on Form 10-K for the year ended December 31, 2007. During the quarterly period covered by this Quarterly Report, we strengthened our managerial controls over our compliance with the established financial closing policies and procedures. Additionally, we enhanced the communications among our scientific, legal and accounting departments including the timing of and control over the flow of documents into our legal database.

We are continuing our efforts in these regards in order to fully remedy previously reported material weaknesses and to ensure that all of our controls and procedures are adequate and effective. Any failure to implement and maintain improvements in the controls over our financial reporting could cause us to fail to meet our reporting obligations under the SEC's rules and regulations. Any failure to improve our internal controls to address the weaknesses we have identified could also cause investors to lose confidence in our reported financial information, which could have a negative impact on the trading price of our common stock.

**PART II OTHER INFORMATION**

**Item 6. Exhibits**

The exhibits listed in the accompanying Index to Exhibits are filed as part of this Quarterly Report on Form 10-Q and incorporated herein by reference.

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**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.

CYTRX CORPORATION  
(Registrant)

Date: May 19, 2008

By: /s/ MITCHELL K. FOGELMAN  
Mitchell K. Fogelman  
Chief Financial Officer (Principal Financial  
Officer)

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**INDEX TO EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>                                                                                                                                |
|---------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1                      | Certification of Chief Executive Officer Pursuant to 17 CFR 240.13a-14(a)                                                                         |
| 31.2                      | Certification of Chief Financial Officer Pursuant to 17 CFR 240.13a-14(a)                                                                         |
| 32.1                      | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2                      | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |