PRO PHARMACEUTICALS INC
Form 10-Q
August 10, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2007

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File No. 000-32877

PRO-PHARMACEUTICALS, INC.

Nevada	**04-3562325**
(State or other jurisdiction of incorporation)	**(I.R.S. Employer Identification No.)**
7 Wells Avenue, Newton, Massachusetts	**02459**
(Address of Principal Executive Offices)	**(Zip Code)**

(617) 559-0033

(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 x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer x

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

The number of shares outstanding of the registrant s common stock as of August 10, 2007 was 40,364,792.

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PRO-PHARMACEUTICALS, INC.

(A Development-Stage Company)

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) (dollars in thousands except share and per share data)

	June 30, 2007	December 31, 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,380	$ 773
Prepaid expenses and other current assets	120	163
Certificate of deposit		5,000
Total current assets	$ 2,500	$ 5,936
PROPERTY AND EQUIPMENT NET	91	112
RESTRICTED CASH	69	59
INTANGIBLE ASSETS NET	320	256
TOTAL ASSETS	$ 2,980	$ 6,363
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
CURRENT LIABILITIES:		
Accounts payable	$ 428	$ 340
Accrued expenses	538	512
Convertible debt instrument	434	5,137
Total current liabilities	$ 1,400	$ 5,989
WARRANT LIABILITIES	872	371
OTHER LONG TERM LIABILITIES	33	25
Total liabilities	$ 2,305	$ 6,385
CONTINGENCIES (Note 7)		
STOCKHOLDERS EQUITY (DEFICIT):		
Common stock, $0.001 par value; 100,000,000 shares authorized, 40,364,792 and 32,518,643 issued and outstanding at June 30, 2007 and December 31, 2006 respectively; Undesignated shares, $.01 par value; 10,000,000 shares authorized, none issued and outstanding	$ 40	$ 32
Additional paid-in capital	31,900	25,673
Deficit accumulated during the development stage	(31,265)	(25,727)
Total stockholders equity (deficit)	$ 675	$ (22)
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)	$ 2,980	$ 6,363

See notes to unaudited condensed consolidated financial statements.

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PRO-PHARMACEUTICALS, INC.

(A Development-Stage Company)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) (dollars in thousands except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,		Cumulative Period from Inception (July 10, 2000) to June 30, 2007
	2007	2006	2007	2006	
OPERATING EXPENSES:					
Research and development	$ 668	$ 998	$ 1,336	$ 1,452	$ 14,864
General and administrative	1,104	1,101	2,360	2,371	20,413
Total operating expenses	$ (1,772)	$ (2,099)	$ (3,696)	$ (3,823)	$ (35,277)
OTHER INCOME AND EXPENSE					
Interest income	18	43	80	70	715
Interest expense	(29)	(582)	(325)	(908)	(4,426)
Change in fair value of convertible debt instrument	15	526	(1,096)	(3,233)	(3,490)
Change in fair value of warrant liabilities	1,804	2,342	(501)	(202)	11,213
Total other income and (expense)	$ 1,808	$ 2,329	$ (1,842)	$ (4,273)	$ 4,012
NET INCOME (LOSS)	$ 36	$ 230	$ (5,538)	$ (8,096)	$ (31,265)
NET INCOME (LOSS) PER SHARE BASIC	$ 0.00	$ 0.01	$ (0.15)	$ (0.29)	
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING BASIC	40,364,792	27,735,713	37,596,303	27,525,562	
NET LOSS PER SHARE DILUTED	$ 0.00	$ (0.03)	$ (0.15)	$ (0.29)	
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING DILUTED	40,364,792	27,750,263	37,596,303	27,525,562	

See notes to unaudited condensed consolidated financial statements.

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PRO-PHARMACEUTICALS, INC.

(A Development-Stage Company)

CONSOLIDATED STATEMENT OF STOCKHOLDERS (DEFICIT) EQUITY

SIX MONTHS ENDED JUNE 30, 2007 (UNAUDITED) (dollars in thousands except share data)

	Common Stock				
	Number of Shares	Amount	Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Total Stockholders (Deficit) Equity
BALANCE, JANUARY 1, 2007	32,518,643	$ 32	$ 25,673	$ (25,727)	$ (22)
Net loss				(5,538)	(5,538)
Common stock issued related to convertible debenture redemptions	7,846,149	8	5,907		5,915
Stock-based compensation expense			320		320
BALANCE, JUNE 30, 2007	40,364,792	$ 40	$ 31,900	$ (31,265)	$ 675

See notes to unaudited condensed consolidated financial statements

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PRO-PHARMACEUTICALS, INC.

(A Development-Stage Company)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (dollars in thousands)

	Six Months Ended June,		Cumulative Period from Inception (July 10, 2000) to June 30,
	2007	2006	2007
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (5,538)	$ (8,096)	$ (31,265)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	33	34	408
Stock-based compensation expense	320	225	1,792
Non-cash interest expense	315	908	4,261
Change in fair value of convertible debt instrument	1,096	3,233	3,490
Change in fair value of warrant liabilities	501	202	(11,213)
Write off of intangible assets			147
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	11	28	(117)
Accounts payable and accrued expenses	114	(497)	1,084
Other long term liabilities	8		33
Net cash used in operating activities	$ (3,140)	$ (3,963)	$ (31,380)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Maturity (purchase) of certificate of deposit	$ 5,000	$ (5,000)	$
Purchases of property and equipment	(2)	(28)	(416)
Increase in restricted cash	(10)		(69)
Increase in patents costs and other assets	(74)	(56)	(441)
Net cash provided by (used in) investing activities	$ 4,914	$ (5,084)	$ (926)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from issuance of common stock and warrants	$	$	$ 25,309
Net proceeds from issuance of convertible debt instruments		9,300	10,621
Repayment of convertible debt instruments	(167)		(1,253)
Proceeds from shareholder advances			9
Net cash provided by financing activities	$ (167)	$ 9,300	$ 34,686
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,607	253	2,380
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	773	4,466	
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 2,380	$ 4,719	$ 2,380
SUPPLEMENTAL DISCLOSURE Cash paid for interest	$ 10	$	$ 107
NONCASH FINANCING ACTIVITIES:			
Issuance of equity warrants in connection with equity offerings			1,172

Conversion of accrued expenses into common stock			303
Cashless exercise of employee stock options			74
Conversion and redemptions of convertible notes and accrued interest into common stock	5,915	2,654	12,243
Conversion of extension costs related to convertible notes into common stock			171
Conversion of prepaid interest into common stock	(32)	49	
Issuance of warrants to induce conversion of notes payable			503
Issuance of stock to acquire Pro-Pharmaceuticals-NV			107

See notes to unaudited condensed consolidated financial statements.

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PRO-PHARMACEUTICALS, INC.

(A DEVELOPMENT-STAGE COMPANY)

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (dollar amounts in thousands)

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements as reported in this Quarterly Report on Form 10-Q reflect all adjustments which are, in the opinion of management, necessary to present fairly the financial position of Pro-Pharmaceuticals, Inc. (the Company) as of June 30, 2007 and the results of its operations for the three and six months ended June 30, 2007 and June 30, 2006 and the cumulative period from inception (July 10, 2000) through June 30, 2007, the statement of stockholders (deficit) equity for the six months ended June 30, 2007 and its cash flows for the six months ended June 30, 2007 and June 30, 2006 and for the cumulative period from inception (July 10, 2000) to June 30, 2007. All adjustments made to the interim financial statements include all those of a normal and recurring nature. The results for interim periods are not necessarily indicative of results which may be expected for any other interim period or for the full year.

The unaudited condensed consolidated financial statements of the Company should be read in conjunction with its Annual Report on Form 10-K for the year ended December 31, 2006.

As shown in the unaudited condensed consolidated financial statements, the Company incurred net losses of $31,265 for the cumulative period from inception (July 10, 2000) through June 30, 2007. The Company s net losses have resulted principally from costs associated with (i) research and development expenses, including clinical trial costs, (ii) general and administrative activities and (iii) the Company s financing transactions including interest and the costs related to fair value accounting for the Company s convertible debt instrument and warrant liabilities. As a result of planned expenditures for future research, discovery, development and commercialization activities and potential legal cost to protect its intellectual property, the Company expects to incur additional losses and use additional cash in its operations for the foreseeable future. From inception (July 10, 2000) through June 30, 2007, the Company has raised $35,930 in capital through sale and issuance of common stock, common stock purchase warrants, and debt securities in public and private offerings. From inception (July 10, 2000) through June 30, 2007, the Company has used $31,380 of cash in its operations. At June 30, 2007, the Company had $2,380 of cash and cash equivalents to fund future operations.

