CYTOKINETICS INC
Form 10-Q
May 07, 2010

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

(Mark One)

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

For the quarterly period ended March 31, 2010

or

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

Commission file number: 000-50633

CYTOKINETICS, INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware	**94-3291317**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
280 East Grand Avenue South San Francisco, California	**94080**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (650) 624-3000

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

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

* The registrant has not yet been phased into the interactive data requirements.

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 o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Number of shares of common stock, $0.001 par value, outstanding as of April 30, 2010: 64,389,446.

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FOR THE QUARTER ENDED MARCH 31, 2010

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CYTOKINETICS, INCORPORATED
(A Development Stage Enterprise)
CONDENSED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

	March 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,715	$ 25,561
Short-term investments	67,091	71,266
Investments in auction rate securities	15,311	15,542
Investment put option related to auction rate securities rights	2,339	2,358
Related party accounts receivable	11	180
Related party notes receivable	9	9
Prepaid and other current assets	1,613	2,005
Total current assets	107,089	116,921
Property and equipment, net	3,282	3,713
Restricted cash	1,233	1,674
Other assets	289	291
Total assets	$ 111,893	$ 122,599
LIABILITIES and STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,700	$ 1,683
Accrued liabilities	4,281	5,935
Related party payables and accrued liabilities	10	
Short-term portion of equipment financing lines	1,453	1,616
Deferred revenue	217	751
Loan with UBS	9,873	10,201
Total current liabilities	17,534	20,186
Long-term portion of equipment financing lines	724	985
Total liabilities	18,258	21,171
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.001 par value:		
Authorized: 170,000,000 shares; Issued and outstanding: 62,479,802 shares at March 31, 2010 and 61,275,036 shares at December 31, 2009	62	61
Additional paid-in capital	417,132	412,729

Accumulated other comprehensive income (loss)	(7)	1
Deficit accumulated during the development stage	(323,552)	(311,363)
Total stockholders equity	93,635	101,428
Total liabilities and stockholders equity	$ 111,893	$ 122,599

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

CYTOKINETICS, INCORPORATED
(A Development Stage Enterprise)
CONDENSED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Period from August 5, 1997 (Date of Inception)
	March 31, 2010	March 31, 2009	to March 31, 2010
Revenues:			
Research and development revenues from related parties	$ 621	$ 20	$ 48,231
Research and development, grant and other revenues			2,955
License revenues from related parties		3,058	112,935
Total revenues	621	3,078	164,121
Operating expenses:			
Research and development	9,068	9,959	386,346
General and administrative	3,836	4,020	119,999
Restructuring charges (reversals)		(58)	2,450
Total operating expenses	12,904	13,921	508,795
Operating loss	(12,283)	(10,843)	(344,674)
Interest and other, net	94	158	21,272
Loss before income taxes	(12,189)	(10,685)	(323,402)
Provision for income taxes			150
Net loss	$ (12,189)	$ (10,685)	$ (323,552)
Net loss per common share basic and diluted	$ (0.20)	$ (0.21)	
Weighted-average number of shares used in computing net loss per common share basic and diluted	61,995	51,582	

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

CYTOKINETICS, INCORPORATED
(A Development Stage Enterprise)
CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended		Period from August 5, 1997 (Date of Inception)
	March 31, 2010	March 31, 2009	to March 31, 2010
Cash flows from operating activities:			
Net loss	$ (12,189)	$ (10,685)	$ (323,552)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization of property and equipment	489	515	25,955
(Gain) loss on disposal of equipment		(32)	311
Non-cash impairment charges			103
Non-cash restructuring expenses, net of reversals		(37)	498
Non-cash interest expense			504
Non-cash forgiveness of loan to officer			425
Stock-based compensation	994	1,249	26,253
Tax benefit from stock-based compensation			(20)
Non-cash warrant expense			1,626
Other non-cash expenses			141
Changes in operating assets and liabilities:			
Related party accounts receivable	169	214	(362)
Prepaid and other assets	394	614	(1,930)
Accounts payable	102	8	1,824
Accrued liabilities	(1,643)	(575)	4,156
Related party payables and accrued liabilities	10	15	10
Deferred revenue	(534)	(3,074)	217
Net cash used in operating activities	(12,208)	(11,788)	(263,841)
Cash flows from investing activities:			
Purchases of investments	(36,393)	(15,631)	(837,963)
Proceeds from sales and maturities of investments	40,810	15,059	753,298
Purchases of property and equipment	(154)	(219)	(30,254)
Proceeds from sale of property and equipment		24	124
(Increase) decrease in restricted cash	441	518	(1,233)
Issuance of related party notes receivable			(1,146)
Proceeds from repayments of notes receivable			859
Net cash provided by (used in) investing activities	4,704	(249)	(116,315)
Cash flows from financing activities:			

Proceeds from initial public offering, sale of common stock to related party, and public offerings, net of issuance costs			206,871
Proceeds from draw down of committed equity financing facility, net of issuance costs	3,370	6,850	42,266
Proceeds from other issuances of common stock	40	30	7,034
Proceeds from issuance of preferred stock, net of issuance costs			133,172
Repurchase of common stock			(68)
Proceeds from loan with UBS		12,441	12,441
Repayment of loan with UBS	(328)	(86)	(2,568)
Proceeds from equipment financing lines			23,696
Repayment of equipment financing lines	(424)	(528)	(21,993)
Tax benefit from stock-based compensation			20
Net cash provided by financing activities	2,658	18,707	400,871
Net increase (decrease) in cash and cash equivalents	(4,846)	6,670	20,715
Cash and cash equivalents, beginning of period	25,561	41,819	
Cash and cash equivalents, end of period	$ 20,715	$ 48,489	$ 20,715

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

CYTOKINETICS, INCORPORATED
(A DEVELOPMENT STAGE ENTERPRISE)
NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

Overview

Cytokinetics, Incorporated (the Company , we or our) was incorporated under the laws of the state of Delaware on August 5, 1997. The Company is a clinical-stage biopharmaceutical company focused on the discovery and development of novel small molecule therapeutics that modulate muscle function for the potential treatment of serious diseases and medical conditions. The Company is a development stage enterprise and has been primarily engaged in conducting research, developing drug candidates and technologies, and raising capital.

The Company s registration statement for its initial public offering (IPO) was declared effective by the Securities and Exchange Commission (SEC) on April 29, 2004. The Company s common stock commenced trading on the NASDAQ National Market, now the NASDAQ Global Market, on April 29, 2004 under the trading symbol CYTK .

The Company s financial statements contemplate the conduct of the Company s operations in the normal course of business. The Company has incurred an accumulated deficit since inception and there can be no assurance that the Company will attain profitability. The Company had a net loss of $12.2 million and net cash used in operations of $12.2 million for the three months ended March 31, 2010, and an accumulated deficit of approximately $323.6 million as of March 31, 2010. Cash, cash equivalents and short-term investments (excluding investments in auction rate securities and the investment put option related to the auction rate securities rights) decreased to $87.8 million at March 31, 2010 from $96.8 million at December 31, 2009. The Company anticipates it will continue to have operating losses and net cash outflows in future periods. If sufficient additional capital is not available on terms acceptable to the Company, its liquidity will be impaired.

The Company has funded its operations primarily through sales of common stock and convertible preferred stock, contract payments under its collaboration agreements, debt financing arrangements, government grants and interest income. Until it achieves profitable operations, the Company intends to continue to fund operations through payments from strategic relationships, additional sales of equity securities and debt financings. Based on the current status of its development plans, the Company believes that its existing cash, cash equivalents and short-term investments (excluding investments in auction rate securities) at March 31, 2010 will be sufficient to fund its cash requirements for at least the next 12 months. If, at any time, the Company s prospects for financing its research and development programs decline, the Company may decide to reduce research and development expenses by delaying, discontinuing or reducing its funding of one or more of its research or development programs. Alternatively, the Company might raise funds through strategic relationships, public or private financings or other arrangements. Such funding, if needed, may not be available on favorable terms, or at all.

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The financial statements include all adjustments (consisting only of normal recurring adjustments) that management believes are necessary for the fair statement of the balances and results for the periods presented. These interim financial statement results are not necessarily indicative of results to be expected for the full fiscal year or any future interim period.

The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date. The financial statements and related disclosures have been prepared with the presumption that users of the interim financial statements have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these financial statements should be read in conjunction with the audited financial statements and notes thereto contained in the Company s Form 10-K for the year ended December 31, 2009, as filed with the SEC on March 11, 2010.

Comprehensive Income (Loss)

Comprehensive loss consists of the net loss and other comprehensive income (loss). Other comprehensive income (loss) includes certain changes in stockholders equity that are excluded from net loss. Comprehensive loss and its components for the three months ended March 31, 2010 and 2009 were as follows (in thousands):

	Three Months Ended	
	March 31, 2010	March 31, 2009
Net loss	$ (12,189)	$ (10,685)
Change in unrealized loss on investments	(8)	(14)
Comprehensive loss	$ (12,197)	$ (10,699)

Restricted Cash

In accordance with the terms of the Company s line of credit agreements with General Electric Capital Corporation, the Company is obligated to maintain a certificate of deposit with the lender. The balance of the certificate of deposit was $1.2 million at March 31, 2010 and $1.7 million at December 31, 2009, and was classified as restricted cash.

Fair Value of Financial Instruments

The carrying amount of the Company s cash and cash equivalents, accounts receivable and accounts payable and notes payable approximates fair value due to the short-term nature of these instruments. The Company bases the fair value of short-term investments, other than its auction rate securities (ARS) and the investment put option related to the Series C-2 Auction Rate Securities Rights issued to the Company by UBS AG (the ARS Rights), on current market prices. The Company determines the fair value of its ARS and the investment put option related to the ARS Rights using discounted cash flow models (Note 5). In connection with the failed auctions of the Company s ARS, which were marketed and sold by UBS AG and its affiliates, in October 2008, the Company accepted a settlement with UBS AG pursuant to which UBS AG issued to the Company the ARS Rights. The carrying value of the investment put option related to the ARS Rights (Note 5) represents its fair value, based on the Black-Scholes option pricing model, which approximates the difference in value between the par value and the fair value of the associated ARS. As permitted under fair value accounting for financial instruments, the Company may elect fair value measurement for certain financial assets on a case by case basis. The Company has elected to use fair value measurement permitted under fair value accounting for the investment put option related to the ARS Rights.

The fair value of the equipment financing line debt was $2.0 million as of March 31, 2010, compared to the carrying value of $2.2 million. As of December 31, 2009, the fair value of the equipment financing line debt was $2.4 million, compared to the carrying value of $2.6 million. The Company determined the fair value of the equipment financing line using a discounted cash flow (DCF) model. The major inputs to the model are the expected cash flows, which equal the contractual payments, and borrowing rates available to the Company for similar debt as of the applicable balance sheet dates.

The fair value of the loan with UBS Bank USA approximated the loan s carrying value of $9.9 million as of March 31, 2010 and $10.2 million as of December 31, 2009, due to the short-term nature of the loan. The Company determined the fair value of the loan with UBS Bank USA using a DCF model. The major inputs to the model are the expected cash flows, borrowing rates available to the Company for similar debt secured by the ARS as of the applicable balance sheet dates, and an expected maturity date of June 30, 2010.

Stock-Based Compensation

The Company applies the accounting guidance for stock compensation, which establishes accounting for share-based payment awards made to employees and directors, including employee stock options and employee stock purchases. Under this guidance, stock-based compensation cost is measured at the grant date based on the calculated fair value of the award, and is recognized as an expense on a straight-line basis over the employee s requisite service period, generally the vesting period of the award.

The Company uses the Black-Scholes option pricing model to determine the fair value of stock options and employee stock purchase plan (ESPP) shares. The key input assumptions used to estimate the fair value of these awards include the exercise price of the award, the expected option term, the expected volatility of the Company s stock over the option s expected term, the risk-free interest rate over the option s expected term and the Company s expected dividend yield, if any.

For employee stock options, the fair value of share-based payments was estimated on the date of grant using the Black-Scholes option pricing model based on the following weighted average assumptions:

	Three Months Ended	
	March 31, 2010	March 31, 2009
Risk-free interest rate	2.88%	2.70%
Volatility	73%	76%
Expected term (in years)	6.12	6.07
Expected dividend yield	0.00%	0.00%

For the ESPP, the fair value of share-based payments was estimated on the date of grant using the Black-Scholes option pricing model based on the following weighted average assumptions:

	Three Months Ended	
	March 31, 2010	March 31, 2009
Risk-free interest rate	0.58%	2.15%
Volatility	74%	68%
Expected term (in years)	1.25	1.25
Expected dividend yield	0.00%	0.00%

The risk-free interest rate that the Company uses in the option pricing model is based on the U.S. Treasury zero-coupon issues with remaining terms similar to the expected terms of the options. The Company does not anticipate paying dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option pricing model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. Historical data is used to estimate pre-vesting option forfeitures and record stock-based compensation expense only on those awards that are expected to vest.

Since January 1, 2008, the Company has used its own historical exercise activity and extrapolates the life cycle of options outstanding to arrive at its estimated expected term for new option grants. Also starting January 1, 2008, the Company has used its own volatility history based on its stock s trading history for the period subsequent to the Company s IPO in April 2004. Because its outstanding options have an expected term of approximately six years, the Company supplements its own volatility history by using comparable companies volatility history for the relevant period preceding the Company s IPO.

The Company measures compensation expense for restricted stock awards at fair value on the date of grant and recognizes the expense over the expected vesting period. The fair value for restricted stock awards is based on the closing price of the Company s common stock on the date of grant.

Note 2. Net Loss Per Common Share

Basic net loss per common share is computed by dividing net loss by the weighted-average number of vested common shares outstanding during the period. Diluted net loss per common share is computed by giving effect to all potentially dilutive common shares, including outstanding stock options, unvested restricted stock, warrants and shares issuable under the ESPP by applying the treasury stock method. The following is the calculation of basic and diluted net loss per common share (in thousands, except per share data):

	Three Months Ended	
	March 31, 2010	March 31, 2009
Net loss	$ (12,189)	$ (10,685)

Weighted-average common shares outstanding	62,184	51,976
Unvested restricted stock	(189)	(394)
Weighted-average shares used in computing basic and diluted net loss per common share	61,995	51,582
Net loss per common share basic and diluted	$ (0.20)	$ (0.21)

The following instruments were excluded from the computation of diluted net loss per common share for the periods presented, because their effect would have been antidilutive (in thousands):

	Three Months Ended	
	March 31, 2010	March 31, 2009
Options to purchase common stock	8,361	7,544
Unvested restricted common stock	183	394
Warrants to purchase common stock	4,027	474
Shares issuable related to the ESPP	123	103
Total shares	12,694	8,515

Note 3. Supplemental Cash Flow Data

Supplemental cash flow data was as follows (in thousands):

	Three Months Ended		Period from August 5, 1997 (date of inception)
	March 31, 2010	March 31, 2009	to March 31, 2010
Significant non-cash investing and financing activities:			
Deferred stock-based compensation	$	$	$ 6,940
Purchases of property and equipment through accounts payable	30	4	30
Purchases of property and equipment through trade in value of disposed property and equipment		8	258
Penalty on restructuring of equipment financing lines			475
Conversion of convertible preferred stock to common stock			133,172
Warrants issued in registered direct equity financing			1,585

Note 4. Related Party Agreements

Research and Development Arrangements

Amgen Inc. (Amgen). Pursuant to its collaboration and option agreement with Amgen (the Amgen Agreement), in the three months ended March 31, 2010, the Company recognized revenue from Amgen of $0.6 million. The $0.6 million consisted of $0.4 million for reimbursements of its costs of full time employee equivalents (FTEs) supporting the research and development program for omecamtiv mecarbil and related compounds, and $0.2 million for reimbursements of other costs related to that program. These reimbursements were recorded as research and development revenues from related parties.

In the three months ended March 31, 2009, the Company recognized $16,000 of revenue from Amgen, recorded as research and development revenues from related parties, and $3.1 million of revenue related to Amgen, recorded as license revenues from related parties. The research and development revenue from Amgen consisted of reimbursements of non-FTE costs. The license revenue consisted of amortization of deferred revenue related to the Amgen 2006 non-exclusive license and technology access fee and stock purchase premium.

Deferred revenue related to Amgen was $0.2 million at March 31, 2010 and $0.8 million at December 31, 2009, and consisted of Amgen s prepayment of FTE reimbursements. Related party accounts receivable from Amgen were $10,000 at March 31, 2010 and $0.2 million at December 31, 2009.

