

CYTRX CORP  
Form 10-Q/A  
November 14, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q/A  
(Amendment No. 1)**

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

**For the quarterly period ended June 30, 2007**

**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, or a non-accelerated filer.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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 November 9, 2007:

90,221,370 exclusive of treasury shares.

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**EXPLANATORY NOTES**

CytRx Corporation ( CytRx, we, our, us and the Company ) is amending in certain respects our Quarterly Report Form 10-Q for the quarter ended June 30, 2007, which we sometimes refer to in this amendment as our original Form 10-Q. The purpose of this amendment is to restate our condensed consolidated financial statements for the quarter ended June 30, 2007 as described below. The restatement relates to our accounting for an equity transaction by our majority-owned subsidiary, RXi Pharmaceuticals Corporation ( RXi ), the accounting for tax withholding amounts related to common stock option exercises and the reclassification of certain general and administrative expenses as research and development expenses.

For the quarter ended June 30, 2007, we originally reported additional paid-in capital of \$2.3 million attributable to RXi's issuance to the University of Massachusetts Medical School, or UMMS, of approximately 462,000 shares of RXi common stock in payment for RXi's acquisition of four technology licenses and an invention disclosure agreement entered into with UMMS in January 2007 that should have been accounted for on our consolidated balance sheet as minority interest in RXi. This accounting correction resulted in a corresponding reduction of \$2.3 million in our additional paid-in capital and stockholders' equity as of June 30, 2007, as well as an increase in loss attributable to minority interests and a decrease in our consolidated net loss of \$176,000 for both the three-month and six-month periods ended June 30, 2007. Additionally, we originally reported \$227,000 in payroll taxes and other withholdings in connection with exercises of employee stock options as an offset to general and administrative expenses in our consolidated statements of operations for the three-month and six-month periods ended June 30, 2007. The \$227,000 is properly classified as a current liability as of June 30, 2007, which correction resulted in an increase in our consolidated net loss by the same amount for both the three-month and six-month periods ended June 30, 2007. The net effect of the correction of both of these items was a \$51,000 increase in our consolidated net loss for the three-month and six-month periods ended June 30, 2007. Our reported earnings per share for these periods were not affected by these corrections.

For the quarter ended June 30, 2007, our originally-reported general and administrative expenses included charges of approximately \$391,000 that we determined are properly classified as research and development expenses. The reclassification of these expenses will have no effect on our consolidated net loss for that period.

The following Items and Exhibits of our original Form 10-Q are amended by this amendment:

Part I Item 1. Financial Statements (unaudited)

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

Part I Item 4. Controls and Procedures

Part II Item 6. Exhibits

Exhibit 31.1 Certification of Chief Executive Officer

Exhibit 31.2 Certification of Chief Financial Officer

Exhibit 32.1 Certification of Chief Executive Officer

Exhibit 32.2 Certification of Chief Financial Officer

Except for the foregoing Items and Exhibits, this amendment does not modify any disclosures contained in our original Form 10-Q. Additionally, the text of this amendment, except for the restatement information, speaks as of the filing date of the original Form 10-Q and does not attempt to update the disclosures in our original Form 10-Q or to discuss any developments subsequent to the date of the original filing. In accordance with the rules and regulations of the Securities and Exchange Commission, the information contained in the original Form 10-Q and this amendment is subject to updated or supplemental information contained in reports filed by us with the Securities and Exchange Commission subsequent to the filing dates of the original Form 10-Q and this amendment.



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EXHIBIT 31.2

EXHIBIT 32.1

EXHIBIT 32.2

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CONDENSED CONSOLIDATED BALANCE SHEETS**

|  | <b>June 30,<br/>2007<br/>(Unaudited)<br/>(Restated)</b> | <b>December 31,<br/>2006</b> |
|--|---|------------------------------|
| <b>ASSETS</b>  |   |                              |
| Current assets:  |   |                              |
| Cash and cash equivalents  | \$ 69,697,571   | \$ 30,381,393                |
| Accounts receivable  | 1,500,000   | 105,930                      |
| Prepaid expense and other current assets   | 666,334   | 233,323                      |
| Total current assets   | 71,863,905  | 30,720,646                   |
| Equipment and furnishings, net   | 214,715   | 252,719                      |
| Molecular library, net   | 238,703   | 283,460                      |
| Goodwill   | 183,780   | 183,780                      |
| Deposits and prepaid insurance expense   | 172,418   | 195,835                      |
| Total assets   | \$ 72,673,521   | \$ 31,636,440                |
| <b>LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS<br/>EQUITY</b>  |   |                              |
| Current liabilities:   |   |                              |
| Accounts payable   | \$ 1,904,002  | \$ 955,156                   |
| Accrued expenses and other current liabilities   | 2,960,002   | 2,722,478                    |
| Deferred revenue, current portion  | 7,329,548   | 6,733,350                    |
| Total current liabilities  | 12,193,552  | 10,410,984                   |
| Deferred revenue, non-current portion  | 11,662,413  | 16,075,117                   |
| Total liabilities  | 23,855,965  | 26,486,101                   |
| Commitment and Contingencies   |   |                              |
| Minority interest in subsidiary  | 2,134,424   |                              |
| Stockholders' equity:  |   |                              |
| Preferred Stock, \$.01 par value, 5,000,000 shares authorized, including 5,000 shares of Series A Junior Participating Preferred Stock; no shares issued and outstanding |   |                              |
| Common stock, \$.001 par value, 125,000,000 shares authorized; 88,528,000 and 70,789,000 shares issued at June 30, 2007 and December 31, 2006, respectively              | 88,528  | 70,789                       |
| Additional paid-in capital   | 199,309,674   | 146,961,657                  |
| Treasury stock, at cost (633,816 shares held at June 30, 2007 and December 31, 2006, respectively)   | (2,279,238)   | (2,279,238)                  |
| Accumulated deficit  | (150,435,832)   | (139,602,869)                |

|   |               |               |
|---|---------------|---------------|
| Total stockholders' equity                                    | 46,683,132    | 5,150,339     |
| Total liabilities, minority interest and stockholders' equity | \$ 72,673,521 | \$ 31,636,440 |

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>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|   | <b>(Restated)</b>         |             | <b>(Restated)</b>       |             |
| Revenue:  |                           |             |                         |             |
| Service revenue   | \$ 2,369,513              | \$          | \$ 3,816,506            | \$ 60,830   |
| Grant revenue   |                           |             | 116,070                 |             |
| Other revenue   | 1,000                     |             | 1,000                   |             |
|   | 2,370,513                 |             | 3,933,576               | 60,830      |
| Expenses:   |                           |             |                         |             |
| Research and development (includes non-cash expense as follows: \$175,000 and \$77,000 of employee stock-based compensation expense for the three months ended June 30, 2007 and 2006, respectively, \$212,000 and \$160,000 of employee stock-based compensation expense for the six months ended June 30, 2007 and 2006 respectively; \$339,000 and \$61,000 of non-employee stock-based compensation for the three months ended June 30, 2007 and 2006, respectively; \$1,315,000 and \$105,000 of non-employee stock-based compensation for the six months ended June 30, 2007 and 2006, respectively, and an aggregate 462,112 shares of RXi common stock valued at \$2,311,560 issued in exchange for licensing rights) | 6,884,296                 | 3,205,372   | 10,892,670              | 5,517,383   |
| General and administrative (includes non-cash expense as follows: \$568,000 and \$274,000 of employee stock-based compensation for the three months ended June 30, 2007 and 2006, respectively, and \$679,000 and \$536,000 of employee stock-based compensation expense for the six months ended June 30, 2007 and 2006, respectively, and \$0 and \$58,000 of non-employee stock-based compensation for the three months ended June 30, 2007 and 2006, respectively, and \$0 and \$126,000 of non-employee stock-based compensation for the six months ended June 30, 2007 and 2006, respectively )   | 4,106,597                 | 2,436,916   | 6,591,681               | 4,459,582   |



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|  |                |                |                 |                 |
|--|----------------|----------------|-----------------|-----------------|
|  | 10,990,893     | 5,642,288      | 17,484,351      | 9,976,965       |
| Loss before other income   | (8,620,380)    | (5,642,288)    | (13,550,775)    | (9,916,135)     |
| Other income:  |                |                |                 |                 |
| Interest and dividend income   | 659,062        | 176,908        | 1,039,676       | 284,398         |
| Other income   | 1,500,000      |                | 1,500,000       |                 |
| Minority interest in losses of subsidiary  | 176,136        |                | 178,136         |                 |
| Net loss applicable to common shareholders before deemed dividend                      | (6,285,182)    | (5,465,380)    | (10,832,963)    | (9,631,737)     |
| Deemed dividend for anti-dilution adjustment made to outstanding common stock warrants |                |                |                 | (488,429)       |
| Net loss applicable to common shareholders   | \$ (6,285,182) | \$ (5,465,380) | \$ (10,832,963) | \$ (10,120,166) |
| Basic and diluted loss per common share  | \$ (0.07)      | \$ (0.08)      | \$ (0.14)       | \$ (0.15)       |
| Weighted average shares outstanding  | 85,379,769     | 69,977,876     | 79,242,321      | 66,181,900      |

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>Six Months Ended June 30,</b> |                   |
|---|----------------------------------|-------------------|
|   | <b>2007</b>                      | <b>2006</b>       |
|   | <b>(Restated)</b>                |                   |
| <b>Cash flows from operating activities:</b>                                |                                  |                   |
| Net loss  | \$ (10,832,963)                  | \$ (9,631,737)    |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                  |                   |
| Depreciation and amortization   | 121,067                          | 138,941           |
| Minority interest in losses of subsidiary                                   | (178,136)                        |                   |
| Common stock, stock options and warrants issued for services                | 2,895,605                        | 230,547           |
| Expense related to employee and non-employee stock options                  | 1,622,874                        | 696,378           |
| Net change in operating assets and liabilities                              | (4,431,803)                      | 788,796           |
| <br>Total adjustments   | <br>29,607                       | <br>1,854,662     |
| <br>Net cash used in operating activities                                   | <br>(10,803,356)                 | <br>(7,777,075)   |
| <b>Cash flows from investing activities:</b>                                |                                  |                   |
| Purchases of property and equipment   | (38,303)                         | (22,335)          |
| <br>Net cash used in investing activities                                   | <br>(38,303)                     | <br>(22,335)      |
| <b>Cash flows from financing activities:</b>                                |                                  |                   |
| Proceeds from exercise of stock options and warrants                        | 15,909,775                       | 339,194           |
| Net proceeds from issuances of common stock                                 | 34,248,062                       | 12,404,360        |
| <br>Net cash provided by financing activities                               | <br>50,157,837                   | <br>12,743,554    |
| <br>Net increase in cash and cash equivalents                               | <br>39,316,178                   | <br>4,944,144     |
| Cash and cash equivalents at beginning of period                            | 30,381,393                       | 8,299,390         |
| <br>Cash and cash equivalents at end of period                              | <br>\$ 69,697,571                | <br>\$ 13,243,534 |
| <b>Supplemental disclosure of cash flow information:</b>                    |                                  |                   |
| Cash received during the period for interest received                       | \$ 1,039,676                     | \$ 248,398        |

**Non-Cash Financing Activities:**

In connection with the Company's adjustment to the terms of certain outstanding warrants on March 2, 2006, the Company recorded a deemed dividend of approximately \$488,000 in the six months ended June, 2006. The deemed dividend was recorded as a charge to retained earnings 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**  
**June 30, 2007**  
**(Unaudited)**

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

CytRx Corporation ( CytRx or the Company ) is a biopharmaceutical research and development company engaged in developing human therapeutic products based primarily upon our small molecule molecular chaperone amplification technology. The Company has completed a three-month Phase IIa clinical trial and six-month open-label trial extension of that trial, for its lead small molecule product candidate, arimoclomol, for the treatment of amyotrophic lateral sclerosis, which is commonly known as ALS or Lou Gehrig's disease. Arimoclomol has received Orphan Drug and Fast Track designation from the U.S. Food and Drug Administration, or FDA, and orphan medicinal product status from the European Commission for the treatment of ALS. The Company plans to initiate a Phase IIb efficacy trial of arimoclomol for this indication during the second half of 2007, subject to FDA clearance. Based on preliminary discussions with the FDA, CytRx is now considering a second efficacy clinical trial for ALS, possibly in parallel with the upcoming Phase IIb trial, to provide additional efficacy data to support a possible approval decision by the FDA. Additionally, recent preclinical animal studies indicated that arimoclomol accelerated the recovery of sensory and motor functions following a stroke, even when administered up to 48 hours after the stroke. Based upon these positive indications, the Company has announced plans to commence a Phase II clinical trial for arimoclomol in stroke recovery in the first half of 2008, subject to FDA clearance. The Company has also announced plans to commence a Phase II clinical trial with its next drug candidate, irovanadine, for diabetic foot ulcers in the first half of 2008, subject to FDA clearance. In addition, subsequent to period end, the Company opened a research and development facility in San Diego to provide it with a dedicated laboratory to accelerate its molecular chaperone drug development programs.

The Company also is engaged in developing therapeutic products based upon ribonucleic acid interference, or RNAi, which has the potential to effectively treat a broad array of diseases by interfering with the expression of targeted disease-associated genes. In order to fully realize the potential value of its RNAi technologies, in January 2007, the Company transferred to RXi Pharmaceuticals Corporation (RXi), its majority-owned subsidiary, substantially all of its RNAi-related technologies and assets in exchange for equity in RXi. These assets consisted primarily of the Company's licenses from University of Massachusetts Medical School, or UMMS, and the Carnegie Institution of Washington relating to fundamental RNAi technologies, as well as research and other equipment situated at the Company's Worcester, Massachusetts, laboratory. On April 30, 2007, the Company contributed to RXi \$15.0 million, net of expenses of approximately \$2.0 million reimbursed to it by RXi, to satisfy certain initial funding requirements under its agreements with UMMS. As a result of these transactions, CytRx owned as of June 30, 2007 approximately 86% of the outstanding capital stock of RXi. RXi is focused solely on developing and commercializing therapeutic products based upon RNAi technologies for the treatment of human diseases, with an initial focus on neurodegenerative diseases, cancer, type 2 diabetes and obesity. The Company has agreed to reduce its share of ownership of RXi to less than a majority of the outstanding voting power as soon as reasonably practicable. In order to do so, the Company has announced its intention to issue a dividend of a portion of its RXi shares to its stockholders. Any proposed dividend to its stockholders of RXi shares would be subject to approval of the CytRx board of directors and compliance with applicable Securities and Exchange Commission, or SEC, rules and the requirements of the Delaware General Corporation Law. Any such dividend may be taxable to CytRx, although any applicable taxes due may be off-set by the Company's net operating loss carryforwards; however there is no assurance that the Company's current net operating loss carryforwards will be sufficient to cover any such taxable event, and if they are not, then CytRx might be required to pay income tax.

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 our business and operations. See Note 5 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 analyzed the transaction and 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

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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 as a percentage of actual research and development expense incurred for the research and development of arimoclomol or the development of other ALS treatments.

The accompanying condensed consolidated financial statements at June 30, 2007 and for the three and six-month periods ended June 30, 2007 and 2006 are unaudited, but include all adjustments, consisting of normal recurring entries, which the Company's 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, 2006 have been derived from our audited financial statements as of that date.

The financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The financial statements should be read in conjunction with the Company's audited financial statements in its Form 10-K for the year ended December 31, 2006. 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.

The accompanying condensed consolidated financial statements have been restated to reflect corrections in our accounting for an equity transaction by RXi, the accounting for tax withholding amounts related to common stock option exercises and the classification of certain general and administrative expenses as research and development expenses. The consolidated balance sheet as of June 30, 2007 was restated to reflect an increase of \$2.3 million in minority interest in RXi (offset by approximately \$178,000 of losses attributable to that minority interest), and a corresponding reduction of \$2.3 million in additional paid-in capital and stockholders' equity, as well as a \$227,000 increase in current liabilities. The consolidated statements of operations were restated to reflect a \$51,000 increase in our consolidated net loss for the three-month and six-month periods ended June 30, 2007, in arriving at the net loss applicable to common stockholders of \$6,285,182 and \$10,832,963 for the those periods, respectively. The restated net loss applicable to common stockholders did not change the net loss per share of \$.07 and \$.14 for those periods, respectively. The consolidated statements of operations were also restated to reflect approximately \$391,000 of expenses that were reclassified from general and administrative expenses to research and development expenses for both the three-month and six-month periods ended June 30, 2007.

**2. Recent Accounting Pronouncements**

On July 13, 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109 ( FIN No. 48 ), to create a single model to address accounting for uncertainty in tax positions. FIN No. 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold in which a tax position be reached before financial statement recognition. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN No. 48 as of January 1, 2007, as required. The adoption of FIN No. 48 did not have an impact on the Company's financial position and results of operations.

On September 15, 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. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect SFAS No. 157 will have a significant impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The 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 is

currently assessing the impact of SFAS No. 159 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 (fiscal year 2008 for the Company). The adoption is not expected to have a material impact on the Company's consolidated financial statements.

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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, which will be the Company's fiscal year 2008. The Company does not expect that the adoption of EITF 07-3 will have an impact on the Company's consolidated financial statements.

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

Basic net loss per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Dilutive potential common shares primarily consist of employee stock options and warrants. Common share equivalents which potentially could dilute basic earnings per share in the future, and which were excluded from the computation of diluted loss per share, as the effect would be anti-dilutive, totaled approximately 20.4 million and 29.2 million shares at June 30, 2007 and 2006, respectively.

In connection with the Company's adjustment to the exercise terms of certain outstanding warrants to purchase common stock on March 2, 2006, the Company recorded deemed dividend of approximately \$488,000. The deemed dividend is reflected as an adjustment to net loss for the first quarter of 2006, 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 shares.

**4. Stock Based Compensation****CytRx Corporation**

As of June 30, 2007, an aggregate of 10,000,000 shares of common stock were reserved for issuance under the Company's 2000 Stock Option Incentive Plan, including approximately 6,294,000 shares subject to outstanding common stock options and approximately 1.9 million shares available for future grant. Additionally, the Company has one other active plan, the 1998 Long Term Incentive Plan, which includes approximately 86,000 shares subject to outstanding common stock options and approximately 30,000 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 will expire, unless previously exercised, not later than ten years from the grant date.

Prior to January 1, 2006, the Company accounted for its common stock based compensation plans under the recognition and measurement provisions of Accounting Principles Board No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ), and related interpretations for all awards granted to employees. Under APB 25, when the exercise price of options granted to employees under these plans equals the market price of the common stock on the date of grant, no compensation expense is recorded. When the exercise price of options granted to employees under these plans is less than the market price of the common stock on the date of grant, compensation expense is recognized over the service period.

The Company's stock-based employee compensation plans are described in Note 13 to our financial statements contained in our Annual Report on Form 10-K filed for the year ended December 31, 2006. On January 1, 2006, the Company adopted SFAS 123(R), *Accounting for Stock-based Compensation (Revised 2004)* ( SFAS 123(R) ), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees, non-employee directors, and consultants, including employee stock options. SFAS 123(R) supersedes the Company's previous accounting under APB 25 and SFAS 123, *Employee Stock-Based Compensation*, for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued SAB 107, *Share-Based Payment*, relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. The Company's Statement of Operations as of and for the year ended December 31, 2006 reflects the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company's Statements of Operations for prior periods have not been restated to reflect, and do

not include, the impact of SFAS 123(R). Stock-based compensation expense recognized under SFAS 123(R) for the year ended December 31, 2006 was \$1.3 million.



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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) and 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*. Under SFAS No. 123(R), the compensation associated with stock options paid to non-employees is generally recognized in the period during which services are rendered by such non-employees. Since its adoption of SFAS 123(R) and EITF 96-18, there have been no changes to the Company's equity plans or modifications of its outstanding stock-based awards.

Non-employee option grants that do not vest immediately upon grant are recorded as an expense over the vesting period of the underlying common stock options, using the method prescribed by FASB Interpretation 28. At the end of each financial reporting period prior to vesting, the value of these options, as calculated using the Black-Scholes option pricing model, will be re-measured using the fair value of the Company's common stock and the non-cash compensation recognized 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. The Company recognized approximately \$1,315,000 and \$105,000 of stock based compensation expense related to non-employee common stock options for the six-month periods ended June 30, 2007 and 2006, respectively. Included in the amount recognized in 2007 is an adjustment of approximately \$303,000 related to options granted to consultants in 2006.

During the first six months of 2007, the Company issued options to purchase 900,000 shares of its common stock. The fair value of the common stock options granted in the six month periods listed in the table below was estimated using the Black-Scholes option-pricing model, based on the following assumptions:

|                         | <b>Six Months Ended</b> |                      |
|-------------------------|-------------------------|----------------------|
|                         | <b>June 30, 2007</b>    | <b>June 30, 2006</b> |
| Risk-free interest rate | 4.43% - 4.78%           | 4.27% - 5.23%        |
| Expected volatility     | 108.9%                  | 117.0%               |
| Expected lives (years)  | 6                       | 6                    |
| Expected dividend yield | 0.00%                   | 0.00%                |

The Company's expected stock price volatility assumption is based upon the historical daily volatility of its publicly traded stock. For option grants issued during the six-month periods ended June 30, 2007 and 2006, the Company used a calculated volatility for each grant. The expected life assumptions were based upon the simplified method provided for under 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 six-month periods ended June 30, 2007 and 2006, the Company has estimated an annualized forfeiture rate of 15% and 10%, respectively, for options granted to its employees and 3% for each period for options granted to senior management and directors. 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. Under provisions of SFAS 123(R), the Company recorded \$1,239,000 and \$696,000 of employee stock-based compensation for the six-month periods ended June 30, 2007 and 2006, respectively. No amounts relating to employee stock-based compensation have been capitalized. Compensation costs will be adjusted for future changes in estimated forfeitures.

At June 30, 2007, there remained approximately \$3.5 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:

**Stock Options**  
**Six-Months Ended**

|                                      | <b>June 30, 2007</b>        |                             |                                   | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> |
|--------------------------------------|-----------------------------|-----------------------------|-----------------------------------|--|
|                                      | <b>Number of<br/>Shares</b> | <b>Number of<br/>Shares</b> | <b>Total Number<br/>of Shares</b> |  |
|                                      | <b>(Employees)</b>          | <b>(Non-Employees)</b>      |                                   |  |
| Outstanding at January 1, 2007       | 4,150,000                   | 2,708,000                   | 6,858,000                         | \$ 1.66  |
| Granted                              | 900,000                     |                             | 900,000                           | \$ 4.40  |
| Exercised                            | (596,000)                   | (136,000)                   | (732,000)                         | \$ 1.91  |
| Forfeited                            | (150,000)                   | (582,000)                   | (732,000)                         | \$ 1.73  |
| Outstanding at June 30, 2007         | 4,304,000                   | 1,990,000                   | 6,294,000                         | \$ 2.02  |
| Options exercisable at June 30, 2007 | 2,642,000                   | 1,740,000                   | 4,382,000                         | \$ 1.76  |

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A summary of the activity for non-vested common stock options as of June 30, 2007 is presented below:

|                               | <b>Number of<br/>Shares</b> | <b>Number of<br/>Shares</b> | <b>Total Number<br/>of<br/>Shares</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair<br/>Value per<br/>Share</b> |
|-------------------------------|-----------------------------|-----------------------------|---------------------------------------|---|
|                               | <b>(Employees)</b>          | <b>(Non-Employees)</b>      |                                       |   |
| Non-vested at January 1, 2007 | 1,183,000                   | 917,000                     | 2,100,000                             | \$ 1.19   |
| Granted                       | 900,000                     |                             | 900,000                               | \$ 3.70   |
| Forfeited                     | (150,000)                   | (582,000)                   | (732,000)                             | \$ 1.52   |
| Vested                        | (272,000)                   | (104,000)                   | (376,000)                             | \$ 1.57   |
| Non-vested at June 30, 2007   | 1,661,000                   | 250,000                     | 1,911,000                             | \$ 2.21   |

The following table summarizes significant ranges of outstanding common stock options under the two plans at June 30, 2007:

| <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> |
|-------------------------------------|------------------------------|--|--|--|--|--|
| \$0.25 1.00                         | 999,000                      | 7.13   | \$ 0.80  | 699,000                                      | 7.13   | \$ 0.81  |
| \$1.01 2.00                         | 3,057,000                    | 7.48   | 1.53   | 2,309,000                                    | 7.48   | 1.24   |
| \$2.01 2.50                         | 1,336,000                    | 6.06   | 2.45   | 1,336,000                                    | 6.06   | 2.45   |
| \$2.51 3.00                         | 2,000                        | 1.95   | 2.63   | 2,000  | 1.95   | 2.63   |
| \$3.01 4.51                         | 900,000                      | 9.81   | 4.40   | 36,000                                       | 9.81   | 4.51   |
|                                     | 6,294,000                    | 7.45   | \$ 2.02  | 4,382,000                                    | 6.75   | \$ 1.76  |

The aggregate intrinsic value of outstanding options as of June 30, 2007 was \$8.8 million, of which \$6.0 million 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 June 30, 2007 (\$3.12) and the exercise price of the underlying options. The intrinsic value of options exercised was \$847,000 for the six-month period ended June 30, 2007, and the intrinsic value of options that vested was approximately \$650,000 for the same period.