In July 2007, in order to conserve cash, employees took a 50% pay reduction and reduced other expenses thereby extending the Company s cash runway. Management believes there is sufficient cash to fund operations through at least September 2007. The Company is actively pursuing additional sources of financing and other strategic alternatives.

On June 22, 2007, the Company received a notice from the American Stock Exchange (Amex) Listing Qualifications Department that it is reviewing the Company s eligibility for continued listing. Specifically, the notice cited that the Company does not comply with the Amex s minimum $2 million stockholders equity when combined with losses from continuing operations and/or net losses in two of its last three years set forth in Section 1003 (a) (i) of the Amex Company Guide. To facilitate the review, the Company has been asked to provide a specific plan and timeframe to achieve and sustain compliance with all Amex market listing requirements. The letter states that the Company may be granted up to 18 months to return to compliance with the Amex listing requirements. On July 23, 2007, the Company timely submitted a plan to the Amex to return to compliance within the specified period of time. The Company has not yet received a response from the Amex.

The Company is subject to a number of risks similar to those of other development-stage companies, including dependence on key individuals, uncertainty of product development and generation of revenues, dependence on outside sources of capital, risks associated with clinical trials of products, dependence on third-party collaborators for research operations, need for regulatory approval of products, successful protection of intellectual property, and competition with larger, better-capitalized companies. Successful completion of the Company s development program and, ultimately, the attainment of profitable operations is dependent upon future events, including obtaining adequate financing to fulfill its development activities and achieving a level of revenues adequate to support the Company s cost structure. There are no assurances, however, that the Company will be able to obtain additional financing on favorable terms, or at all, or successfully market its products.

Impact of New Accounting Standards In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. The Company will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2008. Management is currently evaluating the requirements of SFAS

No. 157 and has not yet determined the impact, if any, 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 provides entities with an option to report selected financial assets and liabilities at fair value, with the objective to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The Company will be required to adopt SFAS No. 159 in the first quarter of fiscal year 2008. The Company is currently evaluating the requirements of SFAS No. 159 and has not yet determined the impact, if any, of its adoption on its consolidated financial statements.

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2. STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment (SFAS No. 123(R)), which was adopted January 1, 2006, using the modified prospective transition method. The Company has two stock-based compensation plans where the Company s common stock has been made available for option grants as part of the Company s compensation programs (the Plans). These Plans are described in more detail in the 2006 Form 10-K.

The fair value of the options granted is determined using the Black-Scholes option-pricing model. Key assumptions used to apply this option-pricing model are as follows:

	Six Months Ended June 30,		Cumulative Period from Inception (July 10, 2000) to June 30,
	2007	2006	2007
Risk-free interest rate	4.45%	4.81%	3.16%
Expected life of the options	5 years	5 years	3.63 years
Expected volatility of the underlying stock	95%	65%	91%
Expected dividend rate	None	None	None

Stock-based compensation expense for both employees and non-employees totaled $145 and $94 for the three months ended June 30, 2007 and 2006. For the six months ended June 30, 2007 and 2006, stock-based compensation expense was $320 and $225, respectively.

Pursuant to the 2001 Pro-Pharmaceuticals, Inc. Employee Stock Incentive Plan, the Company on March 8, 2007 granted to its employees, as a retention incentive, options to purchase 715,000 shares of its common stock exercisable at $1.01 per share and to the members of the Board of Directors, in consideration of special services, options to purchase 67,000 shares of its common stock exercisable at $1.01 per share. Pursuant to the 2003 Pro-Pharmaceuticals, Inc. Non-Employee Director Stock Incentive Plan, on March 8, 2007, the Company granted to each of its non-management directors, in consideration of their service on the Board of Directors in 2006, options to purchase shares of its common stock, exercisable at $1.01 per share. The grants ranged from 2,500 to 9,000 options per Director and totaled 41,500 stock options.

Members of the Board of Directors receive stock options for each Board and Committee meeting attended. The options are typically granted in the year following service. The Company expenses the value of stock options as earned. In the three and six month periods ended June 30, 2007 Board members earned approximately 22,000 and 36,500 stock options respectively.

The following table summarizes the stock option activity in the equity incentive plans from January 1, 2007 through June 30, 2007:

	Shares	Exercise Price Per Share	Weighted Average Exercise Price
Outstanding, January 1, 2007	3,059,354	$ 1.90 5.80	$ 3.60
Granted	823,500	1.01	1.01
Options expired	(85,000)	5.16 5.80	5.35
Options cancelled	(45,000)	1.01	1.01
Outstanding, June 30, 2007	3,752,854	$ 1.01 4.05	$ 3.02

The following tables summarize information about stock options outstanding at June 30, 2007:

Options Outstanding					Options Exercisable	
Exercise Price		Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$1.01	$2.82	1,205,500	5.45	$ 1.48	413,834	$ 2.01
$2.92	$4.05	2,547,354	5.10	$ 3.75	2,319,023	$ 3.75
		3,752,854	5.22	$ 3.02	2,732,857	$ 3.49

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No options were granted during the three month periods ended June 30, 2007 and 2006. The weighted average grant date fair value for options granted during the six month periods ended June 30, 2007 and 2006 and the cumulative period from inception (July 10, 2000) to June 30, 2007 was $.74, $2.22 and $1.83, respectively. No options vested during the three month periods ended June 30, 2007 and 2006. The total fair value of options vested during the six month periods ended June 30, 2007 and 2006 and the cumulative period from inception (July 10, 2000) to June 30, 2007 was $403, $158 and $5,559, respectively. During the three and six month periods ended June 30, 2007, 60,000 and 85,000 options expired respectively. During the three and six month periods ended June 30, 2007 45,000 options were forfeited. During the three and six month periods ended June 30, 2006 15,000 options were forfeited.

As of June 30, 2007 there were 1,019,997 unvested options which will vest as follows: 71,666 in 2007, 390,005 in 2008, 334,995 in 2009 and 223,331 in 2010. Total expected unrecognized compensation cost related to such unvested options is $950, which is expected to be recognized over a weighted average period of 1.2 years. As of June 30, 2007, there is no intrinsic value of outstanding options, fully vested options or exercisable options based on the Company s closing common stock price of $0.35 as of June 30, 2007.

There was no cash received from employees as a result of employee stock option exercises during the three and six month periods ended June 30, 2007 and 2006 and during the cumulative period from inception (July 10, 2000) to June 30, 2007. There were no options exercised during the three and six month periods ended June 30, 2007 and 2006 and the intrinsic value of options exercised for the cumulative period from inception was $74 resulting from the cashless exercise of options in October 2003.

3. ACCRUED EXPENSES

Accrued expenses consist of the following:

	June 30, 2007	December 31, 2006
Legal and accounting fees	$ 142	$ 215
Scientific and clinical fees	308	198
Accrued payroll and vacation	79	87
Other	9	12
Total	$ 538	$ 512

4. CONVERTIBLE DEBT AND WARRANT LIABILITIES

The following table summarizes information with regard to outstanding warrants issued in connection with equity and debt financings as of June 30, 2007. These warrants are classified as warrant liabilities with the exception of the 2001 Placement Agent Warrants which expire on February 1, 2012 and are classified in additional paid-in capital:

Issued in Connection With	Number Issued	Exercise Price	Exercisable Date	Expiration Date
2001 Placement Agents	110,000	$ 3.50	February 1, 2002	February 1, 2012
October 2003 PIPE Transaction (1)				
2003 Investor Warrants	657,293	$ 4.75	October 2, 2003	October 2, 2008
April 2004 PIPE Transaction (2)				
April 2004 Investor Warrants	618,056	$ 4.82	April 7, 2004	April 7, 2009
August 2004 PIPE Transaction				
August 2004 Investor Warrants	2,000,000	$ 4.20	February 13, 2005	August 12, 2009
August 2004 Placement Agent Warrants	100,000	$ 4.20	February 13, 2005	August 12, 2009
February 2006 PIPE Transaction				
2006 Investor Warrants (3)	4,493,296	$ 1.00	August 15, 2006	August 14, 2011

2006 Investor Warrants (4)	149,031	$ 3.35	August 15, 2006	August 14, 2011
2006 Placement Agent Warrants	149,031	$ 3.35	August 15, 2006	August 14, 2011
Total	8,276,707			

(1) The exercise price of the warrants has been adjusted from $5.29 per share to $4.75 per share due to the subsequent issuance of equity related instruments.

