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ALFACELL CORP  
Form 10-K  
October 16, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended July 31, 2006

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

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

0-11088  
Commission file number

ALFACELL CORPORATION  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

22-2369085  
(I.R.S. Employer  
Identification No.)

225 Belleville Avenue, Bloomfield, New Jersey  
(Address of principal executive offices)  
07003  
(Zip Code)

Registrant's telephone number, including area code: (973) 748-8082

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, \$.001 par value  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer,  
as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports  
pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item  
405 of Regulation S-K (ss.229.405 of this chapter) is not contained herein, and  
will not be contained, to the best of registrant's knowledge, in definitive  
proxy or information statements incorporated by reference in Part III of this  
Form 10-K or any amendment to this Form 10-K. ☐

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definitions 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 ☐

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

The aggregate market value of the common stock, par value \$.001 per share, held by non-affiliates based upon the reported last sale price of the Common Stock on January 31, 2006 was approximately \$121,102,000. As of October 10, 2006 there were 44,405,717 shares of common stock, par value \$.001 per share, outstanding.

### Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement for the Annual Meeting of the Stockholders scheduled to be held on January 25, 2007, to be filed with the Commission not later than 120 days after the close of the registrant's fiscal year, have been incorporated by reference, in whole or in part, into Part III Items 10, 11, 12, 13 and 14 of this Annual Report on Form 10-K.

### Table of Contents

#### PART I

- Item 1. Business
- Item 1A Risk Factors
- Item 2. Properties
- Item 3. Legal Proceedings
- Item 4. Submission of Matters to a Vote of Security Holders

#### PART II

- Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
- Item 6. Selected Financial Data
- Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
- Item 7A. Quantitative and Qualitative Disclosures About Market Risk
- Item 8. Financial Statements and Supplementary Data
- Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

## Edgar Filing: ALFACELL CORP - Form 10-K

Item 9A. Controls and Procedures

Item 9B. Other Information

### PART III

Item 10. Directors and Executive Officers of the Registrant

Item 11. Executive Compensation

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13. Certain Relationships and Related Transactions

Item 14. Principal Accounting Fees and Services

### PART IV

Item 15. Exhibits and Financial Statement Schedules

The following trademarks appear in this Annual Report: ONCONASE(R) is the registered trademark of Alfacell Corporation, exclusively for anti-cancer agent; Alimta(R) and Gemzar(R) are registered trademarks of Eli Lilly; Navelbine(R) is a registered trademark of Glaxo Smith Kline.

3

All information in this Form 10-K is as of October 12, 2006 and we undertake no obligation to update this information.

We maintain a website at [www.alfacell.com](http://www.alfacell.com) to provide information to the general public and our stockholders on our products, resources and services along with general information on Alfacell, our management, financial results and press releases. Copies of our most recent Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q or our other reports filed with the Securities and Exchange Commission, or SEC, can be obtained, free of charge as soon as reasonably practicable after such material is electronically filed with, or furnished to the SEC, from our Investor Relations Department by calling 973-748-8082, through an e-mail request from our website at [www.alfacell.com](http://www.alfacell.com) or through the SEC's website by clicking the direct link from our website at [www.alfacell.com](http://www.alfacell.com) or directly from the SEC's website at [www.sec.gov](http://www.sec.gov). Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

Our Board of Directors has adopted a Code of Business Conduct and Ethics that is applicable to all of our directors, officers and employees. Any material changes made to our Code of Business Conduct and Ethics or any waivers granted to any of our directors and executive officers will be publicly disclosed by filing a current report on Form 8-K within five business days of such material change or waiver. We make the Code of Business Conduct and Ethics available on our website at [www.alfacell.com](http://www.alfacell.com). Although our Board of Directors has not established a nominating committee, our formal nominating procedures will be described in our definitive proxy statement for the Annual Meeting of Stockholders to be held on January 25, 2007. In addition, copies of our Code of Business Conduct and Ethics are available to our shareholders upon request either by contacting our Investor Relations Department at 973-748-8082 or through an e-mail request from our website at [www.alfacell.com](http://www.alfacell.com).

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Information contained herein contains, in addition to historical information, forward-looking statements that involve risks and uncertainties. All statements, other than statements of historical fact, regarding our financial position, potential, business strategy, plans and objectives for future operations are "forward-looking statements." These statements are commonly identified by the use of forward-looking terms and phrases such as "anticipates," "believes," "estimates," "expects," "intends," "may," "seeks," "should," or "will" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Actual future results may vary from expectations set forth in these forward-looking statements. The matters set forth herein under the caption "Risk Factors" constitute cautionary statements identifying important factors with respect to these forward-looking statements, including certain risks and uncertainties, that could cause actual results to vary significantly from the future results indicated in these forward-looking statements. Other factors could also cause actual results to differ significantly from the future results indicated in these forward-looking statements.

### Part I

#### Item 1. BUSINESS.

##### Overview

Alfacell Corporation is a biopharmaceutical company primarily engaged in the discovery and development of a new class of therapeutic drugs for the treatment of cancer and other pathological conditions. Our proprietary drug discovery and development program consists of novel therapeutics which are being developed from amphibian ribonucleases (RNases). RNases are biologically active enzymes that split RNA molecules. RNases are enzymes which play important roles in nature, among which is the development of an organism and in cell functions. RNA is an essential bio-chemical cellular component necessary to support life. There are various types of RNA, all of which have specific functions in a living cell. They help control several essential biological activities, namely; regulation of cell proliferation, maturation, differentiation and cell death. Therefore, they are ideal candidates for the development of therapeutics for cancer and other life-threatening diseases, including HIV and autoimmune diseases, that require anti-proliferative and apoptotic, or programmed cell death, properties. ONCONASE(R), the trademark name of our lead investigational drug candidate, is a novel amphibian ribonuclease, unique among the superfamily of pancreatic ribonuclease isolated from the eggs of the Rana pipiens (the Northern Leopard frog). Ranpirinase, the generic name of ONCONASE(R), is the smallest known protein belonging to the superfamily of pancreatic ribonuclease and has been shown, on a molecular level, to re-regulate the unregulated growth and proliferation of

4

cancer cells. Unlike most anti-cancer agents that attack all cells regardless of phenotype (malignant versus normal) and cause severe toxicities, ONCONASE(R) is not an indiscriminate cytotoxic drug (cell killing agent). ONCONASE(R) affects primarily exponentially growing malignant cells, with activity controlled through unique and specific molecular mechanisms. An extensive compendium of in vitro (in cells), in vivo (in animals) and clinical data in man shows that ONCONASE(R) destroys cancer cells.

ONCONASE(R), is currently being evaluated as a treatment for unresectable (inoperable) malignant mesothelioma, a rare cancer primarily affecting the pleura (lining of the lungs) usually caused by exposure to asbestos, in an

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international, centrally randomized, confirmatory Phase IIIb registration trial. The first part of the trial which compared ONCONASE(R) alone to doxorubicin alone, has been completed. The second confirmatory part of the trial is ongoing.

The confirmatory Phase IIIb registration trial is designed to evaluate the efficacy, safety and tolerability of the combination of ONCONASE(R) and doxorubicin as compared to doxorubicin alone. The primary endpoint of the trial is overall survival. The first interim analysis results of the confirmatory registration trial, based on one third of the required events (deaths) of the study, have been reported. The overall median survival time (MST) demonstrated a trend favoring the ONCONASE(R) + doxorubicin treatment group (12 months) over the doxorubicin group (10 months). A two month improvement in median survival had previously been observed in the Treatment Target Group ("TTG") (n=104) analysis from the completed Phase III single agent study that favored patients treated with ONCONASE(R) alone compared with patients treated with doxorubicin (11.6 months vs. 9.6 months). The Company's Phase IIIb confirmatory registration trial was designed based on the conclusions drawn from the TTG analysis but powered to reach a statistically significant difference in MST between the ONCONASE(R) + doxorubicin treatment group and the doxorubicin treatment group at 316 events. These results of the first interim analysis of the confirmatory registration trial were consistent with the results from the first part of the trial and were the basis for our decision to continue the confirmatory registration trial.

We have also conducted other randomized and non-randomized trials with patients with advanced stages of solid tumors in other types of cancers.

In February 2001, we received an Orphan Medicinal Product Designation for ONCONASE(R) for malignant mesothelioma from the European Agency for the Evaluation of Medicinal Products (EMEA). Orphan Medicinal Product Designation is a program designed to provide marketing, and other incentives for pharmaceutical companies to develop and market products in the European Community that address life threatening or very serious conditions that affect not more than five in 10,000 persons in the European Community. Orphan designation in Europe entitles the Company to ten years of marketing exclusivity, reduced filing fees and regulatory guidance from the EMEA.

In December 2002, we received Fast Track Designation from the FDA for ONCONASE(R) for the treatment of malignant mesothelioma. Fast Track Designation is an FDA program designed to expedite the review of new drugs that are intended to treat serious or life threatening conditions and that demonstrate the potential to address unmet medical needs.

In March 2005, we received Orphan Drug Designation for malignant mesothelioma in Australia from the Therapeutics Goods Administration (TGA). This designation in Australia also entitles the company to five years of marketing exclusivity, a 100% waiver of filing fees and regulatory guidance from the TGA.

The FDA, EMEA and TGA designations for ONCONASE(R) may serve to expedite its regulatory review, assuming the clinical trials yield a positive result for malignant mesothelioma. The efficacy and safety of ONCONASE(R) for malignant mesothelioma will ultimately be determined by these regulatory agencies based on the results of our ongoing clinical trial. In the interim, our Fast Track Designation allows us to continue to have meetings and discussions with the FDA to establish mutually agreed upon parameters for the NDA to obtain marketing approval for ONCONASE(R), based on the assumption that the clinical trials will continue to yield favorable results.

Our drug discovery program forms the basis for the development of specific recombinant RNases for chemically linking drugs and other compounds such as monoclonal antibodies, growth factors, etc. and gene fusion

products with the goal of targeting various molecular functions. This program provides for joint design and generation of new products with outside partners. We may own these new products along with a partner(s), or we may grant an exclusive license to the collaborating partner(s).

We have established a number of scientific collaborations with industry partners, academic and research institutions including the National Cancer Institute (NCI) that are designed to develop new therapeutic applications for ONCONASE(R). One collaboration has produced RN321, a conjugate of ranpirnase, with a monoclonal antibody that demonstrated activity in treating non-Hodgkin's lymphoma in preclinical studies. These results were presented by the NCI investigators at the 2002 Ribonuclease Meeting in Bath, England.

The positive results of the initial NCI studies have been independently confirmed. As a result of these findings and the conclusion of the Cooperative Research and Development Agreement (CRADA) between the Company and NIH, Alfacell has entered into a new collaborative agreement with the West German Cancer Center at the University of Duisburg-Essen for the development, characterization and large-scale production of a novel fusion protein for non-Hodgkin's lymphoma (NHL). The fusion protein consists of ONCONASE(R) and a humanized anti-CD22 monoclonal antibody for non-Hodgkin's lymphoma. The new research collaboration involves using a recombinant anti-CD22 antibody fragment that is genetically linked to ONCONASE, hereby creating a homogeneous product and second-generation drug.

This humanized single chain anti-CD22 monoclonal antibody was acquired by the Company under a commercial evaluation license with the NIH in 2004. Under the agreement, we received the right to evaluate commercial applications for this antibody, such as immunotherapeutics derived from the combination of the antibody with Alfacell's proprietary family of cytotoxic RNases, including ONCONASE(R).

We have also discovered another series of proteins, collectively named amphinases that may have therapeutic uses. These proteins are bioactive in that they have an effect on living cells and organisms and have both anti-cancer and anti-viral activity. All of the proteins characterized to date are RNases. One of these compounds, AC-03-636 has been determined to be active against yellow fever, Hepatitis C and Dengue Fever. The same compound has been evaluated at Johns Hopkins University in a sustained time release formulation for the treatment of brain tumors (gliomas) and the manuscripts have been submitted for publication.

In July 2005, we entered into a research collaboration agreement with the Novartis Institute for Tropical Diseases for the evaluation of AC-03-636 against Dengue fever. In August 2006, we announced new data highlighting the definitive antiviral activity of AC 03-636. The in vitro studies were conducted using a cell-based infection assay based on immunodetection of the Dengue fever antigen. The researchers found that AC 03-636 displayed meaningful antiviral activity in both animal and human cell lines, and that its potency was quite considerable compared to the reference compounds. The objectives of this collaboration have been successfully completed.

We are engaged in the research, development and clinical trials of our products both independently and through research collaborations. We have financed our operations since inception primarily through the sale of our equity securities and convertible debentures in registered offerings and private placements. Additionally, we have raised capital through other debt financings, the sale of our tax benefits and research products, interest income and

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financing received from our Chief Executive Officer. During the fiscal year ended July 31, 2006, we received net proceeds of approximately \$12.3 million as a result of private placements of common stock and warrants and exercises of stock options and warrants. These proceeds will be used for general corporate purposes and, most importantly, to support our strategic plan, including the anticipated filing of an NDA of ONCONASE(R) (ranpirnase) for malignant mesothelioma, assuming satisfactory results from the ongoing clinical trial, the expansion of the ONCONASE oncology franchise, and the development of other pipeline products. We have incurred losses since inception and to date we have not consummated any licensing or marketing agreements for ONCONASE(R) or any of our early stage drug candidates.

### 6

#### Research and Development Programs

Research and development expenses for the fiscal years ended July 31, 2006, 2005, and 2004 were \$5,230,000, \$5,082,000, and \$3,353,000, respectively. Our research and development programs focus primarily on the development of therapeutics from amphibian ribonucleases. Because ribonucleases have been shown to be involved in the regulation of cell proliferation, maturation, differentiation and programmed cell death, known as apoptosis, ribonucleases may be ideal candidates for the development of therapeutics for the treatment of cancer and other life-threatening diseases, including viral and autoimmune diseases that require anti-proliferative and pro-apoptotic properties.

#### Technology Platform and Pipeline

Using ribonucleases as therapeutics is a relatively new approach to drug development. The use of these proteins to re-regulate the unregulated growth and proliferation of cancer cells is unlike most anti-cancer drugs that attack all cells regardless of their phenotype, malignant versus normal, and produce a variety of severe toxicities.

ONCONASE(R) and related drug candidates are not indiscriminate cytotoxic, or cell killing, agents, but rather, their activity is controlled through unique and specific molecular mechanisms. They affect primarily exponentially growing malignant cells.

Cancer is associated with the over or under production of many types of proteins in tumor cells. We believe that the ability to selectively halt the production of certain proteins via ribonuclease activity in tumor cells without damaging normal cells, may make treatment of cancer more effective. To make cancer therapy more effective and less toxic, we are developing ONCONASE(R) and a related family of regulatory proteins, collectively named amphinases. These novel RNases are being developed as therapeutics as well as effector moieties (payload), or killer molecules for targeted therapies. We believe that selective degradation of intracellular proteins is central to the process of programmed cell death.

We have devoted resources towards the development of recombinant designer RNases for chemical conjugation and gene fusion products with various targeting moieties such as monoclonal antibodies, growth factors, cytokines, etc.

#### Apoptosis

Apoptosis, or programmed cell death, is essential for the proper development of embryos and of many body systems, including the central nervous system, immune regulation and others. Apoptosis is required to accommodate the billions of new cells produced daily by our bodies and to eliminate aged or

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damaged cells. Abnormal regulation of the apoptosis process can result in disease. For example, cancer, autoimmune disorders and many viral infections are associated with inhibited apoptosis or programmed death of cells occurring too slowly. Conversely, HIV is associated with increased apoptosis or programmed death of cells occurring too rapidly. The process of programmed cell death is genetically regulated. We believe that we are the first company to discover and develop a novel family of primordial "regulatory" proteins that have been shown to play a fundamental role in this regulatory process.

### ONCONASE(R) (ranpirnase) Pro-Apoptotic Mechanisms

The molecular mechanisms were identified which determine the apoptotic cell death induced by ranpirnase. tRNA, rRNA and mRNA are all different types of RNA with specific functions in a living cell. Ranpirnase preferentially degrades tRNA, leaving rRNA and mRNA apparently undamaged. The RNA damage induced by ranpirnase appears to represent a "death signal", or triggers a chain of molecular events culminating in the activation of proteolytic enzyme cascades which, in turn, induces disintegration of the cellular components and finally leads to cell death. It has been shown that there is a protein synthesis inhibition-independent component, which, together with the changes induced by the protein synthesis inhibition, results in tumor cell death.

Many cancer cells become resistant to most types of cancer treatment, including chemotherapy, radiation and monoclonal antibodies. Overcoming resistance to chemotherapy remains a major challenge for cancer therapy.

7

ONCONASE(R) has been shown to overcome multiple drug resistance or prevent resistance to cancer therapy, thereby dramatically increasing the sensitivity of certain cancer cells to chemotherapy and radiation therapy.

### Clinical Studies and Preclinical Development of ONCONASE(R)

We have been very selective in our product development strategy, which is focused on the use of ONCONASE(R) alone or in combination with drugs which have shown evidence of preclinical and clinical efficacy on tumor types for which median survivals are typically less than a year and for which there are few or no approved treatments.

ONCONASE(R) has been tested in Phase I, Phase II and Phase III clinical trials in more than 40 cancer centers across the United States since 1991, in Europe since 2000 and recently, in Canada, Australia, New Zealand, Mexico and Turkey.

ONCONASE(R) has been tested as a single agent in patients with a variety of solid tumors. It has also been tested in combination with tamoxifen in patients with prostate cancer, advanced pancreatic cancer and renal cell carcinoma as well as with doxorubicin in patients with malignant mesothelioma.

Some of our long standing key pre-clinical collaborations include NIH, NCI, Johns Hopkins University, University of Bath and The University of Pennsylvania Medical Center, Metabolic Magnetic Resonance Research and Computing Center, and have developed a considerable body of knowledge in RNase technology and novel RNase-based therapeutics. ONCONASE(R) has demonstrated a broad spectrum of anti-tumor activity in vitro, or studies of tumor cell lines in laboratory vessels, and was determined to kill cancer cells and therefore was judged to be "active" in the NCI Cancer Screen.

In vitro and in vivo studies showed both cytostatic (suppresses cancer



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cells from further dividing) and cytotoxic (kills cancer cells) antitumor activity when ONCONASE(R) was used as a single agent and in combination with other agents.

### In Vitro Studies

ONCONASE(R), in combination with other drugs has been shown to be synergistic, which means that the effect of ONCONASE(R) when given in combination with other drugs is greater than if the drugs were given alone and the results have been published. The combination of ONCONASE(R) and a number of anti-cancer drugs, resulted in a significant cell kill as compared to each drug alone with respect to the following:

- o ONCONASE(R) + tamoxifen in pancreatic, prostate, and ovarian tumor;
- o ONCONASE(R) + cisplatin for non-small cell lung cancer and ovarian cancer;
- o ONCONASE(R) + carboplatin for non-small cell lung cancer;
- o ONCONASE(R) + lovastatin in pancreatic, ovarian, and two types of non-small cell lung cancer;
- o ONCONASE(R) + vincristine in colorectal cancer and ;
- o ONCONASE(R) + doxorubicin in breast cancer including resistant variants, malignant mesothelioma.

### In Vivo Anti-Cancer Activity

#### ONCONASE(R) as a Single Agent

ONCONASE(R), as a single agent has shown in vivo anti-tumor activity in several mouse models of solid tumors. The following are all examples of the effect of ONCONASE(R) on various types of human cancer cells in mouse models:

- o In the human squamous A-253 carcinoma and the NIH-OVCAR-3 ovarian adenocarcinoma models, ONCONASE(R) has produced prolonged survival and delayed time to development of ascites (fluid in the abdomen), respectively.

8

- o In mice bearing M109 Madison lung carcinoma cells, time to appearance of ascites and survival were significantly prolonged in ONCONASE(R) treated animals as compared to controls. Several histologically (microscopic study of cells) confirmed cures were noted.
- o In nude mice bearing human DU-145 prostate carcinoma and pancreatic ASPC-1 carcinoma, ONCONASE(R) inhibited growth of the subcutaneously transplanted tumor.
- o In several mouse tumor models, ONCONASE(R) not only demonstrated direct anti-tumor activity but also increased the potential for other drugs to penetrate the tumor tissue as well as increased the tumor sensitivity to radiation therapy.

#### ONCONASE(R) in Combination With Other Agents

Based on in vivo results, ONCONASE(R) in combination with the following known and approved anti-cancer agents has been evaluated by us, in collaboration with the NCI and other academic collaborators and results published:

- o vincristine
- o doxorubicin
- o tamoxifen

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- o cisplatin
- o carboplatin

When used in combination with vincristine, ONCONASE(R) prolonged the survival of nude mice bearing vincristine-resistant, HT-29 human colorectal carcinomas, a type of cancer cell, transfected with mdr-1 gene, a multiple drug resistant gene. These NCI results demonstrated that ONCONASE(R) can restore the sensitivity of resistant tumor cells to chemotherapy.

NCI experiments in nude mice transplanted intravenously with human breast carcinoma cells treated with the combination of ONCONASE(R) and doxorubicin have shown significantly prolonged survival. Tumor growth was significantly inhibited as demonstrated by a decrease in the number of pulmonary metastases, or disseminated lesions in the lung, present at the time of sacrifice.

NCI reported the ability of ONCONASE(R) to overcome multiple drug resistance as well as other forms of drug resistance (referring to a drug that no longer kills cancer cells) both in vitro and in vivo. We believe that these in vivo results demonstrate the therapeutic utility of ONCONASE(R) in chemotherapy-resistant tumors, and the findings suggest that ONCONASE(R) in combination with other agents has broad clinical application in cancer treatments.

Research being conducted at Small Animal Imaging and Animal Model Core, Department of Radiology, University of Pennsylvania, has shown that ONCONASE(R) exhibits tumoricidal effects on cell cultures and animals for the treatment of Non-Small Cell Lung Cancer (NSCLC). Animal studies have shown that ONCONASE(R) alone effectively kills cancer cells with manageable toxicity. ONCONASE(R) improves radiation response and enhances the efficacy of commonly used chemotherapeutic agents (cisplatin and carboplatin) in human NSCLC xenographs of nude mice.

### Clinical Trials

#### Onconase(R) Phase III Randomized Clinical Trials (Malignant Mesothelioma)

We are currently conducting a two-part Phase III clinical trial of ONCONASE(R) as a treatment for malignant mesothelioma. The first part of the Phase III trial compares ONCONASE(R) alone to doxorubicin. The second part of the trial compares the combination of ONCONASE(R) and doxorubicin versus doxorubicin alone. The trial is an international, centrally randomized, confirmatory Phase IIIb registration trial. The first part of the trial has been completed. The second confirmatory part of the trial is ongoing.

The confirmatory Phase IIIb registration trial is designed to evaluate the efficacy, safety and tolerability of the combination of ONCONASE(R) and doxorubicin as compared to doxorubicin alone. The primary endpoint of the trial is overall survival. The first interim analysis results of the confirmatory registration trial, based on one third of the required events (deaths) of the study, have been reported. The overall median survival time (MST) demonstrated a trend favoring the ONCONASE(R) + doxorubicin treatment group (12 months) over the doxorubicin group (10 months). A two month improvement in median survival had previously been observed in the Treatment Target Group ("TTG") (n=104) analysis from the completed Phase III single agent study that favored patients treated with ONCONASE(R) alone compared with patients treated with doxorubicin (11.6 months vs. 9.6 months). The Company's Phase IIIb confirmatory registration trial was designed based on the conclusions drawn from the TTG analysis but powered to reach a statistically significant difference in MST between the

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ONCONASE(R) + doxorubicin treatment group and the doxorubicin treatment group at 316 events. These results of the first interim analysis of the confirmatory registration trial were consistent with the results from the first part of the trial and were the basis for our decision to continue the confirmatory registration trial.

Other results of this interim analysis included:

- o At one-year, 47% of the ONCONASE + doxorubicin-treated patients were alive as compared to 36% of the patients treated with doxorubicin.
- o Of the patients evaluable for clinical response, more ONCONASE + doxorubicin -treated patients showed evidence of tumor regression or stabilization of disease (minimum of 3 months) and there was a seven-month difference in the MST (17 vs. 10 months) for the ONCONASE + doxorubicin group vs. the doxorubicin group.
- o The analysis of safety data revealed that ONCONASE when given with doxorubicin did not increase the number or severity of known doxorubicin-associated side effects. The most frequent side effects reported for both treatment groups included nausea, fatigue and alopecia. The incidence of these events was comparable for both treatment groups.

Since ONCONASE(R) has Fast Track Designation for the treatment of malignant mesothelioma patients, we continue to have meetings and discussions with the FDA to establish mutually agreed upon parameters for the New Drug Application, or NDA, to seek marketing approval for ONCONASE(R), assuming the Phase III clinical trial yields favorable results. We have completed the chemistry, manufacturing and controls (CMC) section of the NDA and will submit it after completion of a review by external regulatory consultants.

### Phase III Single Agent Results(Malignant Mesothelioma)

An interim subset analysis of the results of this Phase III clinical trial according to the Cancer Adult Leukemia Group B, or CALGB, prognostic groups revealed a marked excess of poor prognosis patients (groups 5 and 6) in the ONCONASE(R) arm of the trial (32 patients or 38.1% of the patients treated with ONCONASE(R)) as compared to the doxorubicin arm of the trial (12 patients or 17% of the patients treated with doxorubicin). By excluding these patients and the 10 patients whose central pathology review did not confirm a diagnosis of malignant mesothelioma (N=5) from the 154 intent-to-treat patients, we defined a target treatment group, or TTG, consisting of 104 patients who met the criteria for CALGB prognostic groups 1-4. Of these patients, 47 were treated with ONCONASE(R) and 57 were treated with doxorubicin. The single agent Phase III results of the TTG showed a median survival benefit, or MST, of 2 months for ONCONASE(R) treated patients, 11.6 months versus 9.6 months. This two month median survival difference favoring ONCONASE(R) represents a 20% advantage over the active agent, doxorubicin. Moreover, the clinical activity of ONCONASE(R) is also evident from the overall 1-year and 2-year survival rates of ONCONASE(R) versus doxorubicin in the TTG, 46.8% versus 38.6% and 20.2% versus 12.3%, respectively. Doxorubicin treatment was associated with a 60% higher risk of death compared to ONCONASE(R) treatment. Tumor assessment by an independent radiologist for evaluable patients (which included a baseline and follow-up radiological assessment) revealed evidence of objective clinical activity in 17 patients in each treatment arm. Four partial responses and 13 stabilization of previously progressive disease were reported in the ONCONASE(R) treated patients and 7 partial responses and 10 stabilization of previously progressive disease were reported in the doxorubicin treated patients. Despite the small number of patients, the analysis revealed a statistically significant difference, log rank test, p. = 0.037, in survival of the responders favoring ONCONASE(R)

treated patients with an MST 23.3 versus 14.4 months for doxorubicin treated patients as well as the 2 year survival rates of 40% for ONCONASE(R) and 9% for doxorubicin. Preliminary results were presented at the 2000 American Society of Clinical Oncologists, or ASCO, meeting.

#### Phase II Single Agent Results (Malignant Mesothelioma)

ONCONASE(R) as a single agent, demonstrated objective clinical activity in 105 patients with unresectable, or inoperable, malignant mesothelioma that included many heavily pretreated patients with refractory tumors, which are tumors that did not readily yield to the treatment. Analysis of the TTG population confirmed the importance of the Cancer and Leukemia Group B (CALGB) prognostic groups and their utility for evaluating systemic therapies in this patient population.

Of the 105 patients treated, 41 patients, or 39%, reported evidence of clinical activity. Of the patients showing evidence of clinical activity, there were four with partial responses, two with minor responses and 35 showed evidence of stabilization of previously progressive disease. The MST of these patients was 18.5 months and the overall 1-year and 2-year survival rates were 61% and 40.8%, respectively. The results of this trial demonstrated a survival benefit for both newly diagnosed patients and patients who failed prior therapies. The presentation of this data to the FDA resulted in the design of our Phase III malignant mesothelioma trial.

These survival advantages were recognized as clinically important in this patient population by opinion leaders and the FDA. Therefore, the FDA has requested confirmation of the survival results in the TTG population in the second part of the ongoing trial.

In March 2005, we received an Orphan Drug Designation for malignant mesothelioma for ONCONASE(R) in Australia from the Therapeutics Goods Administration, or TGA. This designation in Australia entitles us to five years of marketing exclusivity for ONCONASE(R) (for the treatment of malignant mesothelioma), a 100% waiver of filing fees and regulatory guidance from the TGA.

In December 2002, we received Fast Track Designation from the FDA for ONCONASE(R) and doxorubicin for the treatment of malignant mesothelioma. Fast Track is a formal mechanism to interact with the FDA using approaches that are available to all applicants for marketing claims for drugs that are being developed for a serious or life-threatening disease for which there is an unmet medical need. The benefits of Fast Track include scheduled meetings to seek FDA input into development plans, the option of submitting an NDA in sections rather than all components simultaneously, and the option of requesting evaluation of studies using surrogate endpoints. We are making use of this designation to attempt to reduce the marketing approval timeline for ONCONASE(R).

In February 2001, we received an Orphan Medicinal Product Designation for ONCONASE(R) from the European Agency for the Evaluation of Medicinal Products, or the EMEA. Orphan Medicinal Product Designation is a program designed to provide marketing, protocol and other incentives for pharmaceutical companies to develop and market products in the European Community that address life threatening or very serious conditions that affect not more than 5 in 10,000 persons in the European Community. Orphan designation in Europe entitles the Company to 10 years of marketing exclusivity, reduced filing fees and regulatory guidance from the EMEA. We continue to fulfill the EMEA requirements regarding the Marketing Authorization Application, or MAA registration requirements for

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ONCONASE(R) for the treatment of malignant mesothelioma.

### ONCONASE(R) Clinical Trials (Other Tumor Types)

A Phase II program to evaluate a new dose and schedule of ONCONASE(R) was initiated in 2005 and is ongoing. The first indication under evaluation is in patients with refractory non-small cell lung cancer. New Phase II trials are planned in 2006 in patients with esophageal cancer and in patients with advanced breast cancer.

A multicenter Phase II Broad Eligibility trial designed to evaluate ONCONASE(R) as a single agent has been conducted and results of the findings for patients with non-small cell lung cancer, or NSCLC, and advanced breast cancer were published.

11

ONCONASE(R) as a single agent, demonstrated objective clinical activity in patients with advanced NSCLC and breast cancer. The median survival time of 30 patients with advanced NSCLC was greater than that in 19 of 20 regimens when supportive care, a placebo or another single agent was given. Furthermore it was greater than 75% of the reported MSTs in combination chemotherapy trials. The MST and 1 year survival rates of 7.7 months and 27%, respectively, for ONCONASE(R) treated patients compared favorably to 7.2 months and 30% for patients treated with Navelbine(R) (an approved drug for this indication) as a single agent.

Thirty percent of 17 patients with advanced breast cancer demonstrated objective clinical activity, which included, one partial response, two minor responses, the significant reduction in bone pain in one patient, and the control of uncontrollable malignant fluid in the lungs of another patient.

Based on Phase II trial results after meeting with the FDA, we had initiated a Phase III trial in patients with advanced pancreatic cancer in 1995. In the Phase II trial, the median survival time of 5.5 months for 47 patients with stage 4 disease and liver involvement treated with the combination of ONCONASE(R) weekly and tamoxifen daily was more than double the median survival of such patients reported in previously published trials treated with a variety of other systemic therapies (published median survival times ranged from 2.0 to 2.5 months). The Phase III trial was a multicenter randomized trial designed to evaluate an ONCONASE(R) and tamoxifen regimen in untreated patients as well as patients who had failed GEMZAR(R), an approved drug for pancreatic cancer. The primary endpoint of both segments of this Phase III trial was survival, however, early survival analyses of both segments did not reveal a significant survival advantage of ONCONASE(R) over the controls. Thus, due to the negative results of the Phase III trial, despite favorable results produced in Phase II, competitive pressures and our inability to accrue qualified patients in the clinical trials, we made a decision that further evaluation of this end-stage patient population was not warranted at that time and our resources were refocused on the ongoing malignant mesothelioma program.

### Research and Development Pipeline of Targeted Therapies

Our drug discovery program forms the basis for the development of recombinant designer RNases for chemical conjugation and gene fusion products with various targeting moieties such as monoclonal antibodies, growth factors, cytokines, etc. We believe these products can be produced in a cost effective and controlled manufacturing environment.

This program also provides for joint design and generation of new products

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with outside partners. We, along with any outside partners, may own these new products jointly, or we may grant an exclusive license to the collaborating partner(s).

### Ranpirnase Conjugates and Fusion Proteins

The concept of targeting potent toxins as effector molecules to kill cancer or other specifically targeted cells has been extensively evaluated over the last two decades. An immunotoxin is an antibody linked to a toxic molecule that is used to destroy specific cells. Several immunotoxins containing bacterial and plant toxins or other biotoxins, have been evaluated in human clinical trials. Efficacy has always been limited due to the high incidence of immunogenicity, or an immune response, and other intolerable toxicities, including death. Conjugation of ranpirnase to targeting ligands, or binding to other molecules, appears to eliminate this safety problem in pre-clinical studies.

We have established a number of scientific collaborations with academic and research institutions including the NCI. The objective of our collaboration with the NCI is to develop new therapeutic applications for ONCONASE(R). This collaboration has produced RN321, a conjugate of ranpirnase, with a monoclonal antibody that demonstrated activity in treating non-Hodgkin's lymphoma in preclinical studies. The relative benefit in killing targeted tumor cells versus non-targeted healthy cells, or the therapeutic index, is greater than 200,000-fold with this conjugate. These "proof-of-concept" results were presented at the 2002 Ribonuclease Meeting in Bath, England. The positive results of the initial NCI studies have been independently confirmed. As a result of these findings and the conclusion of the Cooperative Research and Development Agreement (CRADA) between the Company and NIH, Alfacell has entered into a new collaborative agreement with the West German Cancer Center at the University of Duisburg-Essen for the development, characterization and large-scale production of a novel fusion protein for non-Hodgkin's lymphoma (NHL). The fusion protein consists of ONCONASE(R) and a humanized anti-CD22 monoclonal

12

antibody for non-Hodgkin's lymphoma. The new research collaboration involves using a recombinant anti-CD22 antibody fragment that is genetically linked to ONCONASE, hereby creating a homogeneous product and second-generation drug.

This humanized single chain anti-CD22 monoclonal antibody was acquired by Alfacell under a commercial evaluation license with the NIH in 2004. Under the agreement, we received the right to evaluate commercial applications for this antibody, such as immunotherapeutics derived from the combination of the antibody with Alfacell's proprietary family of cytotoxic RNases, including ONCONASE(R).

Other conjugates under preclinical evaluation with outside collaborators include a variety of uniquely designed versions of ONCONASE and amphinases. These compounds target the EGF receptors and neo-vascularization (tumor blood vessel formation) which have potential clinical application in a broad spectrum of solid tumors.

### Novel Amphibian Ribonucleases

All of the proteins characterized to date are RNases. Preclinical testing of the new candidates collectively called amphinases showed them to be similarly active to ranpirnase. Their chemical structure makes them ideal candidates for genetic engineering of designer products.

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These products are currently undergoing preclinical testing by the National Institute of Allergy and Infectious Diseases against various RNA viruses and by outside collaborators. One of these compounds, AC-03-636 has been determined to be active in yellow fever, Hepatitis C and Dengue fever. The same compound has been evaluated at Johns Hopkins University in a sustained time release formulation for the treatment of brain tumors (gliomas) and the manuscripts have been submitted for publication.

In July 2005, we entered into a research collaboration agreement with the Novartis Institute for Tropical Diseases for the evaluation of AC-03-636 against Dengue fever. In August 2006, the Company announced new data highlighting the definitive antiviral activity of AC 03-636. The in vitro studies were conducted using a cell-based infection assay based on immunodetection of the Dengue fever antigen. The researchers found that AC 03-636 displayed meaningful antiviral activity in both animal and human cell lines, and that its potency was quite considerable compared to the reference compounds. The objectives of this collaboration have been successfully completed.

### Research Collaborations

The multiple effects of biological activity of ONCONASE(R) led to research in other areas of cancer biology. Two important areas associated with significant market opportunities are radiation therapy and control of tumor angiogenesis, or new tumor blood vessel formation. Many types of cancers undergo radiation therapy at early stages of the disease; however, success of such treatment is often limited. We believe any agent capable of enhancing tumor radiosensitivity has great market potential. Moreover, since the growth of essentially all types of cancer is dependent on new blood vessel formation, any agent that has anti-angiogenic activity, we believe, is most desirable.

The results of the following preclinical research have been presented at a number of scientific meetings as well as have either been published or manuscripts submitted for publication.

### Evaluation Of ONCONASE(R) As A Radiation Enhancer

The p53 gene is a tumor-suppressor gene which means that if it malfunctions, tumors will develop. Published studies have demonstrated that ONCONASE(R) causes an increase in both tumor blood flow and in median tumor oxygen partial pressure causing tumor cells to become less resistant to radiation therapy regardless of the presence or absence of the functional p53 tumor-suppressor gene. We believe these findings further expand the profile of ONCONASE(R) in vivo activities and its potential clinical utility and market potential.

The University of Pennsylvania Medical Center, Metabolic Magnetic Resonance Research and Computing Center has evaluated ONCONASE(R) in combination therapies such as with radiation, cisplatin and carboplatin in a series of animal studies bearing human lung adenocarcinoma (a form of NSCLC lung cancer). They also studied the effects of ONCONASE(R) in the inhibition of sub-lethal damage repair (SLDR) and potentially lethal damage repair (PLDR).

ONCONASE(R), when combined with radiation therapy, enhanced the radiation-sensitivity to treatment in NSCLC tumor cells without causing the common radiation-induced tissue damage to non-tumor cells. ONCONASE(R) inhibited SLDR and PLDR in these animal models.

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### ONCONASE(R) As a Resistance-Overcoming and Apoptosis-Enhancing Agent

The Fas (CD95) cell surface receptor (and its Fas ligand FasL) has been recognized as an important "death" receptor involved in the induction of the "extrinsic" pathway of apoptosis. The apoptotic pathways have been the preferred target for new drug development in cancer, autoimmune, and other therapeutic areas.

The Thoracic Surgery Branch of the NCI confirmed the synergy between ranpirnase and soluble Fas ligand (sFasL) in inducing significant apoptosis in sFasL-resistant Fas+tumor cells. These results provided rationale for using ONCONASE(R) as a potential treatment of FasL-resistant tumors and possibly other disorders such as the autoimmune lympho-proliferative syndrome (ALPS). Further research in this area is ongoing.

### Evaluation Of ONCONASE(R) As An Anti-Viral Agent

The ribonucleolytic activity was the basis for testing ONCONASE(R) as a potential anti-viral agent against HIV. The NIH has performed an independent in vitro screen of ONCONASE(R) against the HIV virus type 1. The results showed ONCONASE(R) to inhibit replication of HIV by up to 99.9% after a four-day incubation period at concentrations not toxic to uninfected cells. In vitro findings by the NIH revealed that ONCONASE(R) significantly inhibited production of HIV in several persistently infected human cell lines, preferentially breaking down viral RNA while not affecting normal cellular ribosomal RNA and messenger RNAs, which are essential to cell function.

Moreover, the NIH, Division of AIDS also screened ONCONASE(R) for anti-HIV activity. ONCONASE(R) demonstrated highly significant anti-HIV activity in the monocyte/macrophage, or anti-viral, system. Ranpirnase may inhibit viral replication at several points during the life cycle of HIV, including its early phases. Ranpirnase may inhibit replication of all different HIV-1 subtypes. These properties of ranpirnase are particularly relevant in view of the extremely high and exponentially increasing rate of mutations of HIV that occur during infection, and which are primarily responsible for the development of resistance to several currently available anti-viral drugs. At present, over 50% of clinical isolates of HIV are resistant to both reverse transcriptase, mechanisms which combat viral replication, and protease inhibitors drugs, a class of anti-viral drugs. An additional 25%, while being sensitive to protease inhibitors, are resistant to RT inhibitor(s) drugs, reverse transcriptase drugs.

European collaborators confirmed the earlier NIH findings of ONCONASE(R) (ranpirnase) anti-HIV activity, and reported new findings of potent inhibition of the replication of two enteroviruses, the Coxsackie A and ECHO type. These viruses affect primarily children under 10 years of age and are known to cause myocarditis, encephalitis and aseptic meningitis.

### Commercial Collaborations

We have signed confidentiality agreements and are presently in discussions with a number of companies regarding the U.S. and/or international marketing rights for ONCONASE(R) and other related products in our pipeline.

### Raw Materials

The major active ingredient derived from leopard frog eggs is the protein ranpirnase. We have sufficient egg inventory on hand to produce enough ONCONASE(R) to complete the current Phase III clinical trial for malignant



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mesothelioma and supply ONCONASE(R) for up to two years after commercialization. In addition, we can successfully produce ranpirnase by using recombinant technology; however, it may not be more cost effective.

### Manufacturing

We have signed an agreement with Scientific Protein Laboratories, which will perform the intermediary manufacturing process of purifying ranpirnase. We contract with Ben Venue Laboratories Inc. for vial filling and with Apptuit and Cardinal Health for the labeling, storage and shipping of ONCONASE(R) during the Phase III trial period. Other than these arrangements, we do not have specific arrangements for the manufacture of our product. Products manufactured for use in Phase III clinical trials and for commercial sale must be manufactured in compliance with Current Good Manufacturing Practices. Scientific Protein Laboratories, LLC, Ben Venue Laboratories Inc. and Cardinal Health all manufacture in accordance with Current Good Manufacturing Practices. For the foreseeable future, we intend to rely on these manufacturers, or substitute manufacturers, if necessary, to manufacture our product. We believe, however, that there are substantial alternative service providers for the services for which we contract. Because we have not yet received drug approval, we utilize the services of these third party manufacturers solely on an as needed basis with prices and terms customary for companies in businesses that are similarly situated. In order to replace an existing manufacturer, we must amend our Investigational New Drug application to notify the FDA of the new manufacturer. We are dependent upon our contract manufacturers to comply with Current Good Manufacturing Practices and to meet our production requirements. It is possible that our contract manufacturers may not comply with Current Good Manufacturing Practices or deliver sufficient quantities of our products on schedule.

### Marketing

We expect to enter into development and marketing agreements with third parties. We have entered into a number of confidentiality agreements and are currently in various stages of active discussions with several major and mid-size pharmaceutical and biotechnology companies as potential commercial partners for our lead product ONCONASE(R) and other related products in our pipeline.

We anticipate that under such arrangements we would grant certain exclusive rights to our corporate partners in return for assuming further research and development cost, upfront licensing fees, milestone payments and royalties on sales. Under these agreements, our marketing partner may have the responsibility for a significant portion of product development and regulatory approval. In the event that our marketing partner fails to develop a marketable product or fails to market a product successfully, our business may be adversely affected.

### Government Regulation

The manufacturing and marketing of pharmaceutical products in the United States requires the approval of the FDA under the Federal Food, Drug and Cosmetic Act. Similar approvals by comparable regulatory agencies are required in most foreign countries. The FDA has established mandatory procedures and safety standards that apply to the clinical testing, manufacturing and marketing of pharmaceutical products in the United States. Obtaining FDA approval for a new therapeutic may take many years and involve substantial expenditures. State, local and other authorities also regulate pharmaceutical manufacturing facilities.

As the initial step in the FDA regulatory approval process, preclinical studies are conducted in laboratory dishes and animal models to assess the

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drug's efficacy and to identify potential safety problems. Moreover manufacturing processes and controls for the product are required. The manufacturing information along with the results of these studies is submitted to the FDA as a part of the IND, which is filed to obtain approval to begin human clinical testing. The human clinical testing program typically involves up to three phases. Data from human trials as well as other regulatory requirements such as chemistry, manufacturing and controls, pharmacology and toxicology sections, are submitted to the FDA in an NDA or Biologics License Application, or BLA. Preparing an NDA or BLA involves considerable data collection, verification and analysis. A similar process in accordance with EMEA regulations in Europe and with TGA regulations in Australia is required to gain marketing approval. Moreover, a commercial entity must be established and approved by the EMEA in a member state of the EU at least three months prior to filing the Marketing Authorization Application, or MAA.

15

We have not received United States or other marketing approval for any of our product candidates and may not receive any approvals. We may encounter difficulties or unanticipated costs in our effort to secure necessary governmental approvals, which could delay or preclude us from marketing our products.

With respect to patented products, delays imposed by the governmental approval process may materially reduce the period during which we may have the exclusive right to exploit them.

### Patents and Proprietary Technology

We have sought to protect our technology by applying for, and obtaining, patents and trademark registrations. We have also relied on trade secrets and know-how to protect our proprietary technology. We continue to develop our portfolio of patents, trade secrets, and know how. We have obtained, and continue to apply for, patents concerning our RNase-based technology.

In addition, we have filed (and we intend to continue to file) foreign counterparts to certain U.S. patent applications. Generally, we apply for patent protection in the United States, Europe, Japan, and other foreign countries.

We own the following U.S. patents:

Patent No. -----	Issue Date -----	Subject Matter -----
6,423,515 B1	July 2002	covers methodology for synthesizing gene sequences of ranpirnase and a genetically engineered variant of ranpirnase
6,290,951 B1	Sept. 2001	covers alteration of the cell cycle in vivo, particularly for inducing apoptosis of tumor cells
6,239,257 B1	May 2001	covers a family of variants of ONCONASE (R)
6,175,003 B1	Jan. 2001	covers the genes of ONCONASE (R) and a variant of ONCONASE (R)

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5,728,805	Mar. 1998	covers a family of variants of ONCONASE(R)
5,595,734	Jan. 1997	covers combinations of ONCONASE(R) with certain other pharmaceuticals
5,559,212	Sept. 1996	covers the amino acid sequence of ONCONASE(R)
5,540,925	July 1996	covers combinations of ONCONASE(R) with certain other pharmaceuticals
5,529,775	June 1996	covers combinations of ONCONASE(R) with certain other pharmaceuticals
4,888,172	Dec. 1989	covers a pharmaceutical produced from fertilized frog eggs (Rana pipiens) and the methodology for producing it
6,649,392 B1*	Nov. 2003	covers a family of recombinant variants of ONCONASE(R)
6,649,393 B1*	Nov. 2003	covers nucleic acids encoding recombinant variants of ONCONASE(R) and methodology for producing such variants

\*We own this patent jointly with the U.S. Government. Alfacell does not pay maintenance fees to keep this patent in force.

We own the following foreign patents in Europe and Japan (European patents are validated in selected European nations):

16

Patent No. -----	Subject Matter -----	E
EP 0 440 633	covers ONCONASE(R) and process technology for making it	
EP 0 500 589 JP 2972334	cover combinations of ONCONASE(R) with certain other pharmaceuticals	
EP 0 656 783 JP 3655628	covers combinations of ONCONASE(R) with certain other pharmaceuticals	
EP 0 837 878 JP 3779999	covers a variant of ONCONASE(R)	

\*\*Assumes timely payment of all applicable maintenance fees and annuities; excludes term extensions that do or may apply.

We also have patent applications pending in the United States, Europe, Japan, and other foreign countries.

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The scope of protection afforded by patents for biotechnological inventions can be uncertain, and such uncertainty may apply to our patents as well. The patent applications we have filed, or that we may file in the future, may not result in patents. Our patents may not give us competitive advantages, may be wholly or partially invalidated or held unenforceable, or may be held not to have been infringed by products that compete with our products. Patents owned by others may adversely affect our ability to do business. Furthermore, others may independently develop products that are similar to our products or that duplicate our products, and may design around the claims of our patents. Although we believe that our patents and patent applications are of substantial value to us, we cannot assure you that such patents and patent applications will be of commercial benefit to us, will adequately protect us from competing products or will not be challenged, declared invalid, or found not to have been infringed by competing products. We also rely on proprietary know-how and on trade secrets to develop and maintain our competitive position. Others may independently develop or obtain access to such know-how or trade secrets. Although our employees and consultants having access to proprietary information are required to sign agreements that require them to keep such information confidential, our employees or consultants may breach these agreements or these agreements may be held to be unenforceable.

### Competition

In February 2004, the Food and Drug Administration granted Eli Lilly & Company approval to sell its Alimta(R) medication as an orphan drug to treat patients with pleural mesothelioma. Alimta(R) is a multi-targeted antifolate that is based upon a different mechanism of action than ONCONASE(R). To our knowledge, no other company is developing a product with the same mechanism of action as ONCONASE(R).

There may be several companies, universities, research teams or scientists, which are engaged in research similar, or potentially similar to research performed by us. Some of these entities or persons may have far greater financial resources, larger research staffs and more extensive physical facilities. In addition, these entities or persons may develop products that are more effective than ours and may be more successful than us at producing and marketing their products.

We are not aware, however, of any product currently being marketed that has the same mechanism of action as our proposed anti-tumor agent, ONCONASE(R). Search of scientific literature reveals no published information that would indicate that others are currently employing this method or producing such an anti-tumor agent. However, we cannot assure you that others may not develop new treatments that are more effective than ONCONASE(R).

### Employees

As of July 31, 2006, we had fourteen full time employees, of whom seven were engaged in research and development activities and seven were engaged in administration and management. We had five employees who

held Ph.D. degrees. All of our employees are covered by confidentiality agreements. We consider relations with our employees to be good. None of our employees is covered by a collective bargaining agreement.

### Environmental Matters

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Our operations are subject to comprehensive regulation with respect to environmental, safety and similar matters by the United States Environmental Protection Agency and similar state and local agencies. Failure to comply with applicable laws, regulations and permits can result in injunctive actions, damages and civil and criminal penalties. If we expand or change our existing operations or propose any new operations, we may need to obtain additional or amend existing permits or authorizations. We spend time, effort and funds in operating our facilities to ensure compliance with environmental and other regulatory requirements.

Such efforts and expenditures are common throughout the biotechnology industry and generally should have no material adverse effect on our financial condition. The principal environmental regulatory requirements and matters known to us requiring or potentially requiring capital expenditures by us do not appear likely, individually or in the aggregate, to have a material adverse effect on our financial condition. We believe that we are in compliance with all current laws and regulations.

### Item 1A. RISK FACTORS.

An investment in our common stock is speculative and involves a high degree of risk. You should carefully consider the risks and uncertainties described below and the other information in this Form 10-K and our other SEC filings before deciding whether to purchase shares of our common stock. If any of the following risks actually occur, our business and operating results could be harmed. This could cause the trading price of our common stock to decline, and you may lose all or part of your investment.

#### Risks related to our business.

We have incurred losses since inception and anticipate that we will incur continued losses for the foreseeable future. We do not have a current source of product revenue and may never be profitable.

We are a development stage company and since our inception one of the principal sources of our working capital has been private sales of our common stock. We incurred net losses of approximately \$7,810,000, \$6,462,000 and \$5,070,000 for the fiscal years ended July 31, 2006, 2005 and 2004, respectively. We have continued to incur losses since July 31, 2006. We may never achieve revenue sufficient for us to attain profitability.

Our profitability will depend on our ability to develop, obtain regulatory approvals for, and effectively market ONCONASE(R) as well as entering into strategic alliances for the development of new drug candidates from the out-licensing of our proprietary RNase technology. The commercialization of our pharmaceutical products involves a number of significant challenges. In particular our ability to commercialize ONCONASE(R) depends on the success of our clinical development programs, our efforts to obtain regulatory approval and our sales and marketing efforts or those of our marketing partners, if any, directed at physicians, patients and third-party payors. A number of factors could affect these efforts including:

- o Our ability to demonstrate clinically that our products have utility and are safe;
- o Delays or refusals by regulatory authorities in granting marketing approvals;
- o Our limited financial resources relative to our competitors;
- o Our ability to obtain an appropriate marketing partner;
- o The availability and level of reimbursement for our products by third party payors;
- o Incidents of adverse reactions to our products;
- o Misuse of our products and unfavorable publicity that could result;

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- and
- o The occurrence of manufacturing or distribution disruptions.

18

We will seek to generate revenue through licensing, marketing and development arrangements prior to receiving revenue from the sale of our products. To date we have not consummated any licensing or marketing arrangements and we may not be able to successfully consummate any such arrangements. We have entered into several development arrangements, which have resulted in limited revenues for us. However, we cannot ensure that these arrangements or future arrangements, if any, will result in significant amounts of revenue for us. We, therefore, are unable to predict the extent of any future losses or the time required to achieve profitability, if at all.

We may need additional financing to continue operations, which may not be available on acceptable terms, if it is available at all.

We may need additional financing in order to continue operations, including completion of our current clinical trials and filing marketing registrations for ONCONASE(R) with the FDA in the United States, with the EMEA in Europe and with the TGA in Australia. If the results from our current clinical trial do not demonstrate the efficacy and safety of ONCONASE(R) for malignant mesothelioma, our ability to raise additional capital will be adversely affected. Even if regulatory applications for marketing approvals are filed and approved, we may need additional financing to continue operations if we are unable to generate sufficient cash flow to support our operations prior to the time our current cash reserves are depleted. During the fiscal year ended July 31, 2006, we received approximately \$12.3 million in net proceeds as a result of private placements of common stock and warrants, and exercises of stock options and warrants. We expect that such net proceeds together with our cash reserves, will be sufficient to fund our operations through July 31, 2008 based on our expected level of expenditures. However, to assure our ability to continue our operations beyond this date, we may continue to seek additional financing through equity or debt financings but we cannot be sure that we will be able to raise capital on favorable terms or at all. We may also obtain additional capital through the exercise of outstanding options and warrants, although we cannot provide any assurance of such exercises or estimate the amount of capital we will receive, if any. If we are required to raise additional capital to fund further operations and are unable to do so, our operations will be severely curtailed and our business and financial condition will be materially adversely affected.

We cannot predict how long it will take us nor how much it will cost us to complete part two of our Phase III trial because it is a survival study.

We currently have ongoing a two-part Phase III trial of ONCONASE(R) as a treatment for malignant mesothelioma. The first part of the clinical trial has been completed and the second confirmatory part is still ongoing for which we have exceeded the full enrollment target of 316 patients. The first interim analysis results based on the 105 events (deaths) showed a two-month survival advantage of ONCONASE(R) + doxorubicin (12 months) vs. doxorubicin (10 months). These results were consistent with the results from the first part of the trial and were the basis for our decision to continue the trial. The primary endpoint of the Phase III clinical trial is survival, which tracks the length of time patients enrolled in the study live. According to the protocol, a sufficient number of patient deaths must occur in order to perform the required statistical analyses to determine the efficacy of ONCONASE(R) in patients with unresectable (inoperable) malignant mesothelioma. Since it is impossible to predict with certainty when these patient deaths in the Phase III trial will occur, we do not

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have the capability of reasonably determining when a sufficient number of deaths will occur, nor when we will be able to file for marketing registrations with the FDA, EMEA and TGA.

In addition, clinical trials are very costly and time consuming. The length of time required to complete a clinical trial depends on several factors including the size of the patient population, the ability of patients to get to the site of the clinical study, and the criteria for determining which patients are eligible to join the study. Although we believe we could modify some of our expenditures to reduce our cash outlays in relation to our clinical trials and other NDA related expenditures, we cannot quantify the amount by which such expenditures might be modified. Hence, a delay in the commercial sale of ONCONASE(R) would increase the time frame of our cash expenditure outflows and may require us to seek additional financing. Such capital financing may not be available on favorable terms or at all.

19

If we fail to obtain the necessary regulatory approvals, we will not be allowed to commercialize our drugs and will not generate product revenue.

The FDA and comparable regulatory agencies in foreign countries impose substantial pre-market approval requirements on the introduction of pharmaceutical products. These requirements involve lengthy and detailed pre-clinical and clinical testing and other costly and time consuming procedures. Satisfaction of these requirements typically takes several years depending on the level of complexity and novelty of the product. We cannot apply for FDA, EMEA or TGA approval to market ONCONASE(R) until the clinical trials and all other registration requirements have been met. Drugs in late stages of clinical development may fail to show the desired safety and efficacy results despite having progressed through initial clinical testing. While limited trials with our product have produced certain favorable results, we cannot be certain that we will successfully complete Phase I, Phase II or Phase III testing of any compound within any specific time period, if at all. Furthermore, the FDA or the company may suspend clinical trials at any time on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk. In addition, we cannot apply for FDA, EMEA or TGA approval to market ONCONASE(R) until pre-clinical and clinical trials have been completed. Several factors could prevent the successful completion or cause significant delays of these trials including an inability to enroll the required number of patients or failure to demonstrate that the product is safe and effective in humans. Also if safety concerns develop, the FDA, EMEA and TGA could stop our trials before completion.

All statutes and regulations governing the conduct of clinical trials are subject to change by various regulatory agencies, including the FDA, in the future, which could affect the cost and duration of our clinical trials. Any unanticipated costs or delays in our clinical studies would delay our ability to generate product revenues and to raise additional capital and could cause us to be unable to fund the completion of the studies.

We may not market or sell any product for which we have not obtained regulatory approval. We cannot assure you that the FDA or other regulatory agencies will ever approve the use of our products that are under development. Even if we receive regulatory approval, such approval may involve limitations on the indicated uses for which we may market our products. Further, even after approval, discovery of previously unknown problems could result in additional restrictions, including withdrawal of our products from the market.

If we fail to obtain the necessary regulatory approvals, we cannot market

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or sell our products in the United States, or in other countries and our long-term viability would be threatened. If we fail to achieve regulatory approval or foreign marketing authorizations for ONCONASE(R) we will not have a saleable product or product revenues for quite some time, if at all, and may not be able to continue operations.

We are and will be dependent upon third parties for manufacturing our products. If these third parties do not devote sufficient time and resources to our products our revenues and profits may be adversely affected.

We do not have the required manufacturing facilities to manufacture our product. We presently rely on third parties to perform certain of the manufacturing processes for the production of ONCONASE(R) for use in clinical trials. Currently, we contract with Scientific Protein Laboratories, LLC for the manufacturing of ranpirnase (protein drug substance) from the oocytes, or the unfertilized eggs, of the *Rana pipiens* frog, which is found in the Northwest United States and is commonly called the leopard frog. We contract with Ben Venue Corporation for the manufacturing of ONCONASE(R) and with Cardinal Health and Apptuit for the labeling, storage and shipping of ONCONASE(R) for clinical trial use. We utilize the services of these third party manufacturers solely on an as needed basis with terms and prices customary for our industry.

We use FDA GMP licensed manufacturers for ranpirnase and ONCONASE(R). We have identified several alternative service providers for the manufacturing services for which we may contract. In order to replace an existing service provider we must amend our IND to notify the FDA of the new manufacturer. Although the FDA generally will not suspend or delay a clinical trial as a result of replacing an existing manufacturer, the FDA has the authority to suspend or delay a clinical trial if, among other grounds, human subjects are or would be exposed to an unreasonable and significant risk of illness or injury as a result of the replacement manufacturer.

20

We intend to rely on third parties to manufacture our products if they are approved for sale by the appropriate regulatory agencies and are commercialized. Third party manufacturers may not be able to meet our needs with respect to the timing, quantity or quality of our products or to supply products on acceptable terms.

Because we do not have marketing, sales or distribution capabilities, we expect to contract with third parties for these functions and we will therefore be dependent upon such third parties to market, sell and distribute our products in order for us to generate revenues.

We currently have no sales, marketing or distribution capabilities. In order to commercialize any product candidates for which we receive FDA or non US approval, we expect to rely on established third party strategic partners to perform these functions. To date, we have not entered into any marketing or licensing agreements for ONCONASE(R). We cannot assure you we will be able to establish or maintain relationships with one or more biopharmaceutical or other marketing companies with existing distribution systems and direct sales forces to market any or all of our product candidates, on acceptable terms, if at all.

In addition, we expect to begin to incur significant expenses in determining our commercialization strategy with respect to one or more of our product candidates. The determination of our commercialization strategy with respect to a product candidate will depend on a number of factors, including:

- o the extent to which we are successful in securing collaborative



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- partners to offset some or all of the funding obligations with respect to product candidates;
- o the extent to which our agreement with our collaborators permits us to exercise marketing or promotion rights with respect to the product candidate;
- o how our product candidates compare to competitive products with respect to labeling, pricing, therapeutic effect, and method of delivery; and
- o whether we are able to establish agreements with third party collaborators, including large biopharmaceutical or other marketing companies, with respect to any of our product candidates on terms that are acceptable

A number of these factors are outside of our control and will be difficult to determine.

Our product candidates may not be accepted by the market.

Even if approved by the FDA and other regulatory authorities, our product candidates may not achieve market acceptance, which means we would not receive significant revenues from these products. Approval by the FDA does not necessarily mean that the medical community will be convinced of the relative safety, efficacy and cost-effectiveness of our products as compared to other products. In addition, third party reimbursers such as insurance companies and HMOs may be reluctant to reimburse expenses relating to our products.

We depend upon Kuslima Shogen and our other key personnel and may not be able to retain these employees or recruit qualified replacement or additional personnel, which would have a material adverse affect on our business.

We are highly dependent upon our founder, Chairman and Chief Executive Officer, Kuslima Shogen. Kuslima Shogen's talents, efforts, personality, vision and leadership have been, and continue to be, critical to our success. The diminution or loss of the services of Kuslima Shogen, and any negative market or industry perception arising from that diminution or loss, would have a material adverse effect on our business.

Because of the specialized scientific nature of our business, our continued success also is dependent upon our ability to attract and retain qualified management and scientific personnel. There is intense competition for qualified personnel in the pharmaceutical field. As our company grows our inability to attract qualified management and scientific personnel could materially adversely affect our research and development programs, the commercialization of our products and the potential revenue from product sales.

21

We do not have employment contracts with Kuslima Shogen or any of our other management and scientific personnel.

Our proprietary technology and patents may offer only limited protection against infringement and the development by our competitors of competitive products.

We own two patents jointly with the United States government. These patents expire in 2016. We also own ten United States patents with expiration dates ranging from 2006 to 2019, four European patents with expiration dates ranging from 2009 to 2016 and three Japanese patents with expiration dates ranging from 2010 to 2016. We also own patent applications that are pending in the United States, Europe, Japan, and other foreign countries. The scope of protection afforded by patents for biotechnological inventions is uncertain, and

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such uncertainty applies to our patents as well. Therefore, our patents may not give us competitive advantages or afford us adequate protection from competing products. Furthermore, others may independently develop products that are similar to our products, and may design around the claims of our patents. Patent litigation and intellectual property litigation are expensive and our resources are limited. If we were to become involved in litigation, we might not have the funds or other resources necessary to conduct the litigation effectively. This might prevent us from protecting our patents, from defending against claims of infringement, or both. To date, we have not received any threats of litigation regarding patent issues.

Developments by competitors may render our products obsolete or non-competitive.

In February 2004, the Food and Drug Administration granted Eli Lilly & Company approval to sell its Alimta(R) medication as an orphan drug to treat patients with pleural mesothelioma. Alimta is a multi-targeted antifolate that is based upon a different mechanism of action than ONCONASE(R). To our knowledge, no other company is developing a product with the same mechanism of action as ONCONASE(R). However, there may be other companies, universities, research teams or scientists who are developing products to treat the same medical conditions our products are intended to treat. Eli Lilly is, and some of these other companies, universities, research teams or scientists are more experienced and have greater clinical, marketing and regulatory capabilities and managerial and financial resources than we do. This may enable them to develop products to treat the same medical conditions our products are intended to treat before we are able to complete the development of our competing product.

Our business is very competitive and involves rapid changes in the technologies involved in developing new drugs. If others experience rapid technological development, our products may become obsolete before we are able to recover expenses incurred in developing our products. We will probably face new competitors as new technologies develop. Our success depends on our ability to remain competitive in the development of new drugs or we may not be able to compete successfully.

We may be sued for product liability.

Our business exposes us to potential product liability that may have a negative effect on our financial performance and our business generally. The administration of drugs to humans, whether in clinical trials or commercially, exposes us to potential product and professional liability risks which are inherent in the testing, production, marketing and sale of new drugs for humans. Product liability claims can be expensive to defend and may result in large judgments or settlements against us, which could have a negative effect on our financial performance and materially adversely affect our business. We maintain product liability insurance to protect our products and product candidates in amounts customary for companies in businesses that are similarly situated, but our insurance coverage may not be sufficient to cover claims. Furthermore, liability insurance coverage is becoming increasingly expensive and we cannot be certain that we will always be able to maintain or increase our insurance coverage at an affordable price or in sufficient amounts to protect against potential losses. A product liability claim, product recall or other claim, as well as any claim for uninsured liabilities or claim in excess of insured liabilities, may significantly harm our business and results of operations. Even if a product liability claim is not successful, adverse publicity and time and expense of defending such a claim may significantly interfere with our business.

As of July 31, 2006, we had a material weakness in our internal control over

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financial reporting. If we fail to maintain an effective system of internal control, we may not be able to provide timely and accurate financial statements.

As more fully described in Item 9A, the Company's management assessed the effectiveness of the Company's internal control over financial reporting as of July 31, 2006. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. As a result of management's assessment, management has concluded that, as of July 31, 2006, the Company did not maintain effective internal control over financial reporting.

The Public Company Accounting Oversight Board has defined a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Accordingly, a material weakness increases the risk that the financial information we report contains material errors.

Management, with oversight by our Audit Committee, is in the process of implementing changes to the Company's internal control systems and procedures which are described in detail in Item 9A. The steps we are taking to address the material weakness may not be effective, however. If we are unable to implement these changes effectively or if other material weaknesses develop and we are unable to effectively address these matters, there could be a material adverse effect on our business, financial condition and results of operations.

If we are unable to obtain favorable reimbursement for our product candidates, their commercial success may be severely hindered.

Our ability to sell our future products may depend in large part on the extent to which reimbursement for the costs of our products is available from government entities, private health insurers, managed care organizations and others. Third-party payors are increasingly attempting to contain their costs. We cannot predict actions third-party payors may take, or whether they will limit the coverage and level of reimbursement for our products or refuse to provide any coverage at all. Reduced or partial reimbursement coverage could make our products less attractive to patients, suppliers and prescribing physicians and may not be adequate for us to maintain price levels sufficient to realize an appropriate return on our investment in our product candidates or compete on price.

In some cases, insurers and other healthcare payment organizations try to encourage the use of less expensive generic brands and over-the-counter, or OTC, products through their prescription benefits coverage and reimbursement policies. These organizations may make the generic alternative more attractive to the patient by providing different amounts of reimbursement so that the net cost of the generic product to the patient is less than the net cost of a prescription brand product. Aggressive pricing policies by our generic product competitors and the prescription benefits policies of insurers could have a negative effect on our product revenues and profitability.

Many managed care organizations negotiate the price of medical services and products and develop formularies for that purpose. Exclusion of a product from a formulary can lead to its sharply reduced usage in the managed care organization patient population. If our products are not included within an adequate number of formularies or adequate reimbursement levels are not provided, or if those policies increasingly favor generic or OTC products, our market share and gross margins could be negatively affected, as could our overall business and financial condition.

The competition among pharmaceutical companies to have their products approved for reimbursement may also result in downward pricing pressure in the

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industry or in the markets where our products will compete. We may not be successful in any efforts we take to mitigate the effect of a decline in average selling prices for our products. Any decline in our average selling prices would also reduce our gross margins.

In addition, managed care initiatives to control costs may influence primary care physicians to refer fewer patients to oncologists and other specialists. Reductions in these referrals could have a material adverse effect on the size of our potential market and increase costs to effectively promote our products.

23

We are subject to new legislation, regulatory proposals and managed care initiatives that may increase our costs of compliance and adversely affect our ability to market our products, obtain collaborators and raise capital.

There have been a number of legislative and regulatory proposals aimed at changing the healthcare system and pharmaceutical industry, including reductions in the cost of prescription products and changes in the levels at which consumers and healthcare providers are reimbursed for purchases of pharmaceutical products. For example, the Prescription Drug and Medicare Improvement Act of 2003 provides a Medicare prescription drug benefit that began in 2006 and mandates other reforms. Although we cannot predict the full effects on our business of the implementation of this new legislation, it is possible that the new benefit, which will be managed by private health insurers, pharmacy benefit managers and other managed care organizations, will result in decreased reimbursement for prescription drugs, which may further exacerbate industry-wide pressure to reduce the prices charged for prescription drugs. This could harm our ability to market our products and generate revenues. It is also possible that other proposals will be adopted. As a result of the new Medicare prescription drug benefit or any other proposals, we may determine to change our current manner of operation, provide additional benefits or change our contract arrangements, any of which could harm our ability to operate our business efficiently, obtain collaborators and raise capital.

Risks related to our common stock.

We were relisted on the Nasdaq Capital Market after being delisted in 1999; our stock is thinly traded and you may not be able to sell our stock when you want to do so.

From April 1999, when we were delisted from Nasdaq, until September 9, 2004, when we were relisted on the Nasdaq Capital Market, there was no established trading market for our common stock. During that time, our common stock was quoted on the OTC Bulletin Board and was thinly traded. There is no assurance that we will be able to comply with all of the listing requirements necessary to remain listed on the Nasdaq Capital Market. In addition, our stock remains thinly traded and you may be unable to sell our common stock during times when the trading market is limited.

The price of our common stock has been, and may continue to be, volatile.

The market price of our common stock, like that of the securities of many other development stage biotechnology companies, has fluctuated over a wide range and it is likely that the price of our common stock will fluctuate in the future. Over the past three years, the sale price for our common stock, as reported by Nasdaq and the OTC Bulletin Board has fluctuated from a low of \$1.25 to a high of \$10.07. The market price of our common stock could be impacted by a variety of factors, including:

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- o announcements of technological innovations or new commercial products by us or our competitors,
- o disclosure of the results of pre-clinical testing and clinical trials by us or our competitors,
- o disclosure of the results of regulatory proceedings,
- o changes in government regulation,
- o developments in the patents or other proprietary rights owned or licensed by us or our competitors,
- o public concern as to the safety and efficacy of products developed by us or others,
- o litigation, and
- o general market conditions in our industry.

In addition, the stock market continues to experience extreme price and volume fluctuations. These fluctuations have especially affected the market price of many biotechnology companies. Such fluctuations have often been unrelated to the operating performance of these companies. Nonetheless, these broad market fluctuations may negatively affect the market price of our common stock.

Events with respect to our share capital could cause the price of our common stock to decline.

Sales of substantial amounts of our common stock in the open market, or the availability of such shares for sale, could adversely affect the price of our common stock. We had 44,289,161 shares of common stock outstanding

24

as of July 31, 2006. The following securities that may be exercised into shares of our common stock were issued and outstanding as of July 31, 2006:

- o Options. Stock options to purchase 3,830,350 shares of our common stock at a weighted average exercise price of approximately \$3.10 per share.
- o Warrants. Warrants to purchase 18,119,598 shares of our common stock at a weighted average exercise price of approximately \$1.91 per share.

The shares of our common stock that may be issued under the options and warrants are currently registered with the SEC or are eligible for sale without any volume limitations pursuant to Rule 144(k) under the Securities Act.

Our incorporation documents may delay or prevent (i) the removal of our current management or (ii) a change of control that a stockholder may consider favorable.

We are currently authorized to issue 1,000,000 shares of preferred stock. Our Board of Directors is authorized, without any approval of the stockholders, to issue the preferred stock and determine the terms of the preferred stock. This provision allows the board of directors to affect the rights of stockholders, since the board of directors can make it more difficult for common stockholders to replace members of the board. Because the board of directors is responsible for appointing the members of our management, these provisions could in turn affect any attempt to replace current management by the common stockholders. Furthermore, the existence of authorized shares of preferred stock might have the effect of discouraging any attempt by a person, through the acquisition of a substantial number of shares of common stock, to acquire control of our company. Accordingly, the accomplishment of a tender offer may be

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more difficult. This may be beneficial to management in a hostile tender offer, but have an adverse impact on stockholders who may want to participate in the tender offer or inhibit a stockholder's ability to receive an acquisition premium for his or her shares.

The ability of our stockholders to recover against Armus Harrison & Co., or AHC, may be limited because we have not been able to obtain the reissued reports of AHC with respect to the financial statements included in our Form 10-K, nor have we been able to obtain AHC's consent to the use of such report herein.

Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act") provides that any person acquiring or selling a security in reliance upon statements set forth in a Form 10-K may assert a claim against every accountant who has with its consent been named as having prepared or certified any part of the Form 10-K, or as having prepared or certified any report or valuation that is used in connection with the Form 10-K, if that part of the Form 10-K at the time it is filed contains a false or misleading statement of a material fact, or omits a material fact required to be stated therein or necessary to make the statements therein not misleading (unless it is proved that at the time of such acquisition such acquiring person knew of such untruth or omission).

In June 1996, AHC dissolved and ceased all operations. Therefore, we have not been able to obtain the reissued reports of AHC with respect to the financial statements included in the Form 10-K for the fiscal year ended July 31, 2006 nor have we been able to obtain AHC's consent to the use of such report herein. As a result, in the event any persons seek to assert a claim against AHC under Section 18 of the Exchange Act for any untrue statement of a material fact contained in these financial statements or any omissions to state a material fact required to be stated therein, such persons will be barred. Accordingly, you may be unable to assert a claim against AHC under Section 18 of the Exchange Act for any purchases of the Company's Common Stock made in reliance upon statements set forth in the Form 10-K for the fiscal year ended July 31, 2006. In addition, the ability of AHC to satisfy any claims properly brought against it may be limited as a practical matter due to AHC's dissolution in 1996.

### Item 2. PROPERTIES.

We lease a total of approximately 17,000 square feet in an industrial office building located in Bloomfield, New Jersey on a month-to-month basis. The monthly rental obligation is \$11,333. We believe that the facility is sufficient for our needs in the foreseeable future.

25

### Item 3. LEGAL PROCEEDINGS.

None.

### Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

## Part II

### Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is listed on the The Nasdaq Capital Market, or Nasdaq, and has traded under the symbol "ACEL" since September 9, 2004. Prior to September 9, 2004, our common stock was traded on the OTC Bulletin Board

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(OTCBB). As of October 12, 2006, there were approximately 1,010 stockholders of record of our common stock.

The following table sets forth the range of high and low sale prices of our common stock for the two fiscal years ended July 31, 2006 and 2005. The prices were obtained from Nasdaq and OTCBB and are believed to be representative of inter-dealer quotations, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

	High ----	Low ---
Year Ended July 31, 2006:		
First Quarter	\$ 2.60	\$ 1.54
Second Quarter	4.99	1.25
Third Quarter	4.49	2.95
Fourth Quarter	3.94	1.90
Year Ended July 31, 2005:		
First Quarter	7.50	3.06
Second Quarter	5.43	3.33
Third Quarter	3.70	1.50
Fourth Quarter	2.80	1.73

We have not paid dividends on our common stock since inception and we do not plan to pay dividends in the foreseeable future. Any earnings we may realize will be retained to finance our growth.

The following table provides additional information on the Company's equity based compensation plans as of July 31, 2006:

Plan Category -----	Number of securities to be issued upon exercise of outstanding options, warrants and rights ----- (a)	Weighted-average exercise price of outstanding options, warrants and rights ----- (b)	Number remain futu equity (exc reflec -----
Equity compensation plans approved by security holders	3,830,350	\$ 3.10	
Equity compensation plans not approved by security holders	12,500 (1)	\$ 3.10	

(1) During the fiscal year ended July 31, 2005, we issued 12,500 warrants to a vendor in consideration for services to be rendered. 5,000 of these warrants vested immediately and have an exercise

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price of \$2.50 per share and 7,500 warrants vested on the 91st day from the grant date and have an exercise price of \$3.50 per share. These warrants will expire twenty-four months from the date the registration statement registering the shares underlying warrants is declared effective or thirty-six months from the date of grant, whichever comes first.

### Recent Sales of Unregistered Securities

None.

### Issuer Purchases of Equity Securities

We did not repurchase any shares of our common stock during the fiscal year 2006.

### Item 6. SELECTED FINANCIAL DATA.

Set forth below is the selected financial data for our company for the five fiscal years ended July 31, 2006:

	Year Ended July 31,				
	2006	2005	2004	2003	2002
	----	----	----	----	----
Investment Income	\$ 107,386	\$ 141,708	\$ 42,113	\$ 9,877	\$ 4,838
Other Income	--	9,836	--	30,000	--
Net Loss (1)	(7,810,175)	(6,461,920)	(5,070,307)	(2,411,532)	(2,591,162)
Dividends	None	None	None	None	None
Total Assets	11,826,428	4,901,624	10,421,063	495,322	228,871
Long-term Debt	--	--	--	242,516	315,929
Total Equity (Deficiency)	9,233,003	3,221,670	8,881,647	(2,491,681)	\$(1,885,437)

- (1) Included in the net loss of \$7,810,175, \$6,461,920 and \$5,070,307 for fiscal years ended July 31, 2006, 2005 and 2004, respectively, are tax benefits of \$317,382, \$287,975 and \$221,847, respectively, related to the sale of certain state tax operating loss carryforwards.

### Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

#### Overview

Since our inception, we have devoted the vast majority of our resources to the research and development of ONCONASE(R) and related drug candidates. We have



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focused our resources towards the completion of the clinical program for unresectable, or inoperable, malignant mesothelioma.

Since ONCONASE(R) has Fast Track Designation from the Food and Drug Administration, or FDA, for the treatment of malignant mesothelioma patients, we continue to have meetings and discussions with the FDA to establish mutually agreed upon parameters for the New Drug Application, or NDA, to obtain marketing approval for ONCONASE(R), assuming the Phase III clinical trial for the treatment of malignant mesothelioma yields favorable results.

We received an Orphan Medicinal Product Designation for ONCONASE(R) from the European Agency for the Evaluation of Medicinal Products, or EMEA. We continue to fulfill the EMEA requirements regarding the Marketing Authorization Application, or MAA, registration requirements for ONCONASE(R) for the treatment of malignant mesothelioma.

We received an Orphan Drug Designation for ONCONASE(R) for malignant mesothelioma in Australia from the Therapeutics Goods Administration, or TGA. This designation in Australia entitles us to five years of marketing exclusivity, a 100% waiver of filing fees and regulatory guidance from the TGA.

Almost all of the \$55,267,000 of research and development expenses we have incurred since our inception has gone toward the development of ONCONASE(R) and related drug candidates. For the fiscal years 2006, 2005 and 2004 our research and development expenses were \$5,230,000, \$5,082,000 and \$3,353,000, respectively, almost all of which were used for the development of ONCONASE(R) and related drug candidates. ONCONASE(R) is currently in an international, centrally randomized, confirmatory Phase IIIb registration trial. The first part of the trial has been completed. The second confirmatory part of the trial is ongoing. The primary endpoint of the trial is overall survival. The first interim analysis results based on one third of the required events (deaths) of the study, which evaluates the efficacy, safety and tolerability of the combination of ONCONASE + doxorubicin as compared to doxorubicin alone have been reported. The overall median survival time (MST) demonstrated a trend favoring the ONCONASE + doxorubicin treatment group (12 months) over the doxorubicin group (10 months). A two month improvement in median survival had previously been observed in the Treatment Target Group (n=104) analysis from the completed Phase III single agent study that favored the ONCONASE over doxorubicin treatments (11.6 months vs. 9.6 months). The Company's Phase IIIb confirmatory registration trial was designed based on the conclusions drawn from the TTG analysis but powered to reach a statistically significant difference in MST between the ONCONASE + doxorubicin treatment group and the doxorubicin treatment group at 316 events. The interim data which represented only one third of the planned number of events was sufficient for us to continue the trial as planned, but was not sufficient for supporting the filing for marketing approvals at that time. At this time, we cannot predict with certainty when a sufficient number of deaths will occur to achieve statistical significance. The timing of when we will be able to file for marketing registrations in the US, EU and Australia is data driven. Therefore, we cannot predict with certainty what our total cost associated with obtaining marketing approvals will be, or when and if such approvals will be granted, or when actual sales will occur. We have completed the chemistry, manufacturing and controls (CMC) section of the NDA and will submit it after completion of a review by external regulatory consultants.

We fund the research and development of our products primarily from cash receipts resulting from the sale of our equity securities and convertible debentures in registered offerings and private placements. Additionally, we have raised capital through other debt financings, the sale of our tax benefits and research products, interest income and financing received from our Chief Executive Officer. During the fiscal year ended July 31, 2006, we received net proceeds of approximately \$12.3 million as a result of private placements of common stock and warrants and from exercises of stock options and warrants.

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These proceeds will be used to support our strategic plan, including

28

the anticipated filing of an NDA of ONCONASE(R) for malignant mesothelioma, assuming satisfactory results from the ongoing clinical trial, the expansion of the ONCONASE oncology franchise, and the development of other pipeline products. We have incurred losses since inception and to date we have not consummated any licensing, or marketing agreements for ONCONASE(R) or any of our early drug candidates.

### Results of Operations

Fiscal Years Ended July 31, 2006, 2005 and 2004

#### Revenues

We are a development stage company as defined in the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 7. We are devoting substantially all our present efforts to establishing a new business and developing new drug products. Our planned principal operations of marketing and/or licensing of new drugs have not commenced and, accordingly, we have not derived any significant revenue from these operations. We focus most of our productive and financial resources on the development of ONCONASE(R). We did not have any sales in fiscal 2006, 2005 and 2004. Investment income for fiscal 2006 was \$107,000 compared to \$142,000 for fiscal 2005, a decrease of \$35,000 due to lower balances of cash and cash equivalents during the fiscal year 2006. Investment income for fiscal 2005 was \$142,000 compared to \$42,000 for fiscal 2004, an increase of \$100,000 due to higher balances of cash and cash equivalents.

#### Research and Development

Research and development expense for fiscal 2006 was \$5,230,000 compared to \$5,082,000 for fiscal 2005, an increase of \$148,000, or 3%. The increase was primarily due to the compensation expense of approximately \$458,000 which is primarily related to share-based compensation; and non-cash expense related to stock options issued to consultants of approximately \$93,000. The share-based compensation expense is expected to continue as a result of the adoption of SFAS 123(R), which requires us to charge compensation expense for all employee stock options. These increases were offset by a decrease in patent expenses of approximately \$170,000; completion of key toxicology requirements and key requirements for chemistry, manufacturing and controls resulting in a decrease in expenses of approximately \$116,000; a decrease in pre-clinical sponsored research and development expenses of approximately \$82,000; and a reduction in costs related to clinical trials of approximately \$35,000.

Research and development expense for fiscal 2005 was \$5,082,000 compared to \$3,353,000 for fiscal 2004, an increase of \$1,729,000, or 52%. The increase was primarily due to expenses in connection with preparing our NDA for ONCONASE(R), including the completion of key toxicology requirements and key requirements for chemistry, manufacturing and controls, including the ONCONASE(R) stability program of approximately \$1,040,000. This increase also resulted from pre-clinical sponsored research and development expenses; the new Phase II program for non-small cell lung, including consulting fees of approximately \$292,000; expansion of the confirmatory Phase IIIb clinical trial in countries outside of the European Union, including the retention of another clinical research organization to assure regulatory compliance in the conduct of the trial in these countries; grant payments; clinical monitoring and data management fees related to our pivotal Phase III clinical trial for malignant

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mesothelioma of approximately \$264,000; increases in patent expenses of approximately \$190,000; personnel costs of approximately \$71,000 and depreciation expense and equipment repairs and maintenance of approximately \$21,000; offset by a decrease in the non-cash expense related to stock options issued for consulting services of approximately \$149,000.

### General and Administrative

General and administrative expense for fiscal 2006 was \$3,005,000 compared to \$1,771,000 for fiscal 2005, an increase of \$1,234,000, or 70%. This increase was primarily due to an increase in compensation expense of approximately \$710,000 which is primarily related to share-based compensation. The share-based compensation expense is expected to continue as a result of the adoption of SFAS 123(R). The increase in general and administrative expense also resulted from legal fees of approximately \$287,000; non-cash share-based compensation expense related to stock options issued to a consultant and board members of approximately \$253,000; and

29

consultant and board of directors fees of approximately \$83,000; offset by decreases in expenses related to investor relations activities of approximately \$45,000; Nasdaq re-listing fees and insurance expense of approximately \$32,000 and \$22,000, respectively.

General and administrative expense for fiscal 2005 was \$1,771,000 compared to \$1,578,000 for fiscal 2004, an increase of \$193,000, or 12%. The increase was due primarily to increases in personnel expenses of approximately \$441,000; professional fees related to board of directors fees and Sarbanes Oxley compliance fees of approximately \$177,000; Nasdaq relisting membership fees of approximately \$70,000; accounting fees of \$38,000 and depreciation expense of \$5,000; offset by decreases in non-cash expense related to stock and stock options issued for consulting services of approximately \$367,000; legal expenses of approximately \$141,000 and expenses related to computer repairs and maintenance of approximately \$30,000.

### Interest

Interest expense for fiscal 2006 was lower by \$48,000 as compared to fiscal 2005. Interest expense for fiscal 2005 was \$48,000 compared to \$403,000 in fiscal 2004, a decrease of \$355,000 or 88%. These decreases were primarily due to the maturity and conversion of convertible notes payable into common stock. The interest expense was based on the value of the warrants using the Black-Scholes option pricing model, amortized on a straight-line basis over the term of the notes.

### Income Taxes

New Jersey has enacted legislation permitting certain corporations located in New Jersey to sell a portion of its state tax loss carryforwards and state research and development credits in order to obtain tax benefits. For the state fiscal year 2006 (July 1, 2005 to June 30, 2006), we had approximately \$1,903,000 of total available tax benefits that were saleable; of which New Jersey permitted us to sell approximately \$356,000. In December 2005, we received approximately \$317,000 from the sale of the \$356,000 of tax benefits, which we recognized as tax benefits for the fiscal year ended July 31, 2006.

For the state fiscal year 2005 (July 1, 2004 to June 30, 2005), we had approximately \$1,335,000 total available tax benefits that were saleable; of which New Jersey permitted us to sell approximately \$339,000. In December 2004,

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we received approximately \$288,000 from the sale of the \$339,000 of tax benefits, which we recognized as tax benefits for the fiscal year ended July 31, 2005.

For the state fiscal year 2004 (July 1, 2003 to June 30, 2004), we had approximately \$1,378,000 total available tax benefits that were saleable; of which New Jersey permitted us to sell approximately \$261,000. In December 2003, we received approximately \$222,000 from the sale of the \$261,000 of tax benefits, which we recognized as tax benefits for the fiscal year ended July 31, 2004.

If still available under New Jersey law, we will attempt to sell the remaining \$1,547,000 of our tax benefits between July 1, 2006 and June 30, 2007 (state fiscal year 2007). This amount, which is a carryover of our remaining tax benefits from state fiscal year 2006 and earlier, may increase if we incur additional tax losses during state fiscal year 2007. We cannot estimate, however, what percentage of our saleable tax benefits New Jersey will permit us to sell, how much money we will receive in connection with the sale, if we will be able to find a buyer for our tax benefits or if such funds will be available in a timely manner.

### Net Loss

We have incurred net losses during each year since our inception. The net loss for fiscal 2006 was \$7,810,000 as compared to \$6,462,000 in fiscal 2005 and \$5,070,000 in fiscal 2004. The cumulative loss from the date of inception, August 24, 1981, to July 31, 2006 amounted to \$83,317,000. Such losses are attributable to the fact that we are still in the development stage and, accordingly, have not derived sufficient revenues from operations to offset the development stage expenses.

30

### Liquidity and Capital Resources

We have reported net losses of approximately \$7,810,000, \$6,462,000, and \$5,070,000 for the fiscal years ended July 31, 2006, 2005 and 2004, respectively. The net losses from date of inception, August 24, 1981, to July 31, 2006, amounts to \$83,317,000.

We have financed our operations since inception primarily through the sale of our equity securities and convertible debentures in registered offerings and private placements. Additionally, we have raised capital through other debt financings, the sale of our tax benefits and research products, and interest income and financing received from our Chief Executive Officer. During the fiscal year 2006, we had a net increase in cash and cash equivalents of \$7,056,000, which resulted from net cash provided by financing activities of \$12,332,000, primarily from private placement of common stock and warrants of \$10,984,000 and from exercises of stock options and warrants of \$1,348,000; offset by net cash used in operating activities of \$5,257,000, principally for research and development activities; and net cash used in investing activities due to the purchase of property and equipment of \$19,000. Total cash resources as of July 31, 2006 were \$11,519,000 compared to \$4,463,000 at July 31, 2005.

Our current liabilities as of July 31, 2006 were \$2,593,000 compared to \$1,680,000 at July 31, 2005, an increase of \$913,000. The increase was primarily due an increase in accounts payable of approximately \$890,000 mainly due to the manufacturing of ONCONASE(R) of approximately \$362,000, pre-clinical studies and clinical trial of approximately \$351,000 and \$92,000, respectively; and legal fees of approximately \$85,000 and a decrease in accruals of approximately

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\$23,000.

The following transactions occurred after July 31, 2006:

- o In August 2006, we issued an aggregate of 28,000 shares of common stock upon the exercise of stock options by an officer and an employee at an exercise price of \$0.85 per share. We realized gross proceeds of \$23,800 from these exercises.

Until and unless our operations generate significant revenues, we expect to continue to fund operations from equity financing. There can be no assurance that we will be able to raise the capital we need on terms which are acceptable, if at all. During the fiscal year ended July 31, 2006, we received net proceeds of approximately \$12.3 million as a result of private placements of common stock and warrants and from exercises of stock options and warrants. We expect that such net proceeds together with our cash reserves, will be sufficient to fund our operations through July 31, 2008 based on our expected level of expenditures. These proceeds will be used to support our strategic plan, including the anticipated filing of an NDA of ONCONASE(R) for malignant mesothelioma, assuming satisfactory results from the ongoing clinical trial, the expansion of the ONCONASE oncology franchise, and the development of other pipeline products. We may also obtain additional capital through the exercise of outstanding options and warrants and the sale of our tax benefits, although we cannot provide any assurance of such exercises or the amount of capital we will receive, if any.

We will continue to incur costs in conjunction with our U.S. and foreign registrations for marketing approval of ONCONASE(R). We are currently in discussions with potential strategic alliance partners to further the development and marketing of ONCONASE(R) and other related products in our pipeline. However, we cannot be sure that any such alliances will materialize.

The market price of our Common Stock is volatile, and the price of the stock could be dramatically affected one way or another depending on numerous factors. The market price of our Common Stock could also be materially affected by the marketing approval or lack of marketing approval of ONCONASE(R).

### Off-balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities or SPE, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

31

### Critical Accounting Policies

In December 2001, the SEC requested that all registrants discuss their most "critical accounting policies" in management's discussion and analysis of financial condition and results of operations. The SEC indicated that a "critical accounting policy" is one which is both important to the portrayal of the company's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The accounting policies set forth below have been considered critical because changes to certain judgments, estimates and assumptions could significantly affect our financial statements.

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### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures during the reporting period. Since some of those estimates are subjective and complex, actual results could differ from those estimates.

### Research and Development

Research and development costs are expensed as incurred.

### Accounting For Stock-Based Compensation

In December 2004, the FASB issued SFAS No. 123(R) (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), which amends SFAS 123 and was effective beginning with our fiscal year ended July 31, 2006. The new standard requires all share-based payments, including stock option grants to employees, to be recognized as an operating expense in the statement of operations. The cost is recognized over the requisite service period based on fair values measured on the date of grant. We adopted SFAS 123(R) effective August 1, 2005 using the modified prospective method and, accordingly, prior period amounts have not been restated. Under the modified prospective method, the fair value of all new stock options issued after July 31, 2005 and the unamortized fair value of unvested outstanding stock options at August 1, 2005 are recognized as expense as services are rendered. As of July 31, 2006, there was approximately \$2,318,000 of total unrecognized compensation cost related to unvested options granted that is expected to be recognized over a weighted average period of 1.16 years.

Prior to the adoption of SFAS 123(R), Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"), provided for the use of a fair value-based method of accounting for employee stock compensation. However, SFAS 123 also allowed an entity to continue to measure compensation cost for stock options granted to employees and directors using the intrinsic value method of accounting prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), which only required charges to compensation expense for the excess, if any, of the fair value of the underlying stock at the date a stock option was granted (or at an appropriate subsequent measurement date) over the amount the employee had to pay to acquire the stock, if such amounts differed materially from the historical amounts. Prior to our adoption of SFAS 123(R), employee stock options were accounted for using the intrinsic value method under APB 25.

Pursuant to SFAS 123, shares, warrants or options issued to non-employees for services are accounted for based on their fair market value determined using the Black-Scholes option pricing model and in accordance with SFAS 123 and Emerging Issues Task Force (EITF) Issue No. 96-18, "Accounting for Equity Instruments that are Issued To Other Than Employees for Acquiring of in Conjunction with Selling Goods or Services."

### Accounting Changes and Error Corrections

The FASB has issued FASB Statement No. 154, Accounting Changes and Error Corrections ("FAS 154"). The new standard replaces APB Opinion No. 20, Accounting Changes and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. Among other changes, FAS 154 provides for correction of errors in previously issued financial statements should be termed "restatement". The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and

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correction of errors made for fiscal years beginning after June 1, 2005. We adopted FAS 154 on August 1, 2005.

### Income Taxes

We account for income taxes under the provisions of SFAS No. 109, "Accounting for Income Taxes". Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect for all years in which the temporary differences are expected to reverse. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

32

### Recently Issued Accounting Pronouncements.

In July 2006, the FASB issued Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in a company's tax return. The provisions of FIN 48 will be effective for our fiscal year ended July 31, 2007. We are currently evaluating the impact of the adoption of FIN 48 will have, if any, on our financial statements.

### Contractual Obligations and Commercial Commitments

Our major outstanding contractual obligations relate to our equipment operating lease. During the fiscal year ended July 31, 2006, we entered into an equipment operating lease, which obligates us to pay approximately \$630 per month for forty-eight months. Below is a table that presents our contractual obligations and commercial commitments as of July 31, 2006:

		Payments Due by Fiscal Year						2012 and
		Total	2007	2008	2009	2010	2011	Thereafter
		-----	-----	-----	-----	-----	-----	-----
Operating lease	\$ 61,392	\$16,743	\$16,743	\$16,743	\$11,163	\$ --	\$ --	\$ --
	-----	-----	-----	-----	-----	-----	-----	-----
Total contractual cash obligations	\$ 61,392	\$16,743	\$16,743	\$16,743	\$11,163	\$ --	\$ --	\$ --
	=====	=====	=====	=====	=====	=====	=====	=====

### Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable.

### Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The response to this Item is submitted as a separate section of this

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report commencing on Page F-1.

### Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

On December 1, 1993, certain stockholders of Armus Harrison & Co., or AHC, terminated their association with AHC, or the AHC termination, and AHC ceased performing accounting and auditing services, except for limited accounting services to be performed on our behalf. In June 1996, AHC dissolved and ceased all operations. The report of J.H. Cohn LLP with respect to our financial statements from inception to July 31, 2006 is based on the report of KPMG LLP from August 1, 1992 to July 31, 2002 and of AHC for the period from inception to July 31, 1992, although AHC has not consented to the use of such report herein and will not be available to perform any subsequent review procedures with respect to such report. Accordingly, investors will be barred from asserting claims against AHC under Section 18 of the Exchange Act on the basis of the use of such report in any Form 10-K into which such report is incorporated by reference. In addition, in the event any persons seek to assert a claim against AHC for false or misleading financial statements and disclosures in documents previously filed by us, such claim will be adversely affected and possibly barred. Furthermore, as a result of the lack of a consent from AHC to the use of its audit report herein, or to its incorporation by reference into a Form 10-K, our officers and directors will be unable to rely on the authority of AHC as experts in auditing and accounting in the event any claim is brought against such persons under Section 18 of the Exchange Act based on alleged false and misleading Financial Statements and disclosures attributable to AHC. The discussion regarding certain effects of the AHC termination is not meant and should not be construed in any way as legal advice to any party and any potential purchaser should consult with his, her or its own counsel with respect to the effect of the AHC termination on a potential investment in our Common Stock or otherwise.

33

### Item 9A. CONTROLS AND PROCEDURES.

#### (a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 ("The Exchange Act")) as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were not effective as of July 31, 2006 due to the material weakness in internal control over financial reporting described below.

#### (b) MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Company's internal control over financial reporting includes those policies and procedures that:

- o pertain to the maintenance of records that in reasonable detail



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- accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- o provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- o provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of July 31, 2006. In making this assessment, management used the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management's assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of our internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of our Board of Directors, and based on this assessment has determined that as of July 31, 2006, there was a material weakness in its internal control due to lack of personnel with financial reporting expertise sufficient to properly record and report non-routine and complex transactions and accounting pronouncements. Such matters were related to the recording of share-based compensation costs pursuant to Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" and the timeliness of consideration of the guidance of Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, A Company's Own Stock". Such weakness in controls resulted in an understatement of the amount recorded as compensation expense during the first three interim periods of the fiscal year ended July 31, 2006, offset by a charge during the final fiscal quarter of 2006. Management believes the amount applicable to the non-cash compensation expense in each of the affected interim periods is not material and that restatement of its interim quarterly reports is not required.

Steps and adjustments that the Company will be taking to remediate this weakness after discovery include:

(i) Forming an accounting oversight committee ("Oversight Committee"), comprising members of our senior management and a third party GAAP advisor, charged with the task of discussing and reviewing all significant transactions that have financial recognition, either to be recorded or disclosed. Additionally, the Oversight Committee will consult with our outside corporate counsel;

34

(ii) Retaining a third party GAAP advisor to assist as well as advise the CFO and Audit Committee on a timely basis, including quarter end and year end review of proposed accounting for and disclosure of significant financial transactions and changes in GAAP; and

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(iii) Enhancing staff training, including relevant continuing education seminars for financial staff on newly issued technical accounting pronouncements.

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Alfacell Corporation

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Alfacell Corporation (A Development Stage Company) maintained effective internal control over financial reporting as of July 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Alfacell Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2006 financial statements, and this report does not affect our report dated October 10, 2006, on those financial statements.

The Company lacks personnel with financial reporting expertise sufficient to

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properly record and report non-routine and complex transactions and accounting pronouncements.

35

In our opinion, management's assessment that Alfacell Corporation did not maintain effective internal control over financial reporting as of July 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, because of the effects of the material weakness described above in the achievement of the objective of the control criteria, the Company has not maintained effective internal control over financial reporting as of July 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Trading Commission (COSO).

We do not express an opinion or any other form of assurance on management's statements relating to new controls being implemented and tested.

/s/ J.H. Cohn LLP

Roseland, New Jersey  
October 10, 2006

### (c) CHANGES IN INTERNAL CONTROLS

There has been no change in the Company's internal control over financial reporting during the quarter ended July 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting subsequent to the date of the evaluation referred to above.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of July 31, 2006 has been audited by J.H. Cohn LLP, an independent registered public accounting firm, as stated in their report which is included herein.

### Item 9B. OTHER INFORMATION.

On October 5, 2006, Kuslima Shogen, the Company's Chief Executive Officer, was granted a ten-year option pursuant to the Company's 2004 Stock Incentive Plan to purchase 120,000 shares of the Company's common stock with an exercise price of \$1.29 per share, the closing price of the Company's common stock on the date of grant. The stock option will vest as to 24,000 shares on April 5, 2007, and then in four equal annual installments of 24,000 shares on each anniversary of the date of grant beginning on October 5, 2007.

On October 5, 2006, Robert Love, the Company's Chief Financial Officer, was granted a ten-year option pursuant to the Company's 2004 Stock Incentive Plan to purchase 50,000 shares of the Company's common stock with an exercise price of \$1.29 per share, the closing price of the Company's common stock on the date of grant. The stock option will vest as to 10,000 shares on April 5, 2007, and then in four equal annual installments of 10,000 shares on each anniversary of the date of grant beginning on October 5, 2007.

### Part III

The information required by Item 10 - Directors and Executive Officers of the Registrant; Item 11 - Executive Compensation; Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters; Item

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13 - Certain Relationships and Related Transactions and Item 14 - Principal Accounting Fees and Services is incorporated into Part III of this Annual Report on Form 10-K by reference to the Proxy Statement for our Annual Meeting of Stockholders scheduled to be held on January 25, 2007.

### Part IV

#### Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) (1) and (2)                The response to these portions of Item 15 is submitted as a separate section of this report commencing on page F-1.

36

(a) (3)                Exhibits (numbered in accordance with Item 601 of Regulation S-K).