GlaxoSmithKline (GSK). Pursuant to its collaboration and license agreement with GSK (the GSK Agreement), the Company recognized revenue for patent expense reimbursements from GSK of zero and $4,000 for the three months ended March 31, 2010 and 2009, respectively. These reimbursements were recorded as research and development revenues from related parties. There was no related party accounts receivable balance due from GSK at March 31, 2010 or December 31, 2009.

In December 2009, the Company and GSK agreed to terminate the GSK Agreement, effective February 28, 2010. As a result, all rights for GSK-923295 reverted to the Company at that time, subject to certain royalty obligations to GSK. GSK remains responsible for all activities and costs associated with completing and reporting on the ongoing Phase I clinical trial of GSK-923295.

Board Members

James H. Sabry, M.D., Ph.D. resigned from the Board of Directors effective March 15, 2010 and remains a consultant to the Company and a member of its Scientific Advisory Board. The Company incurred consulting fees for services provided by Dr. Sabry of $15,000 for both of the three months ended March 31, 2010 and 2009. The related party accounts payable due to Dr. Sabry were $5,000 at March 31, 2010 and zero at December 31, 2009.

James Spudich, Ph.D. is a member of the Company s Board of Directors and a consultant to the Company. The Company incurred consulting fees for services provided by Dr. Spudich of $5,000 and $10,000 for the three months ended March 31, 2010 and 2009, respectively. The related party accounts payable due to Dr. Spudich were $5,000 at March 31, 2010 and zero at December 31, 2009.

Note 5. Cash Equivalents, Investments and Fair Value Measurements

Cash Equivalents and Available for Sale Investments

The amortized cost and fair value of cash equivalents and available for sale investments at March 31, 2010 and December 31, 2009 were as follows (in thousands):

	March 31, 2010				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Maturity Dates
Cash equivalents money market funds	$ 12,039			$ 12,039	
Short-term investments U.S. Treasury securities	$ 67,098	$ 1	$ (8)	$ 67,091	4/2010 10/2010

	December 31, 2009				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Maturity Dates
Cash equivalents money market funds	$ 23,773			$ 23,773	
Short-term investments U.S. Treasury securities	$ 71,265	$ 1	$	$ 71,266	1/2010 6/2010

As of March 31, 2010, the Company s cash equivalents had no unrealized losses, and its U.S. Treasury securities classified as short-term investments had unrealized losses of $8,000. The unrealized losses were primarily caused by rising interest rates. The Company collected the contractual cash flows on its U.S. Treasury securities that matured in April 2010, and expects to be able to collect all contractual cash flows on the remaining maturities of its U.S. Treasury securities. As of December 31, 2009, the Company s cash equivalents and short-term investments had no unrealized losses.

Interest income was $0.2 million and $0.3 million for the three months ended March 31, 2010 and 2009, respectively, and $28.2 million for the period August 5, 1997 (inception) through March 31, 2010.

Investments in Auction Rate Securities and Investment Put Option Related to Auction Rate Securities Rights

The Company s short-term investments in ARS as of March 31, 2010 and December 31, 2009, refer to securities that are structured with short-term interest reset dates every 28 days but with maturities generally greater than 10 years. At the end of each reset period, investors can attempt to sell the securities through an auction process or continue to hold the securities. The Company has classified its ARS holdings as short-term investments as of March 31, 2010 and December 31, 2009, based on its intention to liquidate the investments on June 30, 2010, the earliest date it can exercise the ARS Rights.

At March 31, 2010, the Company held approximately $17.6 million in par value, $15.3 million carrying value, of ARS classified as short-term investments. The assets underlying these ARS are student loans that are substantially backed by the federal government. In February 2008, auctions began to fail for these securities and each auction since then has failed. Consequently, the ARS are not currently liquid and the Company will not be able to access these funds until a future auction of the ARS is successful, a buyer is found outside of the auction process, the ARS are redeemed by the issuer or they mature. Historically, the fair value of the ARS approximated par value due to the frequent interest rate resets associated with the auction process. However, there is not a current active market for the ARS, and therefore they do not have a readily determinable market value. Accordingly, the estimated fair value of the ARS no longer approximates par value. The ARS continue to pay interest according to their stated terms.

The fair value of the Company s investments in its ARS as of March 31, 2010 and December 31, 2009 was determined to be $15.3 million and $15.5 million, respectively. Changes in the fair value of the ARS are recognized in current period earnings in

Interest and Other, net. Therefore, in the first quarter of 2010, the Company recognized the sale of $250,000 of its ARS at par value and unrealized gains of $19,000 on its ARS in the same period to reflect the change in fair value. In the first quarter of 2009, the Company recognized unrealized gains of $0.7 million on its ARS to reflect the change in fair value.

In connection with the failed auctions of the Company s ARS, which were marketed and sold by UBS AG and its affiliates, in October 2008, the Company accepted a settlement with UBS AG pursuant to which UBS AG issued to the Company the ARS Rights. The ARS Rights provide the Company the right to receive the par value of its ARS, i.e., the liquidation preference of the ARS plus accrued but unpaid interest. Pursuant to the ARS Rights, the Company may require UBS AG to purchase its ARS at par value at any time between June 30, 2010 and July 2, 2012. In addition, UBS AG s affiliates may sell or otherwise dispose of some or all of the ARS at their discretion at any time prior to expiration of the ARS Rights, subject to the obligation to pay the Company the par value of such ARS. The ARS Rights are not transferable, tradable or marginable, and will not be listed or quoted on any securities exchange or any electronic communications network. As consideration for the ARS Rights, the Company agreed to release UBS AG, UBS Securities LLC and UBS Financial Services, Inc., and/or their affiliates, directors, and officers from any claims directly or indirectly relating to the marketing and sale of the ARS, other than for consequential damages. UBS AG s obligations in connection with the ARS Rights are not secured by its assets and UBS is not required to obtain any financing to support these obligations. UBS AG has disclaimed any assurance that it will have sufficient financial resources to satisfy its obligations in connection with the ARS Rights. If UBS AG has insufficient funding to buy back the ARS and the auction process continues to fail, the Company may incur further losses on the carrying value of the ARS.

The ARS Rights represent a firm agreement in accordance with the accounting guidance for derivatives and hedging, which defines a firm agreement as an agreement with an unrelated party, binding on both parties and usually legally enforceable, with the following characteristics: a) the agreement specifies all significant terms, including the quantity to be exchanged, the fixed price and the timing of the transaction; and b) the agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable. The enforceability of the ARS Rights results in an investment put option that is recognized as a separate freestanding instrument that is accounted for separately from the ARS investments. As of March 31, 2010 and December 31, 2009, the Company recorded $2.3 million and $2.4 million, respectively, as the fair value of the investment put option related to the ARS Rights, classified as short-term assets on the balance sheet. The investment put option related to the ARS Rights does not meet the definition of a derivative instrument. Therefore, the Company elected to measure the investment put option related to the ARS Rights at fair value, in accordance with the fair value option permitted under fair value accounting guidance for financial instruments, to mitigate volatility in reported earnings due to their linkage to the ARS. Changes in the fair value of the investment put option related to the ARS Rights are recognized in current period earnings in Interest and Other, net. Accordingly, the Company recognized an unrealized loss of $19,000 on the investment put option related to the ARS Rights in the first quarter of 2010 and an unrealized loss of $0.7 million in the first quarter of 2009. The Company anticipates that any future changes in the fair value of the investment put option related to the ARS Rights will be offset by the changes in the fair value of the related ARS with no material net impact to the statements of operations, subject to adjustment for changes in UBS s credit profile. The investment put option related to the ARS Rights will continue to be measured at fair value until the earlier of the Company s exercise of the ARS Rights, UBS s purchase of the ARS in connection with the ARS Rights, or the maturity of the ARS underlying the ARS Rights.

The Company valued the investment put option related to the ARS Rights using a Black-Scholes option pricing model that included estimates of interest rates, based on data available, and was adjusted for any bearer risk associated with UBS s financial ability to repurchase the ARS beginning June 30, 2010. Any change in these assumptions and market conditions would affect the value of the investment put option related to the ARS Rights.

The Company continues to monitor the market for ARS and consider its impact (if any) on the fair market value of its investments. If the market conditions deteriorate further, the Company may be required to record additional unrealized losses in earnings, offset by corresponding increases in the investment put option related to the ARS Rights, assuming no deterioration of UBS AG s credit rating.

Fair Value Measurements

The Company adopted the fair value accounting guidance to value its financial assets and liabilities. Fair value is defined as the price that would be received for assets when sold or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that the Company believes market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable.

The Company primarily applies the market approach for recurring fair value measurements and endeavors to utilize the best information reasonably available. Accordingly, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, and considers the security issuers and the third-party insurers credit risk in its assessment of fair value.

The Company classifies the determined fair value based on the observability of those inputs. Fair value accounting guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three defined levels of the fair value hierarchy are as follows:

Level 1 Observable inputs, such as quoted prices in active markets for identical assets or liabilities;

Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or through corroboration with observable market data; and

Level 3 Unobservable inputs, for which there is little or no market data for the assets or liabilities, such as internally-developed valuation models.

Financial assets measured at fair value on a recurring basis as of March 31, 2010 and December 31, 2009 are classified in the table below in one of the three categories described above (in thousands):

	March 31, 2010			
	Fair Value Measurements Using			Assets
	Level			At Fair
	Level 1	2	Level 3	Value
Money market funds	$ 12,039		$	$ 12,039
U.S. Treasury securities	67,091			67,091
Investments in ARS			15,311	15,311
Investment put option related to ARS Rights			2,339	2,339
Total	$ 79,130		$ 17,650	$ 96,780
Amounts included in:				
Cash and cash equivalents	$ 12,039		$	$ 12,039
Short-term investments	67,091			67,091
Investments in ARS			15,311	15,311
Investment put option related to ARS Rights			2,339	2,339
Total	$ 79,130		$ 17,650	$ 96,780

Financial assets measured at fair value on a recurring basis as of December 31, 2009 are classified in the table below in one of the three categories described above (in thousands):

	December 31, 2009			
	Fair Value Measurements Using			Assets
	Level			At Fair
	Level 1	2	Level 3	Value
Money market funds	$ 23,773		$	$ 23,773
U.S. Treasury securities	71,266			71,266
Investments in ARS			15,542	15,542
Investment put option related to ARS Rights			2,358	2,358
Total	$ 95,039		$ 17,900	$ 112,939

Amounts included in:			
Cash and cash equivalents	$ 23,773	$	$ 23,773
Short-term investments	71,266		71,266
Investments in ARS		15,542	15,542
Investment put option related to ARS Rights		2,358	2,358
Total	$ 95,039	$ 17,900	$ 112,939

The valuation technique used to measure fair value for the Company s Level 1 assets is a market approach, using prices and other relevant information generated by market transactions involving identical assets. The valuation technique used to measure fair value for Level 3 assets is an income approach, where, in most cases, the expected future cash flows are discounted back to present value for each asset, except for the investment put option related to the ARS Rights, which is based on the Black-Scholes option pricing model and approximates the difference in value between the par value and the fair value of the associated ARS.

At March 31, 2010 and December 31, 2009, the Company held approximately $15.3 million and $15.5 million, respectively, in fair value of ARS classified as short-term investments. The assets underlying the ARS are student loans which are substantially backed by the federal government. The fair values of these securities as of March 31, 2010 and December 31, 2009 were estimated using a DCF model. In the first quarter of fiscal year 2008, the Company reclassified its ARS to the Level 3 category, as some of the inputs used in the DCF model are unobservable. The valuation of the Company s ARS investment portfolio is subject to uncertainties that are difficult to predict. The assumptions used in preparing the DCF model include estimates of interest rates, timing and amount of cash flows, credit and liquidity premiums and expected holding periods of the ARS, based on data available as of the applicable balance sheet date. These assumptions are volatile and subject to change as the underlying sources of these assumptions and market conditions change, which could result in significant changes to the fair value of the ARS. The significant assumptions of the DCF model are discount margins that are based on industry recognized student loan sector indices, an additional liquidity discount and an estimated term to liquidity. Other items that this analysis considers are the collateralization underlying the security investments, the creditworthiness of the counterparty and the timing of expected future cash flows. There were no significant changes to the assumptions or inputs for the DCF model for ARS as of March 31, 2010 compared to December 31, 2009. The Company s ARS were also compared, when possible, to other observable market data for securities with similar characteristics as the ARS.

Due to the change of the fair value of the Company s ARS and the investment put option related to the ARS Rights, unrealized gains of $19,000 on the ARS and unrealized losses of $19,000 on the investment put option related to the ARS Rights were included in Interest and Other, net in the accompanying statement of operations for the three months ended March 31, 2010. The ARS investments continue to pay interest according to their stated terms.

Changes to estimates and assumptions used in estimating the fair value of the ARS and the investment put option related to the ARS Rights may result in materially different values. In addition, actual market exchanges, if any, may occur at materially different amounts. Other factors that may impact the valuation of the Company s ARS and investment put option related to the ARS Rights include changes to credit ratings of the securities and to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, counterparty risk and ongoing strength and quality of market credit and liquidity.

As of March 31, 2010, the Company s financial assets measured at fair value on a recurring basis using significant Level 3 inputs consisted solely of the ARS and the investment put option related to the ARS Rights. The following table provides a reconciliation for all assets measured at fair value using significant Level 3 inputs for the three months ended March 31, 2010 (in thousands):

	ARS	Investment Put Option Related to ARS Rights
Balance as of December 31, 2009	$ 15,542	$ 2,358
Unrealized gain on ARS, included in Interest and Other, net	19	
Unrealized loss on the investment put option related to ARS Rights, included in Interest and Other, net		(19)
Sale of ARS	(250)	
Balance as of March 31, 2010	$ 15,311	$ 2,339

The total amount of assets measured using valuation methodologies based on Level 3 inputs represented approximately 18% of the Company s total assets that were measured at fair value as of March 31, 2010.

Note 6. Loan with UBS

In connection with the settlement with UBS AG relating to the Company s ARS in October 2008, the Company entered into a loan agreement with UBS Bank USA and UBS Financial Services Inc. On January 5, 2009, the Company borrowed approximately $12.4 million under the loan agreement, with its ARS held in accounts with UBS

Financial Services Inc. as collateral. The loan amount was based on 75% of the fair value of the ARS as assessed by UBS at the time of the loan. The Company has drawn down the full amount available under the loan agreement. In general, the amount of interest payable under the loan agreement is intended to equal the amount of interest the Company would otherwise receive with respect to its ARS. During the first quarter of 2010, the interest rate due on the UBS loan was lower than the interest rate earned from the ARS, and the principal balance of the loan was lower than the par value of the ARS. During the first quarter of 2010, the Company paid $29,000 of interest expense associated with the loan and received $107,000 in interest income from the ARS. In accordance with the loan agreement, the Company applied the net interest received and the proceeds of $0.2 million from sales of ARS to the principal of the loan.

The borrowings under the loan agreement are payable upon demand. However, upon such demand, UBS Financial Services Inc. or its affiliates will be required to arrange alternative financing for the Company on terms and conditions substantially the same as those under the loan agreement, unless the demand right was exercised as a result of certain specified events or the customer relationship between UBS Financial Services Inc. and the Company is terminated for cause by UBS Financial Services Inc. If such alternative financing cannot be established, then a UBS affiliate will purchase the pledged ARS at par value. Proceeds of sales of the ARS will first be applied to repayment of the loan with the balance, if any, for the Company s account.

Note 7. Restructuring

In September 2008, the Company announced a restructuring plan to realign its workforce and operations in line with a strategic reassessment of its research and development activities and corporate objectives. As a result, at the time, the Company focused its research activities to its muscle contractility programs while continuing to advance its then-ongoing clinical trials in heart failure and cancer, and discontinued early research activities directed to oncology. The Company communicated to affected employees a plan of organizational restructuring through involuntary terminations. Pursuant to the accounting guidance for exit or disposal cost obligations, the Company recorded a charge of approximately $2.5 million in 2008 consisting of $2.2 million for employee severance and benefit related costs and $0.3 million related to the impairment of laboratory equipment that was held-for-sale. To implement this plan, the Company reduced its workforce at the time by approximately 29%, or 45 employees. The affected employees were provided with severance and related benefits payments and outplacement assistance. All severance payments were made as of December 31, 2008.

In the three months ended March 31, 2009, the Company recorded a decrease in restructuring expenses of $0.1 million, which primarily consisted of the reduction of accrued employee benefit related restructuring costs and gains on disposals of held-for-sale equipment. The Company did not record any restructuring charges in the three months ended March 31, 2010 because the Company has completed all restructuring activities and recognized all anticipated restructuring charges.