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(2) The exercise price of the warrants has been adjusted from $5.30 per share to $4.82 per share due to the subsequent issuance of equity related instruments.
(3) The exercise price of the warrants has been adjusted from $3.35 per share to $1.00 per share and an additional 3,152,014 warrants were issued in connection with the Waiver and Exchange Agreement dated March 20, 2007, entered into with certain holders of the 7% Convertible Debentures.
(4) Original investor warrants not subject to the Waiver and Exchange Agreement dated March 20, 2007.

October 2003, April 2004, August 2004 PIPE Transactions In connection with the October 2003, April 2004, and August 2004 PIPE transactions, the Company issued common stock purchase warrants. The warrants were accounted for as freestanding derivative instruments in the consolidated balance sheet under the caption Warrant Liabilities . Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption Change in fair value of warrant liabilities .

February 2006 PIPE Transaction In February 2006, the Company issued $10,000 in aggregate principal amount of convertible debentures (the Debentures) together with warrants to purchase approximately 1,490,313 shares of the Company s common stock (the 2006 Investor Warrants). In March 2007, the Company issued an additional 3,152,014 warrants to investors as part of a Waiver and Exchange Agreement more fully described below. The warrants were accounted for as freestanding derivative instruments in the consolidated balance sheet under the caption Warrant Liabilities . Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption Change in fair value of warrant liabilities . Upon issuance, the Company irrevocably elected to initially and subsequently measure the Debentures in their entirety at fair value with changes in fair value recognized as either a gain or loss in the consolidated statement of operations.

The conversion price of the Debentures and exercise price of the 2006 Investor and Placement Agent Warrants are each subject to certain anti-dilution protections, including for stock splits, stock dividends, change in control events and dilutive issuances of common stock or common stock equivalents, such as stock options, at an effective price per share that is lower than the then conversion price. In the event of a dilutive issuance of common stock or common stock equivalents, the conversion price and exercise price would be reduced to equal the lower price per share of the subsequent transaction.

On March 21, 2007, pursuant to a Waiver and Exchange Agreement (the Exchange Agreement) entered into on March 20, 2007 with certain holders of the Debentures, the Company redeemed $3,889 of the remaining $4,444 principal, and $16 of accrued interest, for 5,205,348 shares of its common stock at $0.75 per share and adjusted the exercise price of the 2006 Investor Warrants held by such holders to $1.00. Giving effect to the anti-dilution provisions of the 2006 Investor Warrants, an additional 3,152,014 shares of stock are issuable if all the warrants are exercised.

The Exchange Agreement also provided that (i) the Company may not redeem any Debentures still outstanding in shares of its common stock unless the trading price per share is at least $0.85; (ii) the Company may not undertake any offering of its equity or equity equivalent securities at an effective price per share below $0.75 for 30 calendar days following the March 21, 2007 closing date of the Exchange Agreement; (iii) the investor parties to the Exchange Agreement are entitled to participate in any subsequent equity financing (other than exempt issuances and an underwritten public offering) undertaken by the Company within 6 months of the March 20, 2007 date of the Exchange Agreement; and (iv) if a holder of shares issued upon redemption of the Debentures or exercise of the 2006 Investor Warrants cannot resell or otherwise dispose the shares under Rule 144 under the Securities Act, the Company must register the resale of the shares.

A summary of changes in the Debentures and Warrant Liabilities is as follows:

	Fair Value of Debentures	Fair Value of Warrant Liabilities	Total
Balance December 31, 2006	$ 5,137	$ 371	$ 5,508
Redemptions, at net carrying amount (1)	(555)		(555)
Redemptions pursuant to the Waiver and Exchange Agreement at net carrying amount (2)	(5,315)		(5,315)
Payments in cash	(167)		(167)
Amortization of debt discount	238		238
Fair value adjustment	1,096	501	1,597
Balance June 30, 2007	$ 434	$ 872	$ 1,306

(1) Represents redemptions in common stock of principal value of $480 and a fair value adjustment of $75. These amounts plus $29 of accrued interest were credited to common stock and additional paid in capital.

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(2) Represents payments in common stock of principal value of $3,889, a debt discount charge of $302 and a fair value credit of $1,728. These amounts plus $16 of accrued interest were credited to common stock and additional paid in capital.

The Company uses a binomial financial model to calculate the fair value of the Debentures. The Company uses the Black-Scholes pricing model to calculate fair value of the 2006 Investor Warrants, 2006 Placement Agent Warrants, August 2004 Investor Warrants, August 2004 Placement Agent Warrants, April 2004 Investor Warrants, April 2004 Placement Agent Warrants, 2003 Investor Warrants, and the 2003 Placement Agent Warrants (expired unexercised in 2006).

Key assumptions used to apply these models as of June 30, 2007 and December 31, 2006 are as follows:

	Warrants		Debentures	
	2007	2006	2007	2006
Risk free interest rate	4.91% - 4.96%	4.71% - 5.00%	4.74%	5.00%
Expected life	1.26 years - 4.13 years	0.25 years - 5.08 years	0.50 years	1 year
Expected volatility of common share price	93% - 95%	65% - 80%	170%	104%
Common share price	$ 0.35	$ 0.45	$ 0.35	$ 0.45

5. EARNINGS PER SHARE

Basic loss per share is based on the weighted-average number of common shares outstanding during each period. Diluted loss per share is based on basic shares as determined above plus the incremental shares that would be issued upon the assumed exercise of in-the-money stock options and warrants using the treasury stock method and convertible debenture using the if-converted method. The computation of diluted net loss per share does not assume the issuance of common shares that have an anti-dilutive effect on net loss per share. For the three and six month period ended June 30, 2007 and the six month period ended June 30, 2006, all stock options, warrants and potential shares related to conversion of the convertible debentures were excluded from the computation of diluted net loss per share. For the three month period ended June 30, 2006 all stock options and convertible debentures and 3,722,497 warrants were excluded from the computation of diluted net loss per share. Dilutive shares which could exist pursuant to the exercise of outstanding stock options and warrants at June 30, 2007, and 2006 totaled approximately 12,029,561 and 8,421,195 respectively.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net Income (loss)-basic	$ 36	$ 230	$ (5,538)	$ (8,096)
Fair value adjustment related to warrant liabilities		(927)		
Net Loss-diluted	$ 36	$ (697)	$ (5,538)	$ (8,096)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Weighted average common shares outstanding-basic	40,364,792	27,735,713	37,596,303	27,525,562
Incremental common shares related to warrants		14,550		
Weighted average common shares outstanding-diluted	40,364,792	27,750,263	37,596,303	27,525,562
Earnings Per Share -Basic	0.00	0.01	(0. 15)	(0.29)

-Diluted	0.00	(0.03)	(0. 15)	(0.29)

6. INCOME TAXES

The Company has established a full valuation allowance equal to the amount of its deferred tax assets as the realization of such assets is uncertain. In addition, the Company s effective tax rate is zero for the periods reserved due to the full valuation allowance and lack of other income tax obligations.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The impact of uncertain income tax positions taken on the income tax return must be recognized at the largest amount that is more

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likely than not to be sustained upon audit by the relevant taxing authority. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, and accounting for interim periods and requires expanded disclosure with respect to the uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect, if any, of adopting FIN 48 is to be reported as an adjustment to the opening balance of retained earnings in the year of adoption.

The Company adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, the total amount of unrecognized tax benefits was $1,031, $880 of which, if recognized, would affect the effective tax rate prior to the adjustment for the Company s full valuation allowance. As a result of the implementation of FIN 48, the Company did not recognize an increase in tax liability for the unrecognized tax benefits because the Company has net operating loss carry forwards and has established a full valuation allowance. There have been no changes in unrecognized tax benefits as a result of tax positions taken during the current period.

The Company is subject to U.S. Federal income tax as well as income tax of certain state jurisdictions. The tax years ranging from 2000 through 2006 remain open to examination by various taxing jurisdictions as the statute of limitations has not expired.

Since the Company s net deferred tax assets and the unrecognized tax benefits determined under FIN 48 would not result in a cash payment, the Company has not accrued for any interest and penalties relating to these unrecognized tax benefits. Should the Company incur interest and penalties related to income taxes, those amounts would be included in income tax expense.

7. CONTINGENCIES

In January 2004, Dr. Platt, the Company s Chairman and Chief Executive Officer, filed a lawsuit in Massachusetts Superior Court against GlycoGenesys, Inc. for various claims including breach of contract. In its filing in February 2004, GlycoGenesys asserted counterclaims against the Company and Dr. Platt alleging tortious interference and misappropriation of proprietary rights. The counterclaims seek monetary damages and injunctive relief related to the Company s intellectual property. In March 2004, the Company and Dr. Platt answered the counterclaims and denied any liability. In June 2004, the Court allowed, without opposition, a motion of GlycoGenesys for leave to file a supplemental counterclaim against the Company for defamation and unfair competition. On February 2, 2006, GlycoGenesys filed a voluntary petition for protection under Chapter 11 of the U.S. Bankruptcy Code, which stayed the counterclaim litigation proceedings. On June 1, 2006, the bankruptcy court approved a motion by GlycoGenesys to convert the proceeding to Chapter 7 liquidation. On October 23, 2006, the judge issued an order allowing the liquidation sale of certain GlycoGenesys assets to Marlborough Research and Development, Inc. including the counterclaim lawsuit. Marlborough Research and Development, Inc. has changed its name to Prospect Therapeutics, Inc. and is continuing the counterclaim lawsuit against the Company and Dr. Platt. The Company believes these claims are without merit and intends to contest them vigorously. Additionally, the Company believes that any impact on the financial statements is neither probable nor reasonably estimable and therefore no amounts have been recorded as of June 30, 2007.

Pursuant to Board approval, the Company has agreed to indemnify Dr. Platt for the expenses of his defense of the counterclaims. In the three and six month periods ended June 30, 2007 the Company incurred no expenses in connection with this defense. Through June 30, 2007 the Company has incurred cumulative expenses of approximately $438 in connection with this defense.

On January 28, 2005, the Company filed a request with the U.S. Patent and Trademark Office (USPTO) for an inter partes re-examination of U.S. Patent No. 6,680,306 owned by GlycoGenesys, Inc. because the Company believes that the invention claimed in this patent is anticipated by other inventions (technically, prior art), including the Company s U.S. Patent No. 6,645,946 for DAVANAT®. In an October 18, 2005 action, the USPTO agreed with the Company s argument that all claims stated in the 306 patent are anticipated by prior art. On December 19, 2005, GlycoGenesys filed a response to the USPTO, and on January 18, 2006, the Company responded to the GlycoGenesys submission. The matter is now before the USPTO for a final decision. The Company believes that the USPTO actions to date support its belief that the invention claimed in the DAVANAT® patent is prior art relative to the GlycoGenesys patent.

In the ordinary course of business, the Company may from time to time be involved in other legal matters that in the Company s estimation will not have a material adverse impact on it. The Company records accruals for such contingencies to the extent that the Company concludes that their occurrence is probable and the related damages are estimable.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations (dollar amounts in thousands)

In addition to historical information, the following Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements as defined under federal securities laws and is subject to the safe harbor created therein for forward-looking statements. Such statements include, but are not limited to, statements concerning our anticipated operating results, research and development, clinical trials, and financial resources, and can be identified by use of words such as, for example, anticipate, estimate, expect, project, intend, plan, believe and would, should, could or may. Forward-looking statements are based on current expectations, estimates and projections a the industry and markets in which Pro-Pharmaceuticals operates, and management s beliefs and assumptions. These statements are not guarantees of future performance and involve certain known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. Such risks and uncertainties are related to, without limitation, our early stage of development, our dependence on outside capital, uncertainties of our technology and clinical trials, intellectual property litigation, risk of default on our debt securities, uncertainties of regulatory approval requirements for our products, competition and stock price volatility in the biotechnology industry, limited trading volume for our stock, concentration of ownership of our stock, and other risks detailed herein and from time to time in our SEC reports. The following discussion should be read in conjunction with the accompanying consolidated financial statements and notes thereto of Pro-Pharmaceuticals appearing elsewhere herein.