**RXi Pharmaceuticals**

RXi is a majority owned subsidiary of CytRx and has its own stock option plan, named the RXi Pharmaceuticals Corporation 2007 Incentive Plan. As of June 30, 2007, an aggregate of 1,902,000 shares of common stock were reserved for issuance under the RXi Pharmaceuticals Corporation 2007 Incentive Plan, including approximately 1,177,000 shares subject to outstanding common stock options granted under this plan and approximately 725,000 shares available for future grant. The administrator of the plan determines the times which an option may become exercisable. Vesting periods of options granted to date include vesting upon grant to vesting at the end of a five year period.

RXi which began its operations on January 8, 2006, adopted SFAS 123(R), Accounting for Stock-based Compensation (Revised 2004), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and non-employee directors. In March 2005, the Securities and

Exchange Commission issued SAB 107, *Share-Based Payment*, relating to SFAS 123(R). RXi has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

For common stock options paid in consideration of services rendered by non-employees, RXi recognizes compensation expense in accordance with the requirements of SFAS No. 123(R) and Emerging Issues Task Force Issue No. 96-18, *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. Under SFAS No. 123(R), the compensation associated with common stock options paid to non-employees is generally recognized in the period during which services are rendered by such non-employees. There have been no changes to RXi's equity plans or modifications of its outstanding stock-based awards.

Non-employee option grants that do not vest immediately upon grant are recorded as an expense over the vesting period of the underlying common stock options, using the method prescribed by FASB Interpretation 28. At the end of each financial reporting period prior to vesting, the value of these options, as calculated using the Black-Scholes option pricing model, will be re-measured using the fair value of the Company's common stock and the non-cash compensation recognized 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. The Company used an independent third-party valuation firm to estimate the fair market value of RXi and the fair market value of RXi options. Based on

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those estimates, RXi recognized approximately \$732,000 of stock based compensation expense related to non-employee stock options for the six-month period ended June 30, 2007.

During the first six months of 2007, the Company issued options to purchase 829,000 shares of its common stock. The fair value of the common stock options granted in the six month period listed in the table below was estimated using the Black-Scholes option-pricing model, based on the following assumptions:

|                         | <b>Six-Months Ended<br/>June 30, 2007</b> |
|-------------------------|---|
| Risk-free interest rate | 4.43% - 4.78%                             |
| Expected volatility     | 1.1% - 1.9%                               |
| Expected lives (years)  | 6   |
| Expected dividend yield | 0.00%                                     |

The fair value of RXi's common stock and RXi's expected common stock price volatility assumption is based upon an independent third-party valuation that determined the RXi corporate valuation and analyzed the volatility of a basket of comparable companies. The expected life assumptions were based upon the simplified method provided for under SAB 107, which averages the contractual term of RXi'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 that RXi has never paid cash dividends and presently has no intention of paying cash dividends. The risk-free interest rate used for each grant was also based upon prevailing short-term interest rates. Based on CytRx's historical experience, for the six-month period ended June 30, 2007, RXi has estimated an annualized forfeiture rate of 15% for options granted to its employees, 8% for options granted to senior management and no forfeiture rate for the directors. RXi 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. Under provisions of SFAS 123(R), RXi recorded \$329,000 of employee stock-based compensation for the six-month period ended June 30, 2007. No amounts relating to employee stock-based compensation have been capitalized. As of June 30, 2007, there was \$2,700,000 of unrecognized compensation cost related to outstanding options that is expected to be recognized as a component of RXi's operating expenses through 2009. Compensation costs will be adjusted for future changes in estimated forfeitures.

At June 30, 2007, the unrecognized compensation expense related to unvested common stock options granted to employees, directors, scientific advisory board members and consultants is expected to be recognized as expense over a weighted-average period of 1.78 years. Presented below is RXi's common stock option activity: