CYTOKINETICS INC
Form 10-Q
November 06, 2008

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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 September 30, 2008

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 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 October 31, 2008: 49,444,563.

CYTOKINETICS, INCORPORATED
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FOR THE QUARTER ENDED SEPTEMBER 30, 2008

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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)

	September 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 70,636	$ 116,564
Short-term investments		3,175
Related party accounts receivable	69	87
Related party notes receivable short-term portion	77	127
Prepaid and other current assets	2,001	2,063
Total current assets	72,783	122,016
Long-term investments	18,230	20,025
Property and equipment, net	5,605	7,728
Assets held-for-sale	294	
Related party notes receivable long-term portion	9	99
Restricted cash	2,750	5,167
Other assets	372	335
Total assets	$ 100,043	$ 155,370
LIABILITIES and STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,013	$ 1,584
Accrued liabilities	8,750	8,558
Related party payables and accrued liabilities	10	22
Short-term portion of equipment financing lines	2,460	4,050
Short-term portion of deferred revenue	12,234	12,234
Total current liabilities	24,467	26,448
Long-term portion of equipment financing lines	3,081	4,639
Long-term portion of deferred revenue	15,191	24,367
Total liabilities	42,739	55,454
Stockholders equity:		
Common stock, $0.001 par value: Authorized: 170,000,000 shares; Issued and outstanding: 49,436,150 shares at September 30, 2008 and 49,282,362 shares at December 31, 2007	49	49
Additional paid-in capital	384,163	379,730
Deferred stock-based compensation	(62)	(329)

Accumulated other comprehensive loss		(1,795)		(1)
Deficit accumulated during the development stage		(325,051)		(279,533)
Total stockholders equity		57,304		99,916
Total liabilities and stockholders equity	$	100,043	$	155,370

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

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

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007	Period from August 5, 1997 (date of inception) to September 30, 2008
Revenues:					
Research and development revenues from related party	$ 67	$ 1,072	$ 93	$ 1,337	$ 40,346
Research and development, grant and other revenues					2,955
License revenues from related parties	3,058	3,058	9,175	9,175	35,509
Total revenues	3,125	4,130	9,268	10,512	78,810
Operating expenses:					
Research and development (1)	13,519	13,217	42,480	39,430	325,968
General and administrative (1)	3,826	4,113	12,235	12,611	97,696
Restructuring charges	2,492		2,492		2,492
Total operating expenses	19,837	17,330	57,207	52,041	426,156
Operating loss	(16,712)	(13,200)	(47,939)	(41,529)	(347,346)
Interest and other income	571	2,055	2,819	6,418	27,563
Interest and other expense	(118)	(176)	(398)	(531)	(5,268)
Net loss	$ (16,259)	$ (11,321)	$ (45,518)	$ (35,642)	$ (325,051)
Net loss per common share basic and diluted	$ (0.33)	$ (0.24)	$ (0.92)	$ (0.76)	
Weighted-average number of shares used in computing net loss per common share basic and diluted	49,416	47,460	49,359	47,040	

(1) Includes the following stock-based compensation charges:

Research and development	$ 702	$ 887	$ 2,220	$ 2,215	$ 10,531
General and administrative	733	638	2,089	1,947	8,525

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

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

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007	Period from August 5, 1997 (date of inception) to September 30, 2008
Cash flows from operating activities:			
Net loss	$ (45,518)	$ (35,642)	$ (325,051)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization of property and equipment	1,893	2,170	22,882
Loss on disposal of property and equipment		4	348
Non-cash restructuring expenses	840		840
Gain on sale of investments			(84)
Allowance for doubtful accounts			191
Non-cash expense related to warrants issued for equipment financing lines and facility lease			41
Non-cash interest expense	69	69	496
Non-cash forgiveness of loan to officer	11	12	375
Stock-based compensation	4,309	4,162	19,056
Other non-cash expenses	7	7	34
Changes in operating assets and liabilities:			
Related party accounts receivable	8	41,932	(419)
Prepaid and other assets	(43)	(184)	(2,393)
Accounts payable	(252)	118	1,142
Accrued liabilities	(392)	754	8,130
Related party payables and accrued liabilities	(12)	(128)	10
Deferred revenue	(9,176)	(2,241)	27,425
Net cash provided by (used in) operating activities	(48,256)	11,033	(246,977)
Cash flows from investing activities:			
Proceeds from sales and maturities of investments	12,576	71,067	634,362
Purchases of investments	(9,400)	(45,300)	(654,303)
Purchases of property and equipment	(638)	(2,167)	(29,530)
Proceeds from sale of property and equipment			50
(Increase) decrease in restricted cash	2,417	867	(2,750)
Issuance of related party notes receivable			(1,146)
Proceeds from payments of related party notes receivable	130	129	829
Net cash provided by (used in) investing activities	5,085	24,596	(52,488)

Cash flows from financing activities:			
Proceeds from initial public offering, sale of common stock to related party and public offerings, net of issuance costs		26,002	193,934
Proceeds from draw down of Committed Equity Financing Facility, net of issuance costs		7,776	32,046
Proceeds from other issuances of common stock	391	819	5,949
Proceeds from issuance of preferred stock, net of issuance costs			133,172
Repurchase of common stock			(68)
Proceeds from equipment financing lines		1,743	23,696
Repayment of equipment financing lines	(3,148)	(2,865)	(18,628)
Net cash provided by (used in) financing activities	(2,757)	33,475	370,101
Net increase (decrease) in cash and cash equivalents	(45,928)	69,104	70,636
Cash and cash equivalents, beginning of period	116,564	39,387	
Cash and cash equivalents, end of period	$ 70,636	$ 108,491	$ 70,636

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

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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 focused on discovering and developing small molecule therapeutics for the potential treatment of cardiovascular disease and other diseases relating to muscle biology, cancer and other diseases. 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 has incurred significant operating losses since inception. At September 30, 2008, the Company had an accumulated deficit of approximately $325.1 million. The Company has generated no revenue from product sales to date. The Company has funded its operations to date primarily through sales of common stock and convertible preferred stock, contract payments under its collaboration agreements, debt financing arrangements, government grants and interest income. The Company expects to incur substantial additional operating losses for the next several years and may need to obtain additional financing in order to complete the clinical development of CK-1827452 and other drug candidates. The Company intends to continue to fund operations through the additional sale of equity securities, payments from strategic collaborations, government grant awards and debt financing. Such financing may not be available when needed or may not be at terms acceptable to the Company.

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with 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, 2007 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, 2007.

Comprehensive Income (Loss)

Comprehensive loss consists of the net loss and other comprehensive income (loss). Other comprehensive income (loss) (OCI) includes certain changes in stockholder s equity that are excluded from net loss. Comprehensive loss and its components for the three-and nine-month periods ended September 30, 2008 and 2007 are as follows (in thousands):

	Three months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Net loss	$ (16,259)	$ (11,321)	$ (45,518)	$ (35,642)
Change in unrealized gain (loss) on investments	(519)	47	(1,794)	62
Comprehensive loss	$ (16,778)	$ (11,274)	$ (47,312)	$ (35,580)

Restricted Cash

In accordance with the terms of the Company s line of credit agreements with General Electric Capital Corporation (GE Capital) to fund certain equipment, the Company is obligated to maintain a certificate of deposit with the lender. The balance of the certificate of deposit, which is classified as restricted cash, was $2.8 million at September 30, 2008 and $5.2 million at December 31, 2007.

Fair Value of Financial Instruments

In September 2006, the Financial Statement Standard Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 established a common definition for fair value, which is to be applied to U.S. generally accepted accounting principles (GAAP) requiring use of fair value, and a framework for measuring fair value, and expanded disclosure about such fair value measurements. This pronouncement applies under the other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. SFAS No. 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. In February 2008, the FASB released a FASB Staff Position (FSP) 157-1, Application of FASB Statement No. 157 to FASB Statement 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13. FSP 157-1 removed leasing transactions accounted for under FASB Statement 13 and related guidance from the scope of SFAS No. 157. FSP 157-2, Partial Deferral of the Effective Date of Statement 157, deferred the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008.

In October 2008 the FASB issued FSP 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active, which amends SFAS No. 157-1 by incorporating an example to illustrate key considerations in determining the fair value of a financial asset in an inactive market. FSP 157-3 is effective as of the date of issuance and applicable to prior periods for which financial statements have not yet been issued. Revisions to fair value estimates resulting from the adoption of FSP 157-3 must be accounted for as a change in accounting estimate under SFAS No. 154, but entities need not provide the required disclosures. The adoption of FSP 157-3 did not have a material effect on the Company s financial position or results of operations.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, became effective for the Company on January 1, 2008. SFAS No. 159 includes an amendment of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, which permits an entity to measure certain financial assets and financial liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option (by instrument) will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option election is irrevocable, unless a new election date occurs. SFAS No. 159 establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity s election on its earnings, but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet. The Company did not elect the fair value option for its financial assets and liabilities existing at January 1, 2008, nor for its financial assets and liabilities transacted in the nine months ended September 30, 2008.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R, Share-Based Payment, which establishes accounting for share-based payment awards made to employees and directors, including employee stock options and employee stock purchases. Under the provisions of SFAS No. 123R, 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, consistent with the provisions of SFAS No. 123R. The key input assumptions used to estimate 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.

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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		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Risk-free interest rate	3.54%	4.41%	2.98%	4.52%
Volatility	68.00%	73.00%	63.50%	73.12%
Expected life (in years)	6.12	6.08	6.08	5.99
Expected dividend yield	0.00%	0.00%	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		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Risk-free interest rate	2.23%	4.84%	2.23%	4.84%
Volatility	67.00%	74.00%	67.00%	74.00%
Expected life (in years)	1.25	1.25	1.25	1.25
Expected dividend yield	0.00%	0.00%	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.

Under Staff Accounting Bulletin (SAB) No. 107, the Company used the simplified method of estimating the expected term for stock-based compensation from January 1, 2006, the date it adopted SFAS No. 123R, through December 31, 2007. Starting January 1, 2008, the Company ceased to use the simplified method, and now uses its own historical exercise activity and extrapolates the life cycle of options outstanding to arrive at its estimated expected term for new option grants.

From January 1, 2006, the date of adopting SFAS No. 123R, through December 31, 2007, the Company estimated the volatility of its common stock by using an average of historical stock price volatility of comparable companies due to the limited length of trading history. Starting January 1, 2008, the Company has used its own volatility history based on its stock s trading history of approximately four years. Because its outstanding options have an expected term of approximately six years, the Company supplemented its own volatility history by using comparable companies volatility history for approximately two years preceding the Company s IPO.

Note 2. Net Loss Per Share

Basic net loss per common share is computed by dividing the 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 options, common stock subject to repurchase, warrants and shares issuable under the ESPP. The following is a reconciliation of the numerator and denominator used in the calculation of basic and diluted net loss per common share (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Numerator net loss	$ (16,259)	$ (11,321)	$ (45,518)	$ (35,642)

Denominator:				
Weighted-average common shares outstanding	49,416	47,460	49,359	47,041
Less: Weighted-average shares subject to repurchase	( )	( )	( )	(1)
Weighted-average shares used in computing basic and diluted net loss per common share	49,416	47,460	49,359	47,040

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The following outstanding 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):

	As of September 30	
	2008	**2007**
Options to purchase common stock	6,264	5,160
Warrants to purchase common stock	474	244
Shares issuable related to the ESPP	75	92
Total shares	6,813	5,496

Note 3. Supplemental Cash Flow Data

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

	Nine Months Ended		Period from August 5, 1997 (date of inception)
	September 30, 2008	**September 30, 2007**	**September 30, 2008**
Significant non-cash investing and financing activities:			
Deferred stock-based compensation	$	$	$ 6,940
Purchases of property and equipment through accounts payable	5	180	5
Purchases of property and equipment through trade in value of disposed property and equipment			258
Penalty on restructuring of equipment financing lines			475
Conversion of convertible preferred stock to common stock			133,172
Unrealized loss on auction rate securities	$1,795	$	$ 1,795

Note 4. Related Party Agreements

Research and Development Arrangements

GlaxoSmithKline (GSK). Pursuant to the collaboration and license agreement between the Company and GSK (the GSK Agreement), the Company recorded as research and development revenues from related party patent expense reimbursements from GSK of $0.1 million for both the three months ended September 30, 2008 and 2007. In addition to the patent expense reimbursement from GSK, the Company also received a $1.0 million milestone payment from GSK in the third quarter of 2007, and recorded the payment as research and development revenue. For the nine months ended September 30, 2008 and 2007, the Company received and recorded as research and development revenues from related party patent expense reimbursements from GSK of $0.1 million and $0.3 million, respectively. Related party accounts payable and accrued liabilities payable to GSK for outsourced services under the GSK Agreement were zero and $20,000 at September 30, 2008 and December 31, 2007, respectively.

Amgen Inc. (Amgen). Pursuant to the collaboration and option agreement between the Company and Amgen (the Amgen Agreement), the Company recognized license revenue of $3.1 million and $9.2 million in both the three and nine months ended September 30, 2008 and September 30, 2007. At September 30, 2008, deferred revenue related to the Amgen Agreement and its related common stock purchase agreement was $27.4 million.

Other

Board member. James Spudich is a member of the Company s Board of Directors and a consultant to the Company. The Company incurred consulting fees earned by Dr. Spudich of $4,500 and $29,500 in the three and nine months ended September 30, 2008, respectively. The Company incurred consulting fees earned by Dr. Spudich of $12,500 and $37,500 in the three and nine months ended September 30 2007, respectively.

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Related Party Notes Receivable. Effective March 31, 2008, James Sabry voluntarily resigned from his position as Executive Chairman of the Board of Directors of the Company, and on April 1, 2008, assumed his new role as the non-employee Chairman of the Board of Directors, as well as Chairman of the Company s Scientific Advisory Board and a consultant to the Company. In accordance with the terms of Dr. Sabry s promissory note payable to the Company, the outstanding balance of the note of $100,000 became due, and was repaid in full, on April 30, 2008. The Company incurred consulting fees earned by Dr. Sabry of $15,000 and $105,000 for the three and nine months ended September 30, 2008, respectively. Dr. Sabry did not earn any consulting fees during 2007.

In May 2008, $11,000 of principal and interest on a loan receivable from an officer of the Company was forgiven in accordance with the terms of the loan agreement.

Note 5. Fair Value Measurement

As stated in Note 1, Organization and Summary of Significant Accounting Policies, on January 1, 2008, the Company adopted the methods of fair value described in SFAS No. 157 to value its financial assets and liabilities. As defined in SFAS No. 157, fair value is 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 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. SFAS No. 157 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 levels of the fair value hierarchy defined by SF