Dollar amounts are presented in thousands throughout this document.

Overview

We are a development-stage company engaged in research and development of carbohydrate-based therapeutic compounds. We believe our compounds offer numerous opportunities to provide advanced disease treatments. Our initial focus is on the target delivery of chemotherapy drugs for the treatment of cancer. We believe our initial carbohydrate compound DAVANAT may increase the body s tolerance to these toxic drugs by targeting the delivery directly to cancerous cells and increasing the efficacy, thereby creating a preferable treatment to existing oncology regimens. For additional information, please see Item 1. Business Business of Pro-Pharmaceuticals included in our Annual Report on Form 10-K for the year ended December 31, 2006.

All of our product candidates are in preclinical and clinical development. We currently have one product candidate DAVANAT in clinical development. In general, in order to commercialize our present and future product candidates, we are required to successfully complete preclinical studies and clinical trials and obtain regulatory approvals. The requirements for regulatory approval include:

- preclinical toxicology, pharmacology and metabolism studies, as well as in-vivo efficacy studies in relevant animal models of disease;
- manufacturing of drug products for use in preclinical studies and clinical trials and ultimately for commercial supply;
- submission of the results of preclinical studies and information regarding manufacturing and control and proposed clinical protocol to the U.S. Food and Drug Administration (FDA) in an investigational new drug application (IND), or similar filings with regulatory agencies outside the United States;
- conduct of clinical trials designed to provide data and information regarding the safety and efficacy of the product candidate in humans; and
- submission of all the results of testing to the FDA in a new drug application (NDA), or similar filings with regulatory agencies outside the United States.

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Upon approval by the appropriate regulatory authorities we may commence commercial marketing and distribution of the product. This process typically takes several years to complete and requires the expenditure of substantial resources. Any delay in obtaining or failure to obtain required approvals will materially adversely affect our ability to generate revenues from commercial sales relating to our drug candidates. We do not expect to file an NDA for a drug candidate before 2008. We anticipate our source of funding for the next several years to come from either financing transactions or collaborations with other pharmaceutical companies.

We are devoting substantially all of our efforts toward product research and development, and raising capital. We have no source of revenue and have incurred significant losses to date. We have incurred net losses of $31,265 for the cumulative period from inception (July 10, 2000) through June 30, 2007. Our losses have resulted principally from costs associated with research and development expenses, including clinical trial costs, general and administrative activities and costs related to our debt financings, including interest and changes in debt carried at fair value. As a result of planned expenditures for future research, discovery, development and commercialization activities, we expect to incur additional operating losses for the foreseeable future.

We are currently dosing patients in two Phase II clinical trials. The first trial is a Phase II line 1 trial for colorectal cancer patients with DAVANAT®, 5-FU, Leucovorin and Avastin®. The second trial is a Phase II line 1 trial with DAVANAT® and 5-FU.

On April 12, 2007, we announced that we received comments from the FDA related to our plans for submitting DAVANAT®, as a functional excipient, under Section 505 (b)(2), to be administered intravenously in combination with 5-FU for cancer applications. We are using Section 505 (b)(2) to obtain more timely and efficient marketing approval of new formulations of previously approved therapeutics. Excipients are the materials, other than active pharmaceutical ingredients, incorporated into dosage forms for specific functional purposes, including modulating solubility, increasing stability and bio-availability, and play critical roles in the effectiveness, safety, potency, purity and stability of a product. In complex products such as chemotherapeutics, the functional role of an excipient is also important when used as a drug delivery system to reduce toxicity and/or increase efficacy.

On June 22, 2007, we received a notice from the American Stock Exchange Listing Qualifications Department that it is reviewing our eligibility for continued listing. Specifically, the notice cited that we do not comply with the Amex s minimum $2 million stockholders equity when combined with losses from continuing operations and/or net losses in two of its last three years set forth in Section 1003 (a) (i)&nb