Exhibit No. ---	Item Title -----
3.1	Certificate of Incorporation, dated June 12, 1981 (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1, File No. 333-112865, filed on February 17, 2004)
3.2	Amendment to Certificate of Incorporation, dated February 18, 1994 (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1, File No. 333-112865, filed on February 17, 2004)
3.3	Amendment to Certificate of Incorporation, dated December 26, 1997 (incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form S-1, File No. 333-112865, filed on February 17, 2004)
3.4	Amendment to Certificate of Incorporation, dated January 14, 2004 (incorporated by reference to Exhibit 3.4 to the Company's Registration Statement on Form S-1, File No. 333-112865, filed on February 17, 2004)
3.5	Certificate of Designation for Series A Preferred Stock, dated September 2, 2003 (incorporated by reference to Exhibit 3.5 to the Company's Registration Statement on Form S-1, File No. 333-112865, filed on February 17, 2004)
3.6	Certificate of Elimination of Series A Preferred Stock, dated February 3, 2004 (incorporated by reference to Exhibit 3.6 to the Company's Registration Statement on Form S-1, File No. 333-112865, filed on February 17, 2004)
3.7	By-Laws (incorporated by reference to Exhibit 3.4 to Registration Statement on Form S-1, File No. 333-111101, filed on December 11, 2003)
10.1	1993 Stock Option Plan and Form of Option Agreement (incorporated by reference to Exhibit 10.10 to Registration Statement on Form SB-2, File No. 33-76950, filed on August 1, 1994)
10.2	1997 Stock Option Plan (incorporated by reference to Exhibit 10.2 to Registration Statement on Form S-1, File No. 333-111101, filed on December 11, 2003)

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- 10.3            2004 Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-1, File No. 333-112865, filed on February 17, 2004)
  
- 10.4            Form of Subscription Agreement and Warrant Agreement used in Private Placements completed in February 2000 (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K, filed on October 30, 2000)
  
- 10.5            Form of Subscription Agreement and Warrant Agreement used in the August and September 2000 Private Placements (incorporated by reference to Exhibit 10.24 to the Company's Quarterly Report on Form 10-Q, filed on December 15, 2000)
  
- 10.6            Form of Subscription Agreement and Warrant Agreement used in the April 2001 Private Placements (incorporated by reference to Exhibit 10.23 to Registration Statement on Form S-1, File No. 333-38136, filed on July 30, 2001)
  
- 10.7            Form of Convertible Note entered into in April 2001 (incorporated by reference to Exhibit 10.24 to Registration Statement on Form S-1, File No. 333-38136, filed on July 30, 2001)

37

Exhibit  
No.  
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Item Title  
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- 10.8            Form of Subscription Agreement and Warrant Agreement used in the July 2001 Private Placements (incorporated by reference to Exhibit 10.25 to Registration Statement on Form S-1, File No. 333-38136, filed on July 30, 2001)
  
- 10.9            Form of Subscription Agreement and Warrant Agreement used in the August and October 2001 private placement (incorporated by reference to Exhibit 10.26 to Registration Statement on Form S-1, File No. 333-38136, filed on December 14, 2001)
  
- 10.10           Form of Subscription Agreement and Warrant Agreement used in the September 2001, November 2001 and January 2002 private placements (incorporated by reference to Exhibit 10.27 to Registration Statement on Form S-1, File No. 333-38136, filed on February 21, 2002)
  
- 10.11           Warrant issued in the February 2002 private placement (incorporated by reference to Exhibit 10.28 to Registration Statement on Form S-1, File No. 333-38136, filed on February 21, 2002)
  
- 10.12           Form of Subscription Agreement and Warrant Agreement used in the March 2002, April 2002 and May 2002 private placements (incorporated by reference to Exhibit 10.29 to Registration Statement on Form S-1, File No. 333-89166, filed on May 24, 2002)
  
- 10.13           Form of Subscription Agreement and Warrant Agreement used in the June 2002 and October 2002 private placements (incorporated by reference to Exhibit 10.30 to the Post-Effective Amendment to Registration Statement on Form S-1, File No. 333-38136, filed on March 3, 2003)
  
- 10.14           Form of Note Payable and Warrant Certificate entered into April, June, July,

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September, November and December 2002 (incorporated by reference to Exhibit 10.31 to the Post-Effective Amendment to Registration Statement on Form S-1, File No. 333-38136, filed on March 3, 2003)

- 10.15      Form of Note Payable and Warrant Certificate entered into November 2001, January, March and May 2003 (incorporated by reference to Exhibit 10.23 to the Company's Annual Report on Form 10-K, filed on October 29, 2003)
  
- 10.16      Form of Subscription Agreement and Warrant Agreement used in the February 2003 and April through August 2003 private placements (incorporated by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K, filed on October 29, 2003)
  
- 10.17      Form of Amended Notes Payable which amends the November 2001, April 2002, June 2002, July 2002, September 2002, November 2002 December 2002, January 2003, March 2003 and May 2003 notes payable (incorporated by reference to Exhibit 10.27 to The Company's Annual Report on Form 10-K, filed on October 29, 2003)
  
- 10.18      Securities Purchase Agreement and Warrant Agreement used in September 2003 private placement and Form of Warrant Certificate issued on January 16, 2004 and January 29, 2004 to SF Capital Partners Ltd. (incorporated by reference to Exhibit 10.25 to the Company's Annual Report on Form 10-K, filed on October 29, 2003)

38

Exhibit No. ---	Item Title -----
10.19	Registration Rights Agreement used in September 2003 private placement with SF Capital Partners Ltd. (incorporated by reference to Exhibit 10.26 to the Company's Annual Report on Form 10-K, filed on October 29, 2003)
10.20	Form of Securities Purchase Agreement used in May 2004 private placement with Knoll Capital Fund II, Europa International, Inc. and Clifford and Phyllis Kalista JTWROS (incorporated by reference to Exhibit 4.3 to Registration Statement on Form S-1, File No. 333-112865, filed on May 18, 2004)
10.21	Form of Registration Rights Agreement used in May 2004 private placement with Knoll Capital Fund II, Europa International, Inc. and Clifford and Phyllis Kalista JTWROS (incorporated by reference to Exhibit 4.4 to Registration Statement on Form S-1, File No. 333-112865, filed on May 18, 2004)
10.22	Form of Warrant Certificate issued on May 11, 2004 to Knoll Capital Fund II, Europa International, Inc. and Clifford and Phyllis Kalista JTWROS (incorporated by reference to Exhibit 4.5 to Registration Statement on Form S-1, File No. 333-112865, filed on May 18, 2004)
10.23	Form of Stock Option Agreement issued to the Company's Board of Directors under the Company's 1997 Stock Option Plan (incorporated by reference to Exhibit 10.23 to the Company's quarterly report on Form 10-Q filed on June 9, 2005)
10.24	Form of Stock Option Agreement issued to the Company's Executive Officers under the Company's 1997 Stock Option Plan (incorporated by reference to Exhibit 10.24 to the Company's quarterly report on Form 10-Q filed on June 9, 2005)

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10.25	Separation Agreement and General Release with Andrew Savadelis dated May 26, 2005 (incorporated by reference to Exhibit 10.25 to the Company's Annual Report on Form 10-K, filed on October 15, 2005)
10.26	Securities Purchase Agreement used in May 2005 private placement with Jeffrey D'Onofrio dated May 1, 2006
10.27	Form of Warrant (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed on July 19, 2006)
10.28	Registration Rights Agreement dated July 17, 2006 (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K, filed on July 19, 2006)
10.29	Agreement to Amend Knoll Warrant dated July 17, 2006 (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K, filed on July 19, 2006)
10.30	Form of Amended Knoll Warrant (incorporated by reference to Exhibit 4.4 to the Company's Current Report on Form 8-K, filed on July 19, 2006)
10.31	Agreement to Amend SF Capital Warrant dated July 17, 2006 (incorporated by reference to Exhibit 4.5 to the Company's Current Report on Form 8-K, filed on July 19, 2006)
10.32	Form of Amended Warrant for SF Capital Partners, Ltd. (incorporated by reference to Exhibit 4.6 to the Company's Current Report on Form 8-K, filed on

39

### Exhibit

No.	Item Title
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	July 19, 2006)
10.33	Securities Purchase Agreement dated July 17, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on July 19, 2006)
21.1	Subsidiaries of Registrant
23.1	Consent of J.H. Cohn LLP
23.2	Consent of KPMG LLP
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Principal Financial Officer pursuant to Section 906 of the

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Sarbanes-Oxley Act of 2002

\* Previously filed; incorporated herein by reference  
+ Filed herewith

40

## Signature

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ALFACELL CORPORATION

Dated: October 16, 2006

By: /s/ KUSLIMA SHOGEN  
Kuslima Shogen, Chief Executive Officer  
and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Dated: October 16, 2006

/s/ KUSLIMA SHOGEN  
Kuslima Shogen, Chief Executive Officer  
and Chairman of the Board (Principal  
Executive Officer)

Dated: October 16, 2006

/s/ ROBERT D. LOVE  
Robert D. Love, Chief Financial Officer  
(Principal Financial Officer  
and Principal Accounting Officer)

Dated: October 16, 2006

/s/ JOHN P. BRANCACCIO  
John P. Brancaccio, Director

Dated: October 16, 2006

/s/ STEPHEN K. CARTER  
Stephen K. Carter, M.D., Director

Dated: October 16, 2006

/s/ DONALD R. CONKLIN  
Donald R. Conklin, Director

Dated: October 16, 2006

/s/ JAMES J. LOUGHLIN  
James J. Loughlin, Director

Dated: October 16, 2006

/s/ DAVID SIDRANSKY  
David Sidransky, M.D., Director

Dated: October 16, 2006

/s/ PAUL M. WEISS  
Paul M. Weiss, Ph.D., Director



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41

## Alfacell Corporation

### Index to Financial Statements

	Page
	----
Audited Financial Statements:	
Report of Independent Registered Public Accounting Firm: J.H. Cohn LLP.....	F-2
Report of Independent Registered Public Accounting Firm: KPMG LLP.....	F-3
Independent Auditors' Report of Armus, Harrison & Co.....	F-4
Balance Sheets - July 31, 2006 and 2005.....	F-6
Statements of Operations - Years ended July 31, 2006, 2005, and 2004 and the Period from August 24, 1981 (Date of Inception) to July 31, 2006.....	F-7
Statement of Stockholders' Equity (Deficiency) Period from August 24, 1981 (Date of Inception) to July 31, 2006.....	F-8
Statements of Cash Flows - Years ended July 31, 2006, 2005, and 2004 and Period from August 24, 1981 (Date of Inception) to July 31, 2006.....	F-14
Notes to Financial Statements - Years ended July 31, 2006, 2005 and 2004 and the Period from August 24, 1981 (Date of Inception) to July 31, 2006.....	F-17

F-1

### Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Alfacell Corporation

We have audited the accompanying balance sheets of ALFACELL CORPORATION (A Development Stage Company) as of July 31, 2006 and 2005, and the related statements of operations, stockholders' equity (deficiency) and cash flows for each of the years in the three-year period ended July 31, 2006 and for the period from August 24, 1981 (date of inception) to July 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of Alfacell Corporation for the period from August 24, 1981 to July 31, 2002 were audited by other auditors whose reports dated November 4, 2002 and December 9, 1992, except for Note 18 which is as of July 19, 1993 and Note 3 which is as of October 28, 1993, expressed unqualified opinions on those statements with explanatory paragraphs relating to the Company's ability to continue as a going concern.

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We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and, for the effect on the period from August 24, 1981 to July 31, 2006 of the amounts for the period from August 24, 1981 to July 31, 2002, on the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Alfacell Corporation as of July 31, 2006 and 2005, and its results of operations and cash flows for each of the years in the three-year period ended July 31, 2006 and for the period from August 24, 1981 to July 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the Company changed the manner in which it accounts for share-based compensation in fiscal year 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Alfacell Corporation's internal control over financial reporting as of July 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated October 10, 2006, expressed an adverse opinion thereon.

/s/ J.H. Cohn LLP

Roseland, New Jersey  
October 10, 2006

F-2

### Report Of Independent Registered Public Accounting Firm

The Stockholders and Board of Directors  
Alfacell Corporation:

We have audited the statements of operations, stockholders' equity (deficiency), and cash flows for the period from August 24, 1981 (date of inception) to July 31, 2002 (not presented herein) of Alfacell Corporation (a development stage company). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Alfacell Corporation for the period from August 24, 1981 to July 31, 1992 were audited by other auditors who have ceased operations and whose report dated December 9, 1992, except as to note 18 which is July 19, 1993 and note 3 which is October 28, 1993, expressed an unqualified opinion on those statements with an explanatory paragraph regarding the Company's ability to continue as a going concern.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a

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test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit and, for the effect on the period from August 24, 1981 to July 31, 2002 of the amounts for the period from August 24, 1981 to July 31, 1992, on the report of other auditors who have ceased operations, the financial statements referred to above present fairly, in all material respects, the results of operations and cash flows for the period from August 24, 1981 to July 31, 2002 (not presented herein) of Alfacell Corporation in conformity with U.S. generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations, has a working capital deficit and has limited liquid resources which raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ KPMG LLP

Short Hills, New Jersey  
November 4, 2002

F-3

On December 1, 1993, certain shareholders of Armus Harrison & Co. ("AHC") terminated their association with AHC (the "AHC termination"), and AHC ceased performing accounting and auditing services, except for limited accounting services to be performed on behalf of the Company. In June 1996, AHC dissolved and ceased all operations. The report of AHC with respect to the financial statements of the Company from inception to July 31, 1992 is included herein, although AHC has not consented to the use of such report herein and will not be available to perform any subsequent review procedures with respect to such report. Accordingly, investors will be barred from asserting claims against AHC under Section 11 of the Securities Act of 1933, as amended (the "Securities Act") on the basis of the use of such report in any registration statement of the Company into which such report is incorporated by reference. In addition, in the event any persons seek to assert a claim against AHC for false or misleading financial statements and disclosures in documents previously filed by the Company, such claim will be adversely affected and possibly barred. Furthermore, as a result of the lack of a consent from AHC to the use of its audit report herein, or, to its incorporation by reference into a registration statement or other filings, the officers and directors of the Company will be unable to rely on the authority of AHC as experts in auditing and accounting in the event any claim is brought against such persons under Section 11 of the Securities Act based on alleged false and misleading financial statements and disclosures attributable to AHC. The discussion regarding certain effects of the AHC termination is not meant and should not be construed in any way as legal advice to any party and any potential purchaser should consult with his, her or its own counsel with respect to the effect of the AHC termination on a potential investment in the Common Stock of the Company or otherwise.

Independent Auditors' Report

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Board of Directors  
Alfacell Corporation  
Bloomfield, New Jersey

We have audited the balance sheets of Alfacell Corporation (a Development Stage Company) as of July 31, 1992 and 1991, as restated, and the related statements of operations, stockholders' deficiency, and cash flows for the three years ended July 31, 1992, as restated, and for the period from inception August 24, 1981 to July 31, 1992, as restated. In connection with our audit of the 1992 and 1991 financial statements, we have also audited the 1992, 1991 and 1990 financial statement schedules as listed in the accompanying index. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly in all material respects, the financial position of Alfacell Corporation as of July 31, 1992 and 1991, as restated, and for the three years ended July 31, 1992, as restated, and for the period from inception August 24, 1981 to July 31, 1992, as restated, and the results of operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

F-4

The accompanying financial statements have been prepared on a going concern basis which contemplates the realization of assets and the satisfaction of liability in the normal course of business. As shown in the statement of operations, the Company has incurred substantial losses in each year since its inception. In addition, the Company is a development stage company and its principal operation for production of income has not commenced. The Company's working capital has been reduced considerably by operating losses, and has a deficit net worth. These factors, among others, as discussed in Note 2 to the Notes of Financial Statements, indicates the uncertainties about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and the amount or classification of liabilities that might be necessary should the Company be unable to continue its existence.

/s/ Armus, Harrison & Co.

-----  
Armus, Harrison & Co.

Mountainside, New Jersey  
December 9, 1992  
Except as to Note 18 which  
is July 19, 1993 and Note 3

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which is October 28, 1993

F-5

## ALFACELL CORPORATION (A Development Stage Company)

### Balance Sheets

July 31, 2006 and 2005

	2006	2005
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,518,540	\$ 4,462,951
Other assets	67,090	196,936
	-----	-----
Total current assets	11,585,630	4,659,887
Property and equipment, net of accumulated depreciation and amortization of \$1,090,715 in 2006 and \$1,061,012 in 2005	69,928	80,395
Loan receivable, related party	170,870	161,342
	-----	-----
Total assets	\$ 11,826,428	\$ 4,901,624
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,286,170	\$ 396,263
Accrued expenses	1,307,255	1,283,691
	-----	-----
Total liabilities	2,593,425	1,679,954
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.001 par value. Authorized and unissued, 1,000,000 shares at July 31, 2006 and 2005	--	--
Common stock \$.001 par value. Authorized 100,000,000 shares at July 31, 2006 and 2005; issued and outstanding 44,289,161 shares and 36,534,235 shares at July 31, 2006 and 2005, respectively	44,289	36,534
Capital in excess of par value	92,505,325	78,691,572
Deficit accumulated during development stage	(83,316,611)	(75,506,436)
	-----	-----
Total stockholders' equity	9,233,003	3,221,670
	-----	-----
Total liabilities and stockholders' equity	\$ 11,826,428	\$ 4,901,624
	=====	=====

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See accompanying notes to financial statements.

F-6

## ALFACELL CORPORATION (A Development Stage Company)

### Statements of Operations

Years ended July 31, 2006, 2005 and 2004  
and the Period from August 24, 1981  
(Date of Inception) to July 31, 2006

	2006	2005	2004	August (da ince to July
	-----	-----	-----	-----
Revenues:				
Sales	\$ --	\$ --	\$ --	\$ --
Investment income	107,386	141,708	42,113	
Other income	--	9,836	--	
	-----	-----	-----	-----
	107,386	151,544	42,113	
	-----	-----	-----	-----
Cost and expenses:				
Cost of sales	--	--	--	
Research and development	5,229,996	5,082,339	3,352,977	5
General and administrative	3,004,835	1,771,379	1,578,357	2
Interest:				
Related parties	--	--	--	
Others	112	47,721	402,933	
	-----	-----	-----	-----
	8,234,943	6,901,439	5,334,267	8
	-----	-----	-----	-----
Loss before state tax benefit	(8,127,557)	(6,749,895)	(5,292,154)	(8
State tax benefit	317,382	287,975	221,847	
	-----	-----	-----	-----
Net loss	\$ (7,810,175)	\$ (6,461,920)	\$ (5,070,307)	\$ (8
	=====	=====	=====	=====
Loss per basic and diluted common share	\$ (0.21)	\$ (0.18)	\$ (0.17)	
	=====	=====	=====	=====
Weighted average number of shares outstanding	37,308,000	35,379,000	29,438,000	
	=====	=====	=====	=====

See accompanying notes to financial statements.