Note 8. Stockholders Equity

Common Stock

During the three months ended March 31, 2010, under the October 2007 committed equity financing facility (the 2007 CEFF) with Kingsbridge Capital Limited (Kingsbridge), the Company sold 1,187,198 shares of its common stock to Kingsbridge and received gross proceeds of $3.4 million, a price equal to 90% of the volume weighted average price of the Company s stock on each trading day during an eight day pricing period prior to the sale. As of March 31, 2010, 4,995,485 shares remained available to the Company for sale under the 2007 CEFF.

Stock Option Plans

Stock option activity for the three months ended March 31, 2010 under the 2004 Equity Incentive Plan, as amended, and the 1997 Stock Option/Stock Issuance Plan was as follows:

	Shares Available for Grant of Options or Awards	Stock Options Outstanding	Weighted Average Exercise Price per Share Stock Options
Balance at December 31, 2009	4,098,228	6,984,463	$ 4.58
Options granted	(1,666,537)	1,666,537	$ 3.08
Options exercised		(25,738)	$ 1.55
Options cancelled	263,937	(263,937)	$ 3.12
Restricted stock awards forfeited	8,170		

Balance at March 31, 2010	2,703,798	8,361,325	$	4.34

The weighted average fair value of options granted in the three months ended March 31, 2010 was $2.05 per share. Restricted stock award activity for the three months ended March 31, 2010 was as follows:

	Number of Shares		Weighted Average Award Date Fair Value per Share
Unvested restricted stock awards outstanding at December 31, 2009	191,630	$	2.37
Awards forfeited	(8,170)	$	2.37
Unvested restricted stock awards outstanding at March 31, 2010	183,460	$	2.37

Note 9. Interest and Other, net

Components of Interest and Other, net were as follows (in thousands):

	Three Months Ended		Period from August 5, 1997 (date of inception)
	March 31, 2010	March 31, 2009	to March 31, 2010
Unrealized gain (loss) on ARS (Note 5)	$ 19	$ 670	$ (2,339)
Unrealized gain (loss) on investment put option related to ARS Rights (Note 5)	(19)	(670)	2,339
Warrant expense			(1,585)
Interest income and other income	163	258	28,697
Interest expense and other expense	(69)	(100)	(5,840)
Interest and Other, net	$ 94	$ 158	$ 21,272

Investments that the Company designates as trading securities are reported at fair value, with gains or losses resulting from changes in fair value recognized in earnings and included in Interest and Other, net. The Company classified its investments in ARS as trading securities in short-term assets as of March 31, 2010 and December 31, 2009.

The Company elected to measure the investment put option related to the ARS Rights at fair value to mitigate volatility in reported earnings due to its linkage to the ARS. The Company recorded $2.3 million as the fair value of the investment put option related to the ARS Rights as of March 31, 2010 and $2.4 million as the fair value of the investment put option related to the ARS Rights as of December 31, 2009, classified as a short-term asset on the balance sheet with a corresponding credit to Interest and Other, net. Changes in the fair value of the ARS are recognized in current period earnings in Interest and Other, net.

Warrant expense of $1.6 million for the period from inception to March 31, 2010 related to the change in the fair value of the warrant liability that was recorded in connection with the Company s registered direct equity offering in May 2009.

Interest income and other income primarily consists of interest income generated from the Company s cash, cash equivalents and investments. Interest expense and other expense primarily consists of interest expense on borrowings under the Company s equipment financing lines and on its loan agreement with UBS Bank USA and UBS Financial Services Inc.

Note 10. Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

The Company has adopted new accounting guidance for improving disclosures about fair value measurements. The new guidance adds a requirement to disclose transfers in and out of Level 3 and fair value measurements, and clarifies existing guidance about the level of disaggregation of fair value measurements and disclosures regarding inputs and valuation techniques. The Company s adoption of the new guidance did not have a material impact on its financial position or results of operations.

Accounting Pronouncements Not Yet Adopted

In October 2009, the Financial Accounting Standards Board (FASB) issued new accounting guidance for recognizing revenue for a multiple-deliverable revenue arrangement. The new guidance amends the existing guidance for separately accounting for individual deliverables in a revenue arrangement with multiple deliverables, and removes the criterion that an entity must use objective and reliable evidence of fair value to separately account for the deliverables. The new guidance also establishes a hierarchy for determining the value of each deliverable and

establishes the relative selling price method for allocating consideration when vendor specific objective evidence or third party evidence of value does not exist. The Company must adopt the new guidance prospectively for new revenue arrangements entered into or materially modified beginning in the first quarter of 2011. Earlier adoption is permitted. The Company is currently evaluating the impact that the new guidance will have on its financial statements and the timing of its adoption.

In January 2010, the FASB issued new accounting guidance for improving disclosures about fair value measurements, which requires a gross presentation of Level 3 fair value rollforwards. The guidance is effective for the Company beginning in the first quarter of 2011. The Company does not expect that its adoption of the new fair value guidance will have a material impact on its financial position or results of operations.

In April 2010, the FASB issued new accounting guidance on the milestone method of revenue recognition. The new guidance codifies the milestone method as an acceptable revenue recognition model when a milestone is deemed to be substantive. The guidance is effective for the Company beginning in the first quarter of 2011, and is to be applied prospectively for milestones achieved after the effective date, although early adoption is permitted. Retrospective adoption of the guidance for all prior periods is also allowed. The Company is currently evaluating the timing of its adoption of the new revenue recognition guidance, but does not expect that its adoption of the guidance will have a material impact on its financial position or results of operations.

Note 11. Subsequent Events

In April 2010, the Company sold 1,898,119 shares of its common stock to Kingsbridge under the 2007 CEFF and received proceeds of $5.6 million. Kingsbridge is not obligated to purchase any further shares under the 2007 CEFF unless certain conditions are met, including a minimum volume weighted average price of $2.00 for the Company s common stock. The gross proceeds represent prices equal to 90% of the volume weighted average price of the Company s stock on each trading day during an eight day pricing period prior to each sale date.

On May 3, 2010, the Company issued 71,961 shares of common stock pursuant to the ESPP at an average price of $1.71 per share.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis should be read in conjunction with our financial statements and accompanying notes included elsewhere in this report. Operating results are not necessarily indicative of results that may occur in future periods.

This report contains forward-looking statements that are based upon current expectations within the meaning of the Private Securities Litigation Reform Act of 1995. We intend that such statements be protected by the safe harbor created thereby. Forward-looking statements involve risks and uncertainties and our actual results and the timing of events may differ significantly from the results discussed in the forward-looking statements. Examples of such forward-looking statements include, but are not limited to, statements about or relating to:

- guidance concerning revenues, research and development expenses and general and administrative expenses for 2010;
- the sufficiency of existing resources to fund our operations for at least the next 12 months;
- our capital requirements and needs for additional financing;
- the initiation, design, progress, timing and scope of clinical trials and development activities for our drug candidates and potential drug candidates conducted by ourselves or our partners, such as Amgen, Inc. (Amgen), including the anticipated timing for initiation of clinical trials and anticipated dates of data becoming available or being announced from clinical trials;
- the results from the clinical trials and non-clinical studies of our drug candidates and other compounds, and the significance and utility of such results;
- our and our partners , such as Amgen s, plans or ability to conduct the continued research and development of our drug candidates and other compounds;
- our expected roles in research, development or commercialization under our strategic alliances, such as with Amgen;

the properties and potential benefits of, and the potential market opportunities for, our drug candidates and other compounds, including the potential indications for which they may developed;

the sufficiency of the clinical trials conducted with our drug candidates to demonstrate that they are safe and efficacious;

our receipt of milestone payments, royalties, reimbursements and other funds from current or future partners under strategic alliances, such as with Amgen;

our plans to seek strategic alternatives for our oncology program with third parties;

our ability to continue to identify additional potential drug candidates that may be suitable for clinical development;

our plans or ability to commercialize drugs with or without a partner, including our intention to develop sales and marketing capabilities;

the focus, scope and size of our research and development activities and programs;

the utility of our focus on the cytoskeleton and our ability to leverage our experience in muscle contractility to other muscle functions;

our plans and ability to liquidate our auction rate securities (ARS) investments;

the issuance of shares of our common stock under our committed equity financing facility entered into with Kingsbridge Capital Limited (Kingsbridge) in 2007;

our ability to protect our intellectual property and to avoid infringing the intellectual property rights of others;

expected future sources of revenue and capital;

losses, costs, expenses and expenditures;

future payments under loan and lease obligations and equipment financing lines;

potential competitors and competitive products;

increasing the number of our employees, retaining key personnel and recruiting additional key personnel;

expected future amortization of employee stock-based compensation; and

the potential impact of recent accounting pronouncements on our financial position or results of operations.

Such forward-looking statements involve risks and uncertainties, including, but not limited to, those risks and uncertainties relating to:

Amgen s decisions with respect to the timing, design and conduct of development activities for omecamtiv mecarbil, including decisions to postpone or discontinue research or development activities relating to omecamtiv mecarbil;

our ability to obtain additional financing;

our receipt of funds under our current or future strategic alliances;

difficulties or delays in the development, testing, production or commercialization of our drug candidates;

difficulties or delays in or slower than anticipated patient enrollment in our or our partners clinical trials;

unexpected adverse side effects or inadequate therapeutic efficacy of our drug candidates that could slow or prevent product approval (including the risk that current and past results of preclinical studies or clinical trials may not be indicative of future clinical trials results);

results from non-clinical studies that may adversely impact the timing or the further development of our drug candidates and potential drug candidates;

the possibility that the U.S. Food and Drug Administration (FDA) or foreign regulatory agencies may delay or limit our or our partners ability to conduct clinical trials or may delay or withhold approvals for the manufacture and sale of our products;

activities and decisions of, and market conditions affecting, current and future strategic partners;

our ability to enter into partnership agreements for any of our programs on acceptable terms and conditions;

UBS s ability to fulfill its obligations to purchase our ARS beginning on June 30, 2010 pursuant to our settlement agreement;

the conditions in our 2007 committed equity financing facility with Kingsbridge that must be fulfilled before we can require Kingsbridge to purchase our common stock, including the minimum volume-weighted average share price;

our ability to maintain the effectiveness of our registration statement permitting resale of securities to be issued to Kingsbridge by us in connection with our 2007 committed equity financing facility;

changing standards of care and the introduction of products by competitors or alternative therapies for the treatment of indications we target that may make our drug candidates commercially unviable;

the uncertainty of protection for our intellectual property, whether in the form of patents, trade secrets or otherwise; and

potential infringement or misuse by us of the intellectual property rights of third parties.

In addition such statements are subject to the risks and uncertainties discussed in the Risk Factors section and elsewhere in this document. Operating results reported are not necessarily indicative of results that may occur in future periods.

When used in this report, unless otherwise indicated, Cytokinetics, the Company, we, our and us refers to Cytokinetics, Incorporated.

CYTOKINETICS, and our logo used alone and with the mark CYTOKINETICS, are registered service marks and trademarks of Cytokinetics. Other service marks, trademarks and trade names referred to in this report are the property of their respective owners.

Overview

We are a clinical-stage biopharmaceutical company focused on the discovery and development of novel small molecule therapeutics that modulate muscle function for the potential treatment of serious diseases and medical conditions. Our research and development activities relating to the biology of muscle function have evolved from our knowledge and expertise regarding the cytoskeleton, a complex biological infrastructure that plays a fundamental role within every human cell. Our current research and development programs relating to the biology of muscle function are directed to small molecule modulators of the contractility of cardiac, skeletal and smooth muscle. We intend to leverage our experience in muscle contractility in order to expand our current pipeline into new therapeutic areas, and expect to continue to be able to identify additional potential drug candidates that may be suitable for clinical development.

We currently have five drug candidates that have progressed into clinical development: omecamtiv mecarbil for the potential treatment of heart failure; CK-2017357 for the potential treatment of diseases or medical conditions associated with muscle weakness or wasting; and ispinesib, SB-743921, and GSK-923295 for potential treatment of cancer. We are also conducting non-clinical development of a backup compound to CK-2017357 and of compounds that inhibit smooth muscle contractility and which may be useful as potential treatments for diseases and conditions such as systemic hypertension or bronchoconstriction.

Muscle Contractility Programs

Cardiac Muscle Contractility

Our lead drug candidate from this program is omecamtiv mecarbil, a novel cardiac muscle myosin activator. In December 2006, we entered into a collaboration and option agreement with Amgen to discover, develop and commercialize novel small molecule

therapeutics that activate cardiac muscle contractility for potential applications in the treatment of heart failure, including omecamtiv mecarbil. The agreement provided Amgen with a non-exclusive license and access to certain technology. The agreement also granted Amgen an option to obtain an exclusive license worldwide, except Japan, to develop and commercialize omecamtiv mecarbil and other drug candidates arising from the collaboration. In May 2009, Amgen exercised this option and subsequently paid us an exercise fee of $50.0 million. As a result, Amgen is now responsible for the development and commercialization of omecamtiv mecarbil and related compounds, at its expense worldwide, except Japan, subject to our development and commercialization participation rights. Under the agreement, Amgen will reimburse us for agreed research and development activities we perform. The agreement provides for potential pre-commercialization and commercialization milestone payments of up to $600.0 million in the aggregate on omecamtiv mecarbil and other potential products arising from research under the collaboration, and royalties that escalate based on increasing levels of annual net sales of products commercialized under the agreement. The agreement also provides for us to receive increased royalties by co-funding Phase III development costs of drug candidates under the collaboration. If we elect to co-fund such costs, we would be entitled to co-promote omecamtiv mecarbil in North America and participate in agreed commercialization activities in institutional care settings, at Amgen s expense.

We have conducted a clinical trials program for omecamtiv mecarbil comprised of multiple Phase I and Phase IIa clinical trials designed to evaluate the safety, tolerability, pharmacodynamics and pharmacokinetic profiles of both intravenous and oral formulations in a diversity of patients, including patients with stable heart failure and patients with ischemic cardiomyopathy. In these trials, omecamtiv mecarbil exhibited generally linear, dose-proportional pharmacokinetics across the dose ranges studied. The adverse effects observed in humans at doses that exceeded the maximum-tolerated dose appeared similar to the adverse findings which occurred in preclinical safety studies at similar plasma concentrations. These effects are believed to be related to the mechanism of action of this drug candidate which, at doses that exceeded the maximum-tolerated dose, resulted in an excessive prolongation of the systolic ejection time. However, these effects resolved promptly with discontinuation of the infusions of omecamtiv mecarbil.

Amgen is now responsible for clinical development of omecamtiv mecarbil following its exercise of its option. We anticipate that in mid-2010, Amgen will initiate a Phase IIa multi-center, open-label, dose-escalating, sequential-cohort pharmacokinetic clinical trial of a modified-release and an immediate-release oral formulation of omecamtiv mecarbil in stable heart failure patients. The trial is anticipated to enroll up to 84 patients with the primary objective to evaluate the pharmacokinetics of the two formulations of omecamtiv mecarbil following dosing twice or three times a day for eight days. The secondary endpoint will be to evaluate the safety and tolerability of the two formulations of omecamtiv mecarbil at steady state. We also anticipate that in mid-2010, Amgen will initiate a Phase Ib, multi-center, open-label, single-dose, safety and pharmacokinetic clinical study of a modified-release oral formulation of omecamtiv mecarbil in patients with renal dysfunction.

We also anticipate that by year-end 2010, Amgen will initiate a randomized, double-blind, placebo-controlled, Phase IIb clinical trial of an intravenous formulation of omecamtiv mecarbil in hospitalized acute heart failure patients with left ventricular systolic dysfunction. The trial is anticipated to examine clinical, echocardiographic and pharmacokinetic endpoints at three dose levels of omecamtiv mecarbil and placebo. The primary and secondary endpoints to be assessed in this trial are still under discussion. This development program is expected to proceed alongside the previously announced plans to conduct additional pharmacokinetic studies of the oral formulations of omecamtiv mecarbil.

The clinical trials program for omecamtiv mecarbil may proceed for several years, and we will not be in a position to generate any revenues or material net cash flows from sales of this drug candidate until the program is successfully completed, regulatory approval is achieved, and the drug is commercialized. Omecamtiv mecarbil is at too early a stage of development for us to predict when or if this may occur. We funded all research and development costs associated with this program prior to Amgen s option exercise in May 2009. We recorded research and development expenses for activities relating to our cardiac muscle contractility program of approximately $0.5 million and $3.8 million in the three months ended March 31, 2010 and 2009, respectively. We recognized revenue of $0.6 million for expense and full-time employee equivalent (FTE) reimbursements and $16,000 for expense reimbursements as

research and development revenue from Amgen in the three months ended March 31, 2010 and 2009, respectively.

We anticipate that our expenditures relating to the research and development of compounds in our cardiac muscle contractility program will increase if we participate in the future advancement of omecamtiv mecarbil through clinical development. Our expenditures will also increase if Amgen terminates development of omecamtiv mecarbil or related compounds and we elect to develop them independently or if we elect to co-fund later-stage development of omecamtiv mecarbil or other compounds in our cardiac muscle contractility program under our collaboration and option agreement with Amgen.

Skeletal Muscle Contractility

CK-2017357 is the lead potential drug candidate from this program. CK-2017357 and its backup development compound are structurally distinct and selective small molecule activators of the fast skeletal sarcomere. These compounds act on fast skeletal muscle troponin. Activation of troponin increases its sensitivity to calcium, leading to an increase in skeletal muscle contractility. This mechanism of action has demonstrated encouraging pharmacological activity in preclinical models. We are evaluating the potential indications for which CK-2017357 may be useful. In March 2010, CK-2017357 received an orphan drug designation from the FDA for the treatment of amyotrophic lateral sclerosis, also known as ALS or Lou Gehrig s disease.

During the first quarter of 2010, we completed enrollment and treatment of healthy volunteers in the first part, or Part A, of a two-part, Phase I, first-time-in-humans, ascending, single-dose, double-blind, placebo-controlled clinical trial of CK-2017357. Part A of this trial was designed to assess the safety, tolerability and pharmacokinetic profile of this drug candidate administered orally in healthy male volunteers and to determine its maximum tolerated dose and plasma concentration. The maximum-tolerated dose was determined to be 2000 mg. At this dose, the most common adverse events were dizziness and euphoric mood; these events were deemed mild in severity. At the single dose that exceeded the maximum-tolerated dose, 2500 mg, moderately severe dizziness and an episode of syncope (a temporary loss of consciousness) were reported.

During the first quarter, we also announced positive data from the second part, or Part B, of this clinical trial. Part B evaluated in healthy volunteers the pharmacodynamic effect of single oral doses of CK-2017357 that had been tolerated in Part A. Results from Part B of the trial showed that CK-2017357 produced concentration-dependent, statistically significant increases, versus placebo, in the force developed by the tibialis anterior muscle, and that the doses administered were well-tolerated.

In both Part A and Part B of this clinical trial, adverse events of dizziness and euphoric mood appeared to increase in frequency with escalating doses of CK-357; however, at the maximum tolerated dose and below, all these adverse events were characterized as mild in severity. No serious adverse events were reported in either Part A or Part B of this clinical trial.

Also during the first quarter of 2010, we announced data from a second Phase I clinical trial designed to investigate the safety, tolerability and pharmacokinetic profile of CK-2017357 after multiple oral doses to steady state in healthy male volunteers. Results from this trial showed that both the maximum CK-2017357 plasma concentration and the area under the CK-2017357 plasma concentration versus time curve from dosing until 24 hours after dosing were generally dose-proportional and exhibited only modest accumulation compared to the values measured after the first dose. In general, systemic exposure to CK-2017357 in this trial was high and inter-subject variability was low. In addition, these multiple dose regimens of CK-2017357 were well-tolerated, and no serious adverse events were observed. Adverse events included dizziness, headache and euphoric mood; all these events were judged to have been mild in severity except for one complaint of dizziness that was classified as moderately severe.

In April 2010, we initiated dosing in a Phase IIa evidence of effect clinical trial of CK-2017357 in patients with ALS. Our evidence of effect clinical trials are intended to translate pharmacodynamic assessments demonstrated in healthy volunteers to impaired populations and potentially to establish statistically significant and clinically relevant evidence of pharmacodynamic effects. These trials may then form the basis for larger clinical trials designed to demonstrate proof of concept in which improvements may be seen in the consequences of disease over time. We anticipate initiating a Phase IIa evidence of effect clinical trial of CK-2017357 for patients with claudication associated with peripheral artery disease in the second quarter of 2010. We also anticipate continuing non-clinical development studies of the backup potential drug candidate in our skeletal muscle contractility program throughout 2010.

CK-2017357 is at too early a stage of development for us to predict if or when we will be in a position to generate any revenues or material net cash flows from its commercialization. We currently fund all research and development costs associated with this program. We recorded research and development expenses for activities relating to our skeletal muscle contractility program of approximately $6.4 million and $2.6 million in the three months ended March 31, 2010 and 2009, respectively. We anticipate that our expenditures relating to the research and development of compounds in our skeletal muscle contractility program will increase significantly if and as we advance

CK-2017357, its back-up compound or other compounds from this program into and through development.

Smooth Muscle Contractility

Our smooth muscle contractility program is focused on the discovery and development of small molecule smooth muscle myosin inhibitors, and leverages our expertise in muscle function and its application to drug discovery. Our inhaled smooth muscle myosin inhibitors have demonstrated pharmacological activity in preclinical models of bronchoconstriction and may have application for indications such as asthma or chronic obstructive pulmonary disease. Our smooth muscle myosin inhibitors, administered orally or intravenously, have demonstrated pharmacological activity in preclinical models of vascular constriction. Smooth muscle myosin inhibitors administered orally may have application in systemic hypertension. We anticipate continuing non-clinical development studies of our smooth muscle myosin inhibitors throughout 2010.

This potential drug candidate is at too early a stage of development for us to predict if or when we will be in a position to generate any revenues or material net cash flows from its commercialization. We currently fund all research and development costs associated with this program. We recorded research and development expenses for activities relating to our smooth muscle contractility program of approximately $0.6 million and $1.7 million in the three months ended March 31, 2010 and 2009, respectively. We anticipate that our expenditures relating to the research and development of compounds in our smooth muscle contractility program will increase significantly if and as we advance compounds from this program into and through development.

Oncology Program: Mitotic Kinesin Inhibitors

We currently have three drug candidates for the potential treatment of cancer: ispinesib, SB-743921 and GSK-923295. All of these arose from our earlier research activities directed to the role of the cytoskeleton in cell division and were progressed under our strategic alliance with GSK. Under this strategic alliance, we focused primarily on two mitotic kinesins: kinesin spindle protein (KSP) and centromere-associated protein E (CENP-E). Inhibition of KSP or CENP-E interrupts cancer cell division, causing cell death. Ispinesib and SB-743921 are structurally distinct small molecules that specifically inhibit KSP. GSK-923295 specifically inhibits CENP-E.

In November 2006, we amended our strategic alliance with GSK and assumed responsibility, at our expense, for the continued research, development and commercialization of inhibitors of KSP, including ispinesib and SB-743921, and other mitotic kinesins, other than CENP-E. GSK retained an option to resume responsibility for the development and commercialization of either or both of ispinesib and SB-743921. This option expired at the end of 2008. As a result, we have retained all rights to develop and commercialize ispinesib and SB-743921, subject to certain royalty obligations to GSK. In December 2009, we agreed with GSK to terminate this strategic alliance, effective February 28, 2010. Accordingly, we have retained all rights to develop and commercialize GSK-923295, subject to certain royalty obligations to GSK. We are evaluating strategic alternatives for the future development and commercialization of ispinesib, SB-743921 and GSK-923295 with third parties.

Ispinesib

We have completed patient treatment in the Phase I portion of our Phase I/II clinical trial evaluating ispinesib as monotherapy administered as a first-line treatment in chemotherapy-naïve patients with locally advanced or metastatic breast cancer and have closed this trial. As a result of the expiration of GSK s option relating to ispinesib, we have retained all development and commercialization rights to ispinesib, subject to certain royalty obligations to GSK. We are evaluating strategic alternatives for the future development and commercialization of ispinesib with third parties.

SB-743921

We have closed enrollment and intend to complete patient treatment in the Phase I portion of our Phase I/II clinical trial of SB-743921 in patients with Hodgkin or non-Hodgkin lymphoma. As a result of the expiration of GSK s option relating to SB-743921, we have retained all development and commercialization rights to SB-743921, subject to certain royalty obligations to GSK. We are evaluating strategic alternatives for the future development and commercialization of SB-743921 with third parties.

GSK-923295

GSK has closed enrollment and continues patient treatment in its Phase I clinical trial of GSK-923295. GSK has agreed to complete this clinical trial at its cost. Following the agreed termination of our strategic alliance with GSK in February 2010, we have retained all development and commercialization rights to GSK-923295, subject to certain royalty obligations to GSK. We are evaluating strategic alternatives for the future development and commercialization

of GSK-923295 with third parties.

Each of ispinesib, SB-743921 and GSK-923295 is at too early a stage of development for us to predict if or when we will be in a position to generate any revenues or material net cash flows from its commercialization. We currently fund all research and development costs associated with ispinesib and SB-743921. We recorded research and development expenses for activities relating to our mitotic kinesins inhibitors program of approximately $0.5 million and $1.2 million in the three months ended March 31, 2010 and 2009, respectively. We received and recognized as revenue reimbursements from GSK of patent expenses related to our mitotic kinesin inhibitors program of zero and $4,000 for the three months ended March 31, 2010 and 2009, respectively. We have completed the Phase I portion of the Phase I/II clinical trial for ispinesib and intend to complete the Phase I portion of the Phase I/II clinical trial for SB-743921. GSK is completing the current Phase I clinical trial of GSK-923295. We do not currently intend to conduct any further development of these drug candidates ourselves. We are evaluating strategic alternatives to continue the development of ispinesib, SB-743921 and GSK-923295 with third parties. We may not be able to enter into an agreement regarding such an alternative on acceptable terms, if at all.

Development Risks

The successful development of any of our drug candidates is highly uncertain. We cannot estimate with certainty or know the exact nature, timing and costs of the activities necessary to complete the development of any of our drug candidates or the date of completion of these development activities due to numerous risks and uncertainties, including, but not limited to:

- decisions made by Amgen with respect to the development of omecamtiv mecarbil;
- the uncertainty of the timing of the initiation and completion of patient enrollment and treatment in our clinical trials;
- the possibility of delays in the collection of clinical trial data and the uncertainty of the timing of the analyses of our clinical trial data after these trials have been initiated and completed;
- our potential inability to obtain additional funding and resources for our development activities on acceptable terms, if at all, including, but not limited to, our potential inability to obtain or retain partners to assist in the design, management, conduct and funding of clinical trials;
- delays or additional costs in manufacturing of our drug candidates for clinical trial use, including developing appropriate formulations of our drug candidates;
- the uncertainty of clinical trial results, including variability in patient response;
- the uncertainty of obtaining FDA or other foreign regulatory agency approval required for the clinical investigation of our drug candidates;
- the uncertainty related to the development of commercial scale manufacturing processes and qualification of a commercial scale manufacturing facility; and
- possible delays in the characterization, formulation and manufacture of potential drug candidates.

If we fail to complete the development of any of our drug candidates in a timely manner, it could have a material adverse effect on our operations, financial position and liquidity. In addition, any failure by us or our partners to obtain, or any delay in obtaining, regulatory approvals for our drug candidates could have a material adverse effect on our results of operations. A further discussion of the risks and uncertainties associated with completing our programs on schedule, or at all, and certain consequences of failing to do so are discussed further in the risk factors entitled We have never generated, and may never generate, revenues from commercial sales of our drugs and we may not have drugs to market for at least several years, if ever, Clinical trials may fail to demonstrate the desired safety and efficacy of our drug candidates, which could prevent or significantly delay completion of clinical development and regulatory

approval and Clinical trials are expensive, time-consuming and subject to delay, and other risk factors.

Revenues

Our current revenue sources are limited, and we do not expect to generate any revenue from product sales for several years, if at all. We have recognized revenues from our strategic alliances with Amgen and GSK for license fees and agreed research and development activities.

In December 2006, we entered into our collaboration and option agreement with Amgen, under which we received an upfront, non-refundable, non-exclusive license and technology access fee of $42.0 million. In connection with entering into the agreement, we also entered into a common stock purchase agreement with Amgen. In January 2007, we issued 3,484,806 shares of our common stock to Amgen for net proceeds of $32.9 million, of which the $6.9 million purchase premium was recorded as deferred revenue. Through May 2009, we amortized the upfront non-exclusive license and technology access fee and stock purchase premium to license revenue ratably over the maximum term of the non-exclusive license, which was four years. In June 2009, we recognized as revenue the remaining balance of $21.4 million of the related deferred revenue when Amgen exercised its option, triggering the end of the non-exclusive license period. In June 2009, we received a non-refundable option exercise fee from Amgen of $50.0 million, which we recognized in revenue as license fees from a related party. We may receive additional payments from Amgen upon achieving certain precommercialization and commercialization milestones. Milestone payments are non-refundable and are recognized as revenue when earned, as evidenced by the achievement of the specified milestones and the absence of ongoing performance obligations.

We have received reimbursements from Amgen for agreed research and development activities, which we recorded as revenue as the related expenses were incurred. We may be eligible to receive further reimbursements from Amgen for agreed research and development activities, which we will record as revenue if and when the related expenses are incurred. We record amounts received in advance of performance as deferred revenue.

In 2007, we received a $1.0 million milestone payment from GSK relating to its initiation of a Phase I clinical trial of GSK-923295. Milestone payments are non-refundable and are recognized as revenue when earned, as evidenced by achievement of the specified milestones and the absence of ongoing performance obligations. We record amounts received in advance of performance as deferred revenue. The revenues recognized to date are non-refundable, even if the relevant research effort is not successful. In December 2008, GSK s option to license ispinesib and SB-743291 expired and all rights to these drug candidates remain with us under the collaboration and license agreement, subject to certain royalty obligations to GSK. In December 2009, we agreed with GSK to terminate this strategic alliance, effective February 28, 2010. Accordingly, we have retained all rights to develop and commercialize GSK-923295, subject to certain royalty obligations to GSK.

Because a substantial portion of our revenues for the foreseeable future will depend on achieving development and other precommercialization milestones under our strategic alliance with Amgen, our results of operations may vary substantially from year to year.

If one or more of our drug candidates is approved for sale as a drug, we expect that our future revenues will most likely be derived from royalties on sales from drugs licensed to Amgen under our strategic alliance and from those licensed to future partners, and from direct sales of our drugs. We retain a product-by-product option to co-fund certain later-stage development activities under our strategic alliance with Amgen, thereby potentially increasing our royalties and affording us co-promotion rights in North America. If we exercise our co-promotion rights under this strategic alliance, we are entitled to receive reimbursement for certain sales force costs we incur in support of our commercial activities.

Research and Development

We incur research and development expenses associated with both partnered and unpartnered research activities. We expect to incur research and development expenses for omecamtiv mecarbil for the potential treatment of heart failure in accordance with agreed upon research and development plans with Amgen. We expect to incur research and development expenses for the continued conduct of preclinical studies and non-clinical and clinical development for CK-2017357 and other skeletal sarcomere activators for the potential treatment of diseases and medical conditions associated with muscle weakness or wasting, preclinical studies and non-clinical development of our smooth muscle myosin inhibitor compounds for the potential treatment of diseases and medical conditions associated with bronchoconstriction, vascular constriction, or both, and our research programs in other disease areas.

Research and development expenses related to our strategic alliance with GSK consisted primarily of costs related to research and screening, lead optimization and other activities relating to the identification of compounds for development as mitotic kinesin inhibitors for the treatment of cancer. Prior to June 2006, certain of these costs were reimbursed by GSK on an FTE basis. From 2001

through November 2006, GSK funded the majority of the costs related to the clinical development of ispinesib and SB-743921. Under our amended collaboration and license agreement with GSK, we assumed responsibility for the continued research, development and commercialization of inhibitors of KSP, including ispinesib and SB-743921, and other mitotic kinesins other than CENP-E, at our sole expense. We expect to incur minimal research and development expenses relating to the close-out of the clinical trials for ispinesib and SB-743921.

Research and development expenses related to any development and commercialization activities we elect to fund consist primarily of employee compensation, supplies and materials, costs for consultants and contract research and manufacturing, facilities costs and depreciation of equipment. From our inception through March 31, 2010, we incurred costs of approximately $135.3 million for research and development activities relating to our cardiac muscle contractility program, $42.4 million for our skeletal muscle contractility program, $27.0 million for our smooth muscle contractility program, $71.3 million for our mitotic kinesin inhibitors program, $53.7 million for our proprietary technologies and $56.6 million for other research programs.

General and Administrative Expenses

General and administrative expenses consist primarily of compensation for employees in executive and administrative functions, including, but not limited to, finance, human resources, legal, business and commercial development and strategic planning. Other significant costs include facilities costs and professional fees for accounting and legal services, including legal services associated with obtaining and maintaining patents and regulatory compliance. We expect that general and administrative expenses will increase in 2010 compared to 2009.

Stock Compensation

The following table summarizes stock-based compensation related to stock options, restricted stock awards and employee stock purchases for the three months ended March 31, 2010 and March 31, 2009 (in thousands):

	Three Months Ended