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F-7

## ALFACELL CORPORATION (A Development Stage Company)

### Statement of Stockholders' Equity (Deficiency)

Period from August 24, 1981  
(Date of Inception) to July 31, 2006

	Common Stock			
	Number of Shares	Amount	Capital In Excess of par Value	Com Stock Iss
Issuance of shares to officers and stockholders for equipment, research and development, and expense reimbursement	712,500	\$ 713	\$ 212,987	
Issuance of shares for organizational legal service	50,000	50	4,950	
Sale of shares for cash, net	82,143	82	108,418	
Adjustment for 3 for 2 stock split declared September 8, 1982	422,321	422	(422)	
Net loss	--	--	--	
Balance at July 31, 1982	1,266,964	1,267	325,933	
Issuance of shares for equipment	15,000	15	13,985	
Sale of shares to private investors	44,196	44	41,206	
Sale of shares in public offering, net	660,000	660	1,307,786	
Issuance of shares under stock grant program	20,000	20	109,980	
Exercise of warrants, net	1,165	1	3,494	
Net loss	--	--	--	
Balance at July 31, 1983	2,007,325	2,007	1,802,384	
Exercise of warrants, net	287,566	287	933,696	
Issuance of shares under stock grant program	19,750	20	101,199	
Issuance of shares under stock bonus plan for directors and consultants	130,250	131	385,786	
Net loss	--	--	--	
Balance at July 31, 1984	2,444,891	2,445	3,223,065	
Issuance of shares under stock grant program	48,332	48	478,057	
Issuance of shares under stock bonus plan for directors and consultants	99,163	99	879,379	
Shares canceled	(42,500)	(42)	(105,783)	
Exercise of warrants, net	334,957	335	1,971,012	
Net loss	--	--	--	
Balance at July 31, 1985	2,884,843	2,885	6,445,730	
Issuance of shares under stock grant program	11,250	12	107,020	

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Issuance of shares under stock bonus plan for directors and consultants	15,394	15	215,385
Exercise of warrants, net	21,565	21	80,977
Net loss	--	--	--
	-----	-----	-----
Balance at July 31, 1986 (carried forward)	2,933,052	2,933	6,849,112
	Subscription Receivable	Deferred compensation, restricted stock	Total Stockholders' Equity (Deficiency)
	-----	-----	-----
Issuance of shares to officers and stockholders for equipment, research and development, and expense reimbursement	\$ --	\$ --	\$ 213,700
Issuance of shares for organizational legal service	--	--	5,000
Sale of shares for cash, net	--	--	108,500
Adjustment for 3 for 2 stock split declared September 8, 1982	--	--	--
Net loss	--	--	(121,486)
	-----	-----	-----
Balance at July 31, 1982	--	--	205,714
Issuance of shares for equipment	--	--	14,000
Sale of shares to private investors	--	--	41,250
Sale of shares in public offering, net	--	--	1,308,446
Issuance of shares under stock grant program	--	--	110,000
Exercise of warrants, net	--	--	3,495
Net loss	--	--	(558,694)
	-----	-----	-----
Balance at July 31, 1983	--	--	1,124,211
Exercise of warrants, net	--	--	933,983
Issuance of shares under stock grant program	--	--	101,219
Issuance of shares under stock bonus plan for directors and consultants	--	--	385,917
Net loss	--	--	(1,421,083)
	-----	-----	-----
Balance at July 31, 1984	--	--	1,124,247
Issuance of shares under stock grant program	--	--	478,105
Issuance of shares under stock bonus plan for directors and consultants	--	--	879,478
Shares canceled	--	--	(105,825)
Exercise of warrants, net	--	--	1,971,347
Net loss	--	--	(2,958,846)
	-----	-----	-----
Balance at July 31, 1985	--	--	1,388,506
Issuance of shares under stock grant program	--	--	107,032
Issuance of shares under stock bonus plan for directors and consultants	--	--	215,400
Exercise of warrants, net	--	--	80,998
Net loss	--	--	(2,138,605)
	-----	-----	-----
Balance at July 31, 1986 (carried forward)	--	--	(346,669)



F-8

ALFACELL CORPORATION  
(A Development Stage Company)

Statement of Stockholders' Equity (Deficiency), Continued

	Common Stock			
	Number of	Amount	Capital In	Common
	Shares		Excess of par	Stock to
			Value	Issued
Balance at July 31, 1986 (brought forward)	2,933,052	\$ 2,933	\$ 6,849,112	
Exercise of warrants, net	14,745	15	147,435	
Issuance of shares under stock bonus plan for directors and consultants	5,000	5	74,995	
Issuance of shares for services	250,000	250	499,750	
Sale of shares to private investors, net	5,000	5	24,995	
Net loss	--	--	--	
Balance at July 31, 1987	3,207,797	3,208	7,596,287	
Issuance of shares for legal and consulting services	206,429	207	724,280	
Issuance of shares under employment incentive program	700,000	700	2,449,300	
Issuance of shares under stock grant program	19,000	19	66,481	
Exercise of options, net	170,000	170	509,830	
Issuance of shares for litigation settlement	12,500	12	31,125	
Exercise of warrants, net	63,925	64	451,341	
Sale of shares to private investors	61,073	61	178,072	
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
Balance at July 31, 1988	4,440,724	4,441	12,006,716	
Sale of shares for litigation settlement	135,000	135	1,074,703	
Conversion of debentures, net	133,333	133	399,867	
Sale of shares to private investors	105,840	106	419,894	
Exercise of options, net	1,000	1	3,499	
Issuance of shares under employment agreement	750,000	750	3,749,250	
Issuance of shares under the 1989 Stock Plan	30,000	30	149,970	
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
Balance at July 31, 1989	5,595,897	5,596	17,803,899	

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Issuance of shares for legal and consulting services	52,463	52	258,725
Issuance of shares under the 1989 Stock Plan	56,000	56	335,944
Sale of shares for litigation settlement	50,000	50	351,067
Exercise of options at, net	105,989	106	345,856

	Subscription Receivable	Deferred compensation, restricted stock	Total Stockholders Equity (Deficiency)
	-----	-----	-----
Balance at July 31, 1986 (brought forward)	\$ --	\$ --	\$ (346,66)
Exercise of warrants, net	--	--	147,45
Issuance of shares under stock bonus plan for directors and consultants	--	--	75,00
Issuance of shares for services	--	--	500,00
Sale of shares to private investors, net	--	--	25,00
Net loss	--	--	(2,604,61)
	-----	-----	-----
Balance at July 31, 1987	--	--	(2,203,83)
Issuance of shares for legal and consulting services	--	--	724,48
Issuance of shares under employment incentive program	--	(2,450,000)	--
Issuance of shares under stock grant program	--	--	66,50
Exercise of options, net	--	--	510,00
Issuance of shares for litigation settlement	--	--	31,13
Exercise of warrants, net	--	--	451,40
Sale of shares to private investors	--	--	178,13
Amortization of deferred compensation, restricted stock	--	449,167	449,16
Net loss	--	--	(3,272,77)
	-----	-----	-----
Balance at July 31, 1988	--	(2,000,833)	(3,065,78)
Sale of shares for litigation settlement	--	--	1,074,83
Conversion of debentures, net	--	--	400,00
Sale of shares to private investors	--	--	420,00
Exercise of options, net	--	--	3,50
Issuance of shares under employment agreement	--	(3,750,000)	--
Issuance of shares under the 1989 Stock Plan	--	(150,000)	--
Amortization of deferred compensation, restricted stock	--	1,050,756	1,050,75
Net loss	--	--	(2,952,86)
	-----	-----	-----
Balance at July 31, 1989	--	(4,850,077)	(3,069,55)
Issuance of shares for legal and consulting services	--	--	258,77
Issuance of shares under the 1989 Stock Plan	--	(336,000)	--
Sale of shares for litigation settlement	--	--	351,11
Exercise of options at, net	--	--	345,96

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## ALFACELL CORPORATION (A Development Stage Company)

### Statement of Stockholders' Equity (Deficiency), Continued

	Common Stock			
	Number of	Amount	Capital In	Common
	Shares		Excess of par	Stock to
	-----	-----	-----	-----
Sale of shares to private investors	89,480	\$ 90	\$ 354,990	
Issuance of shares under employment agreement	750,000	750	3,749,250	
Conversion of debentures, net	100,000	100	499,900	
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
	-----	-----	-----	-----
Balance at July 31, 1990	6,799,829	6,800	23,699,631	
Exercise of options, net	16,720	16	108,664	
Issuance of shares for legal consulting services	87,000	87	358,627	
Issuance of shares under the 1989 Stock Plan	119,000	119	475,881	
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
	-----	-----	-----	-----
Balance at July 31, 1991	7,022,549	7,022	24,642,803	
Exercise of options at, net	1,000	1	3,499	
Sale of shares to private investors	70,731	71	219,829	
Conversion of debentures, net	94,000	94	469,906	
Issuance of shares for services	45,734	46	156,944	
Issuance of shares under the 1989 Stock Plan	104,000	104	285,896	
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
	-----	-----	-----	-----
Balance at July 31, 1992	7,338,014	7,338	25,778,877	
Sale of shares to private investors	352,667	353	735,147	
Issuance of shares for legal services	49,600	50	132,180	
Issuance of shares for services	5,000	5	9,995	
Issuance of shares under the 1989 Stock Plan	117,000	117	233,883	
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
	-----	-----	-----	-----
Balance at July 31, 1993	7,862,281	7,863	26,890,082	
Conversion of debentures, net	425,400	425	1,701,575	
Sale of shares to private investors, net	743,000	743	1,710,048	
Conversion of short-term borrowings	72,800	73	181,927	

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Issuance of shares for services	16,200	16	43,334
---------------------------------	--------	----	--------

	Subscription Receivable	Deferred compensation, restricted stock	Total Stockholders Equity (Deficiency)
	-----	-----	-----
Sale of shares to private investors	\$ --	\$ --	\$ 355,08
Issuance of shares under employment agreement	--	(3,750,000)	--
Conversion of debentures, net	--	--	500,00
Amortization of deferred compensation, restricted stock	--	3,015,561	3,015,56
Net loss	--	--	(4,860,11
	-----	-----	-----
Balance at July 31, 1990	--	(5,920,516)	(3,103,17
Exercise of options, net	--	--	108,68
Issuance of shares for legal consulting services	--	--	358,71
Issuance of shares under the 1989 Stock Plan	--	(476,000)	--
Amortization of deferred compensation, restricted stock	--	2,891,561	2,891,56
Net loss	--	--	(5,202,30
	-----	-----	-----
Balance at July 31, 1991	--	(3,504,955)	(4,946,52
Exercise of options at, net	--	--	3,50
Sale of shares to private investors	--	--	219,90
Conversion of debentures, net	--	--	470,00
Issuance of shares for services	--	--	156,99
Issuance of shares under the 1989 Stock Plan	--	(286,000)	--
Amortization of deferred compensation, restricted stock	--	3,046,726	3,046,72
Net loss	--	--	(4,772,82
	-----	-----	-----
Balance at July 31, 1992	--	(744,229)	(5,822,23
Sale of shares to private investors	--	--	735,50
Issuance of shares for legal services	--	--	132,23
Issuance of shares for services	--	(10,000)	--
Issuance of shares under the 1989 Stock Plan	--	(234,000)	--
Amortization of deferred compensation, restricted stock	--	664,729	664,72
Net loss	--	--	(2,357,35
	-----	-----	-----
Balance at July 31, 1993	--	(323,500)	(6,647,12
Conversion of debentures, net	--	--	1,702,00
Sale of shares to private investors, net	--	--	1,710,79
Conversion of short-term borrowings	--	--	182,00
Issuance of shares for services	--	--	43,35

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## ALFACELL CORPORATION (A Development Stage Company)

### Statement of Stockholders' Equity (Deficiency), Continued

	Common Stock			
	Number of	Amount	Capital In	Common
	Shares		Excess of par	Stock to
	-----	-----	-----	Issue
Issuance of shares under the 1989 Stock Plan, for services	5,000	\$ 5	\$ 14,995	
Issuance of options to related parties upon conversion of accrued interest, payroll and expenses	--	--	3,194,969	
Repurchase of stock options from related party	--	--	(198,417)	
Issuance of options upon conversion of accrued interest	--	--	142,441	
Common stock to be issued	--	--	--	50
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
Balance at July 31, 1994	9,124,681	9,125	33,680,954	50
Sale of shares to private investors, net	961,000	961	2,023,241	(50)
Conversion of short-term borrowings	17,600	17	43,983	
Issuance of shares for services	30,906	31	77,234	
Exercise of options, net	185,000	185	437,015	
Common stock to be issued	--	--	--	339
Common stock to be issued, for services	--	--	--	4
Amortization of deferred compensation, restricted stock	--	--	--	
Net loss	--	--	--	
Balance at July 31, 1995	10,319,187	10,319	36,262,427	343
Sale of shares to private investors, net	2,953,327	2,953	8,969,655	(339)
Issuance of shares for services	19,995	20	70,858	(4)
Exercise of options, net	566,700	567	1,657,633	
Sale of warrants	--	--	12,084	
Issuance of options/warrants for services	--	--	50,872	
Common stock to be issued	--	--	--	258
Subscription receivable	--	--	--	
Net loss	--	--	--	
Balance at July 31, 1996	13,859,209	13,859	47,023,529	258
Sale of shares to private investors, net	112,000	112	503,888	
Issuance of options for services	--	--	76,504	
Exercise of options, net	729,134	729	2,620,359	(258)
Exercise of warrants, net	147,450	148	737,102	
Net loss	--	--	--	
Balance at July 31, 1997 (carried forward)	14,847,793	14,848	50,961,382	

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	Subscription Receivable	Deferred compensation, restricted stock	Total Stockholders' Equity (Deficiency)
	-----	-----	-----
Issuance of shares under the 1989 Stock Plan, for services	\$ --	\$ --	\$ 15,000
Issuance of options to related parties upon conversion of accrued interest, payroll and expenses	--	--	3,194,969
Repurchase of stock options from related party	--	--	(198,417)
Issuance of options upon conversion of accrued interest	--	--	142,441
Common stock to be issued	--	--	50,000
Amortization of deferred compensation, restricted stock	--	265,000	265,000
Net loss	--	--	(2,234,428)
	-----	-----	-----
Balance at July 31, 1994	--	(58,500)	(1,774,418)
Sale of shares to private investors, net	--	--	1,974,202
Conversion of short-term borrowings	--	--	44,000
Issuance of shares for services	--	--	77,265
Exercise of options, net	--	--	437,200
Common stock to be issued	--	--	339,008
Common stock to be issued, for services	--	--	4,800
Amortization of deferred compensation, restricted stock	--	58,500	58,500
Net loss	--	--	(1,993,123)
	-----	-----	-----
Balance at July 31, 1995	--	--	(832,566)
Sale of shares to private investors, net	--	--	8,633,600
Issuance of shares for services	--	--	66,078
Exercise of options, net	--	--	1,658,200
Sale of warrants	--	--	12,084
Issuance of options/warrants for services	--	--	50,872
Common stock to be issued	--	--	258,335
Subscription receivable	(254,185)	--	(254,185)
Net loss	--	--	(2,942,152)
	-----	-----	-----
Balance at July 31, 1996	(254,185)	--	6,650,266
Sale of shares to private investors, net	--	--	504,000
Issuance of options for services	--	--	76,504
Exercise of options, net	254,185	--	2,616,938
Exercise of warrants, net	--	--	737,250
Net loss	--	--	(5,018,867)
	-----	-----	-----
Balance at July 31, 1997 (carried forward)	--	--	5,566,091

F-11

ALFACELL CORPORATION  
(A Development Stage Company)

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## Statement of Stockholders' Equity (Deficiency), Continued

	Common Stock			
	Number of	Amount	Capital In	Common
	Shares		Excess of par	Stock to
	-----	-----	Value	Issued
Balance at July 31, 1997 (brought forward)	14,847,793	\$14,848	\$ 50,961,382	
Sale of shares to private investors, net	2,337,150	2,337	4,199,877	
Issuance of options for services	--	--	199,954	
Exercise of warrants, net	4,950	5	11,080	
Issuance of shares for services, net	50,000	50	99,950	
Net loss	--	--	--	
Balance at July 31, 1998	17,239,893	17,240	55,472,243	
Issuance of options for services	--	--	205,593	
Issuance of shares for services, net	46,701	46	16,359	
Net loss	--	--	--	
Balance at July 31, 1999	17,286,594	17,286	55,694,195	
Sale of shares to private investors, net	875,000	875	547,417	
Exercise of options, net	95,000	95	45,755	
Issuance of shares for services, net	174,965	175	92,009	
Vesting of options previously issued for services	--	--	146,912	
Net loss	--	--	--	
Balance at July 31, 2000	18,431,559	18,431	56,526,288	
Sale of shares to private investors, net	863,331	863	955,561	
Exercise of options, net	165,555	166	83,565	
Issuance of shares for services, net	11,800	12	10,018	
Exercise of convertible debentures, net	330,000	330	296,670	
Issuance of warrants with convertible debt	--	--	178,807	
Issuance of options for services	--	--	160,426	
Net loss	--	--	--	
Balance at July 31, 2001	19,802,245	19,802	58,211,335	
Sale of shares to private investors, net	2,622,122	2,623	1,047,925	
Exercise of stock options and warrants	186,000	186	92,814	
Issuance of shares for services, net	78,340	78	64,048	
Exercise of convertible debentures, net	72,214	72	64,921	
Vesting of options previously issued for services	--	--	173,436	
Net loss	--	--	--	
Balance at July 31, 2002 (carried forward)	22,760,921	22,761	59,654,479	

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	Subscription Receivable	Deferred compensation, restricted stock	Total Stockholders' Equity (Deficiency)
	-----	-----	-----
Balance at July 31, 1997 (brought forward)	\$ --	\$ --	\$ 5,566,091
Sale of shares to private investors, net	--	--	4,202,214
Issuance of options for services	--	--	199,954
Exercise of warrants, net	--	--	11,085
Issuance of shares for services, net	--	--	100,000
Net loss	--	--	(6,387,506)
	-----	-----	-----
Balance at July 31, 1998	--	--	3,691,838
Issuance of options for services	--	--	205,593
Issuance of shares for services, net	--	--	16,405
Net loss	--	--	(3,156,636)
	-----	-----	-----
Balance at July 31, 1999	--	--	757,200
Sale of shares to private investors, net	--	--	548,292
Exercise of options, net	--	--	45,850
Issuance of shares for services, net	--	--	92,184
Vesting of options previously issued for services	--	--	146,912
Net loss	--	--	(1,722,298)
	-----	-----	-----
Balance at July 31, 2000	--	--	(131,860)
Sale of shares to private investors, net	--	--	956,424
Exercise of options, net	--	--	83,731
Issuance of shares for services, net	--	--	10,030
Exercise of convertible debentures, net	--	--	297,000
Issuance of warrants with convertible debt	--	--	178,807
Issuance of options for services	--	--	160,426
Net loss	--	--	(2,294,936)
	-----	-----	-----
Balance at July 31, 2001	--	--	(740,378)
Sale of shares to private investors, net	--	--	1,050,548
Exercise of stock options and warrants	--	--	93,000
Issuance of shares for services, net	--	--	64,126
Exercise of convertible debentures, net	--	--	64,993
Vesting of options previously issued for services	--	--	173,436
Net loss	--	--	(2,591,162)
	-----	-----	-----
Balance at July 31, 2002 (carried forward)	--	--	(1,885,437)

F-12

ALFACELL CORPORATION  
(A Development Stage Company)



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## Statement of Stockholders' Equity (Deficiency), Continued

	Common Stock			
	Number of Shares	Amount	Capital In Excess of par Value	Common Stock to Issue
Balance at July 31, 2002 (brought forward)	22,760,921	\$22,761	\$ 59,654,479	—
Sale of shares to private investors, net	1,315,000	1,315	652,312	—
Exercise of stock options and warrants	764,000	764	376,896	—
Issuance of shares for payment of accounts payable	186,208	186	94,037	—
Issuance of options for services rendered	--	--	75,521	—
Vesting of options previously issued for services	--	--	10,038	—
Issuance of warrants in connection with debt issuances	--	--	594,219	—
Net loss	--	--	--	—
Balance at July 31, 2003	25,026,129	25,026	61,457,502	—
Sale of shares to private investors, net	3,035,200	3,036	10,732,942	—
Exercise of stock options and warrants	3,100,160	3,100	4,155,397	—
Issuance of shares for payment of accounts payable	14,703	15	52,161	—
Issuance of shares for conversion of subordinated debentures	3,042,817	3,043	924,829	—
Issuance of shares for services rendered	128,876	128	288,372	—
Issuance of options for services rendered	--	--	280,612	—
Net loss	--	--	--	—
Balance at July 31, 2004	34,347,885	34,348	77,891,815	—
Exercise of stock options and warrants, net	438,372	438	306,717	—
Issuance of shares and warrants for conversion of subordinated debentures	1,744,978	1,745	462,754	—
Issuance of shares for services rendered	3,000	3	13,497	—
Issuance of options and warrants for services rendered	--	--	16,789	—
Net loss	--	--	--	—
Balance at July 31, 2005	36,534,235	36,534	78,691,572	—
Sale of shares to private investors, net	6,632,099	6,632	10,977,288	—
Exercise of stock options and warrants, net	1,122,827	1,123	1,347,201	—
Issuance of stock options and warrants for services rendered	--	--	1,489,264	—
Net loss	--	--	--	—
Balance at July 31, 2006	44,289,161	\$44,289	\$ 92,505,325	—

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	Subscription Receivable	Deferred compensation, restricted stock	Total Stockholder Equity (Deficiency)
	-----	-----	-----
Balance at July 31, 2002 (brought forward)	\$ --	\$ --	\$ (1,885,4
Sale of shares to private investors, net	--	--	653,6
Exercise of stock options and warrants	--	--	377,6
Issuance of shares for payment of accounts payable	--	--	94,2
Issuance of options for services rendered	--	--	75,5
Vesting of options previously issued for services	--	--	10,0
Issuance of warrants in connection with debt issuances	--	--	594,2
Net loss	--	--	(2,411,5
	-----	-----	-----
Balance at July 31, 2003	--	--	(2,491,6
Sale of shares to private investors, net	--	--	10,735,9
Exercise of stock options and warrants	--	--	4,158,4
Issuance of shares for payment of accounts payable	--	--	52,1
Issuance of shares for conversion of subordinated debentures	--	--	927,8
Issuance of shares for services rendered	--	--	288,5
Issuance of options for services rendered	--	--	280,6
Net loss	--	--	(5,070,3
	-----	-----	-----
Balance at July 31, 2004	--	--	8,881,6
Exercise of stock options and warrants, net	--	--	307,1
Issuance of shares and warrants for conversion of subordinated debentures	--	--	464,4
Issuance of shares for services rendered	--	--	13,5
Issuance of options and warrants for services rendered	--	--	16,7
Net loss	--	--	(6,461,9
	-----	-----	-----
Balance at July 31, 2005	--	--	3,221,6
Sale of shares to private investors, net	--	--	10,983,9
Exercise of stock options and warrants, net	--	--	1,348,3
Issuance of stock options and warrants for services rendered	--	--	1,489,2
Net loss	--	--	(7,810,1
	-----	-----	-----
Balance at July 31, 2006	\$ -- =====	\$ -- =====	\$ 9,233,0 =====

See accompanying notes to financial statements.

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(A Development Stage Company)

## Statements of Cash Flows

Years ended July 31, 2006, 2005 and 2004  
and the Period from August 24, 1981  
(Date of Inception) to July 31, 2006

	2006	2005	2004
	-----	-----	-----
Cash flows from operating activities:			
Net loss	\$ (7,810,175)	\$ (6,461,920)	\$ (5,070,000)
Adjustments to reconcile net loss to net cash used in operating activities:			
Gain on sale of marketable equity securities	--	--	--
Depreciation and amortization	29,703	28,917	9,000
Loss on disposal of property and equipment	--	--	--
Issuance of common stock, stock options and warrants for services rendered	1,489,264	30,289	569,000
Amortization of debt discount	--	34,120	316,000
Amortization of deferred compensation	--	--	--
Changes in assets and liabilities:			
(Increase) decrease in other current assets	129,846	(132,165)	(54,000)
Increase in loans receivable, related party	(9,528)	(9,527)	(9,000)
Increase in loans and interest payable, related party	--	--	--
Increase (decrease) in accounts payable	889,907	(145,337)	(105,000)
Increase in accrued payroll and expenses, related parties	--	--	--
Increase (decrease) in accrued expenses	23,564	722,985	(669,000)
	-----	-----	-----
Net cash used in operating activities	(5,257,419)	(5,932,638)	(5,014,000)
	-----	-----	-----
Cash flows from investing activities:			
Purchase of marketable equity securities	--	--	--
Purchase of short-term investments	--	--	--
Proceeds from sale of marketable equity securities	--	--	--
Proceeds from sale of short-term investments	--	--	--
Purchase of property and equipment	(19,236)	(52,529)	(53,000)
Patent costs	--	--	--
	-----	-----	-----
Net cash used in investing activities	(19,236)	(52,529)	(53,000)
	-----	-----	-----

F-14

ALFACELL CORPORATION  
(A Development Stage Company)

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## Statements of Cash Flows, Continued

	2006	2005	
	-----	-----	-----
Cash flows from financing activities:			
Proceeds from short-term borrowings	\$ --	\$ --	\$
Payment of short-term borrowings	--	--	
Increase in loans payable, related party, net	--	--	
Proceeds from bank debt and other long-term debt, net of deferred debt costs	--	--	
Reduction of bank debt and long-term debt	--	(6,731)	
Proceeds from issuance of common stock, net	10,983,920	--	10,
Proceeds from exercise of stock options and warrants, net	1,348,324	307,155	4,
Proceeds from issuance of convertible debentures, related party	--	--	
Proceeds from issuance of convertible debentures, unrelated party	--	--	
	-----	-----	-----
Net cash provided by financing activities	12,332,244	300,424	14,
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents	7,055,589	(5,684,743)	9,
Cash and cash equivalents at beginning of period	4,462,951	10,147,694	
	-----	-----	-----
Cash and cash equivalents at end of period	\$11,518,540	\$ 4,462,951	\$10,
	=====	=====	=====
Supplemental disclosure of cash flow information - interest paid	\$ 112	\$ 305	\$
	=====	=====	=====
Noncash financing activities:			
Issuance of convertible subordinated debenture for loan payable to officer	\$ --	\$ --	\$
	=====	=====	=====
Issuance of common stock upon the conversion of convertible subordinated debentures, related party	\$ --	\$ --	\$
	=====	=====	=====
Conversion of short-term borrowings to common stock	\$ --	\$ --	\$
	=====	=====	=====
Conversion of accrued interest, payroll and expenses by related parties to stock options	\$ --	\$ --	\$
	=====	=====	=====
Repurchase of stock options from related party	\$ --	\$ --	\$
	=====	=====	=====
Conversion of accrued interest to stock options	\$ --	\$ --	\$
	=====	=====	=====

F-15

ALFACELL CORPORATION  
(A Development Stage Company)

Statements of Cash Flows, Continued

	2006	2005	
	-----	-----	-----
Conversions of accounts payable to common stock	\$ -- =====	\$ -- =====	\$ =====
Conversion of notes payable, bank and accrued interest to long-term debt	\$ -- =====	\$ -- =====	\$ =====
Conversion of loans and interest payable, related party and accrued payroll and expenses, related parties to long-term accrued payroll and other, related party	\$ -- =====	\$ -- =====	\$ =====
Issuance of common stock and warrants upon the conversion of convertible subordinated debentures and accrued interest, other	\$ -- =====	\$ 464,499 =====	\$ =====
Issuance of common stock for services rendered	\$ -- =====	\$ -- =====	\$ =====
Issuance of warrants with notes payable	\$ -- =====	\$ -- =====	\$ =====

See accompanying notes to financial statements.

F-16

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements

Years ended July 31, 2006, 2005 and 2004  
and the Period From August 24, 1981  
(Date of Inception) to July 31, 2006

(1) Summary of Significant Accounting Policies

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### Business Description

Alfacell Corporation (the "Company") was incorporated in Delaware on August 24, 1981 for the purpose of engaging in the discovery, investigation and development of a new class of anti-cancer drugs and anti-viral agents. The Company is a development stage company as defined in Statement of Financial Accounting Standards No. 7. The Company is devoting substantially all of its present efforts to establishing its business. Its planned principal operations have not commenced and, accordingly, no significant revenue has been derived therefrom.

The Company's current operations encompass all the risks inherent in discovering and developing a new drug, including: an uncertainty regarding the timing and amount of future revenues to be derived from the Company's technology; obtaining future capital as needed; attracting and retaining key personnel; and a business environment with heightened competition, rapid technological change and strict government regulations.

### Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts and disclosures in these financial statements. Actual results could differ from those estimates.

### Property and Equipment

Property and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets ranging from three to seven years. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is included in operations for the period.

The cost of repairs and maintenance is charged to operations as incurred; significant renewals and betterments are capitalized.

### Cash Equivalents

The Company considers all highly-liquid investments with maturities of three months or less, at the time of purchase, to be cash equivalents. Cash equivalents are in excess of the federally insured amount.

### Research and Development

Research and development costs are expensed as incurred.

### Fair Value of Financial Instruments

For all financial instruments, carrying value approximates fair value due to the short maturity of those instruments.

F-17

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued

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### (1) Summary of Significant Accounting Policies, (Continued)

#### Earnings (Loss) Per Common Share

"Basic" earnings (loss) per common share equals net income (loss) divided by weighted average common shares outstanding during the period. "Diluted" earnings per common share equals net income divided by the sum of weighted average common shares outstanding during the period, adjusted for the effects of potentially dilutive securities. The Company's Basic and Diluted per share amounts are the same since the Company has net losses in all periods and the assumed exercise of stock options and warrants prior to July 31, 2006 would be anti-dilutive. The number of outstanding options and warrants that could dilute earnings per share in future periods was 21,949,948, 16,242,519 and 14,329,413 at July 31, 2006, 2005 and 2004, respectively.

#### Long-Lived Assets

The Company reviews long-lived assets for impairment annually or whenever events or changes in business circumstances occur that indicate that the carrying amount of the assets may not be recoverable. The Company assesses the recoverability of long-lived assets held and to be used based on undiscounted cash flows, and measures the impairment, if any, using discounted cash flows.

#### Stock Option Plans

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), provides for the use of a fair value-based method of accounting for employee stock compensation. However, SFAS 123 also allowed an entity to continue to measure compensation cost for stock options granted to employees and directors using the intrinsic value method of accounting prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), which only required charges to compensation expense for the excess, if any, of the fair value of the underlying stock at the date a stock option was granted (or at an appropriate subsequent measurement date) over the amount the employee had to pay to acquire the stock, if such amounts differed materially from the historical amounts. Prior to August 1, 2005, the Company had elected to continue to account for employee stock options using the intrinsic value method under APB 25. As the exercise price of all options granted under the stock option plans was equal to the market value of the underlying common stock on the grant date, no stock-based employee compensation cost had been recognized in the statement of operations for the years ended July 31, 2005 and 2004.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R) (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), which amends SFAS 123. The new standard requires all share-based payments, including stock option grants to employees, to be recognized as an operating expense in the statement of operations. The cost is recognized over the requisite service period based on fair values measured on the date of grant. The Company adopted SFAS 123(R) effective August 1, 2005 using the modified prospective method and, accordingly, prior period amounts have not been restated. Under the modified prospective method, the fair value of all new stock options issued after July 31, 2005 and the unamortized fair value of unvested outstanding stock options at August 1, 2005 are recognized as expense as services are rendered. The Company recorded approximately \$1,318,000 or \$.04 per basic and diluted common share of stock-based compensation expense for employees under SFAS 123R for the fiscal year ended July 31, 2006. Had the Company accounted for its stock-based awards under the fair value method for the fiscal years ended July 31, 2005 and

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2004 the pro forma impact to its financial statements would have been as follows:

F-18

## ALFACELL CORPORATION (A Development Stage Company)

### Notes to Financial Statements, Continued

#### 1) Summary of Significant Accounting Policies, (Continued)

Net loss:	2005 ----
As reported	\$ (6,461,920)
Total stock-based employee compensation expense determined under a fair value based method for all awards, net of related tax effects	(3,278,082) -----
Pro forma	\$ (9,740,002) =====
Basic and diluted loss per common share:	
As reported	\$ (0.18)
Pro forma	(0.28)

For options granted to employees during the fiscal years ended 2006, 2005 and 2004, the per option weighted-average fair value at the grant date was \$1.27, \$3.87 and \$4.36, respectively, and the per option weighted average exercise price was \$1.69, \$4.40 and \$5.26, respectively. The fair value of the stock options at the grant date was estimated using the Black-Scholes options pricing model based on the weighted-average assumptions as noted in the following table. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The expected stock price volatility is based on historical volatility of the Company's stock price. The expected term until exercise is derived using the "simplified" method as allowed under the provisions of the Securities and Exchange Commission's Staff Accounting Bulletin No. 107 and represents the period of time that options granted are expected to be outstanding. As of July 31, 2006, there was approximately \$2,318,000 of total unrecognized compensation cost related to unvested options granted that is expected to be recognized over a weighted average period of 1.16 years.

	2006 ----	2005 ----	2004 ----
Expected dividend yield	0%	0%	0%
Risk-free interest rate	4.4%	4.25%	4.00%
Expected stock price volatility	95.6%	95.2%	78.0%
Expected term until exercise (years)	5.33	9.56	6.86

Shares, warrants or options issued to non-employees for services are accounted for through charges to expense over the service period based on



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their fair market value determined using the Black-Scholes option pricing model in accordance with SFAS 123R and Emerging Issues Task Force ("EITF") 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."

### Accounting For Warrants Issued With Convertible Debt

The Company accounts for the intrinsic value of beneficial conversion rights arising from the issuance of convertible debt instruments with non-detachable conversion rights that are in-the-money at the commitment date pursuant to the consensuses of EITF Issue No. 98-5 and EITF Issue No. 00-27. Such value is allocated to additional paid-in capital and the resulting debt discount is charged to interest expense over the terms of the notes payable. Such value is determined after first allocating an appropriate portion of the proceeds received to warrants or any other detachable instruments included in the exchange.

F-19

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

#### (1) Summary of Significant Accounting Policies, (Continued)

##### Accounting Changes and Error Corrections

The FASB has issued FASB Statement No. 154, Accounting Changes and Error Corrections ("FAS 154"). The new standard replaces APB Opinion No. 20, Accounting Changes and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. Among other changes, FAS 154 provides for correction of errors in previously issued financial statements should be termed "restatement". The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made for fiscal years beginning after June 1, 2005. The Company adopted FAS 154 on August 1, 2005.

##### Income Taxes

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect for all years in which the temporary differences are expected to reverse. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

#### (2) Liquidity

The Company has reported net losses of approximately \$7,810,000, \$6,462,000, and \$5,070,000 for the fiscal years ended July 31, 2006, 2005 and 2004, respectively. The loss from date of inception, August 24, 1981 to July 31, 2006, amounts to \$83,317,000.

The Company's long-term continued operations will depend on its ability to

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raise additional funds through various potential sources such as equity and debt financing, collaborative agreements, strategic alliances, sale of tax benefits, revenues from the commercial sale of ONCONASE(R), licensing of its proprietary RNase technology and its ability to realize revenues from its technology and its drug candidates via out-licensing agreements with other companies. Such additional funds may not become available as the Company may need them or be available on acceptable terms. Until and unless the Company's operations generate significant revenues, the Company expects to continue to fund operations from equity financing. There can be no assurance that the Company will be able to raise the capital it needs on terms which are acceptable, if at all. During the fiscal year ended July 31, 2006, the Company received net proceeds of approximately \$12.3 million as a result of private placements of common stock and warrants and from exercises of stock options and warrants. The Company expects that such net proceeds together with its cash reserves, will be sufficient to fund its operations through July 31, 2008 based on its expected level of expenditures. The Company may also obtain additional capital through the exercise of outstanding options and warrants and the sale of its tax benefits, although it cannot provide any assurance of such exercises or sale or the amount of capital it will receive, if any.

### (3) Property and Equipment

Property and equipment, at cost, consists of the following at July 31:

	2006 ----	2005 ----
Laboratory equipment	\$ 774,757	\$ 769,760
Office equipment	288,053	273,814
Leasehold improvements	97,833	97,833
	-----	-----
Total	1,160,643	1,141,407
Less accumulated depreciation and amortization	1,090,715	1,061,012
	-----	-----
Property and equipment, net	\$ 69,928 =====	\$ 80,395 =====

### (4) Long-term Debt

During the fiscal year ended July 31, 2004, the principal and accrued interest on 8% convertible notes payable (see Note 7) in an aggregate amount of \$927,872 were converted resulting in the issuance of 3,042,817 shares of common stock and 3,733,839 five year warrants with exercise prices ranging from \$1.00 to \$1.10 per share.

F-20

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued

### (4) Long-term Debt, (Continued)

During the fiscal year ended July 31, 2005, the principal and accrued interest on 8% convertible notes payable (see Note 7) in an aggregate

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amount of \$464,499 were converted resulting in the issuance of 1,744,978 shares of common stock and 2,044,978 five year warrants with an exercise price of \$1.00 per share.

### (5) Related Party Transactions

Amounts due from the Company's CEO totaling \$170,870 and \$161,342 at July 31, 2006 and 2005, respectively, are classified as a long-term asset in Loan receivable, related party as the Company does not expect repayment of these amounts within one year. In each of the fiscal years ended July 31, 2006, 2005 and 2004, the Company earned 8% interest in the amount of approximately \$9,500 on the unpaid principal balance.

### (6) Leases

The Company leases its facility on a month-to-month basis and its office equipment for five years pursuant to a lease which expires in 2010. Rent expense charged to operations was \$148,000, \$139,000 and \$136,000 in each of fiscal years ended July 31, 2006, 2005 and 2004, respectively.

### (7) Stockholders' Equity

On September 1, 1981, the Company issued 712,500 shares of common stock (1,068,750 shares adjusted for the stock split on September 8, 1982) to officers and stockholders in exchange for equipment, research and development services, stock registration costs, reimbursement of expenses and other miscellaneous services. The common stock issued for services was recorded at the estimated fair value of services rendered based upon the Board of Directors' determination and ratification of the value of services. Equipment received in exchange for common stock was recorded at the transferor's cost. Common stock issued for reimbursement of expenses was recorded based upon expenses incurred. All values assigned for expenses and services rendered were charged to operations except for stock registration costs, which were charged against proceeds.

On July 30, 1982, the Company sold 82,143 shares of common stock (123,214 shares adjusted to reflect the stock split on September 8, 1982) to a private investor at a price of \$1.40 per share, resulting in net proceeds to the Company of approximately \$108,500.

On September 8, 1982, the Company declared a 3-for-2 stock split. Shares previously issued by the Company were restated in accordance with the stock split.

On September 8, 1982, the Company issued 15,000 shares of common stock to an officer and stockholder in exchange for equipment. The equipment received in exchange for the common stock was recorded at the transferor's cost.

On November 1, 1982 and January 3, 1983, the Company sold 28,125 and 16,071 shares of common stock, respectively, to private investors at \$.93 per share, resulting in net proceeds to the Company of approximately \$41,250.

On January 17, 1983, the Company sold 660,000 shares of its common stock and 330,000 common stock purchase warrants in a public offering at a price of \$2.50 per share, resulting in net proceeds to the Company of approximately \$1,308,446. The warrants were to expire 12 months after issuance; however, the Company extended the expiration date to July 16, 1984. During the fiscal years ended July 31, 1983 and 1984, the net proceeds to the Company from the exercise of the warrants amounted to \$934,000. Each common stock purchase warrant was not detachable from its

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common stock or exercisable until six months after the issuance date of January 17, 1983. Each warrant entitled the holder to purchase one share of common stock at an exercise price of \$3.00 after six months and prior to nine months after issuance. The exercise price increased to \$3.50 after nine months and prior to 12 months after issuance.

F-21

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

##### (7) Stockholders' Equity, (Continued)

In connection with the public offering, the Company sold 60,000 five-year purchase warrants to the underwriters at a price of \$.001 per warrant. Each warrant entitled the holder to purchase one share of common stock at an exercise price of \$3.00. Pursuant to the antidilution provisions of the warrants, the underwriters received warrants to purchase 67,415 shares at an exercise price of \$2.67 per share. By July 31, 1986, all such warrants were exercised and the Company received proceeds of approximately \$180,000.

On February 22, 1984, the Company filed a registration statement with the Securities and Exchange Commission for the issuance of two series of new warrants, each to purchase an aggregate of 330,000 shares (hereinafter referred to as one-year warrants and two-year warrants). The one-year warrants had an exercise price of \$6.50 per share and expired July 17, 1985. The two-year warrants had an exercise price of \$10.00 per share and were to expire July 17, 1986. However, the Company extended the expiration date to August 31, 1987. The one-year warrants and two-year warrants were issued as of July 17, 1984 on a one-for-one basis to those public offering warrant holders who exercised their original warrants, with the right to oversubscribe to any of the warrants not exercised. During the fiscal years ended July 31, 1985, 1986, 1987 and 1988, the Company received net proceeds of approximately \$2,471,000 as a result of the exercise of the warrants.

On January 2, 1987, the Company issued 250,000 shares of common stock to officers and stockholders, including the President and Chief Executive Officer, in recognition of services performed for the Company. The fair value of such shares was recorded as compensation expense.

On February 3, 1987, the Company sold 5,000 shares of common stock to a private investor for \$5.00 per share, resulting in net proceeds to the Company of approximately \$25,000.

On September 1, 1987, the Board of Directors approved new wage contracts for three officers. The contracts provided for the issuance of 700,000 shares of common stock as an inducement for signing. The fair value of these shares was recorded as deferred compensation and was amortized over the term of the employment agreements. The contracts also provided for the issuance of 1,500,000 shares of common stock in 750,000 increments upon the occurrence of certain events. These shares were issued during the fiscal years ended July 31, 1989 and 1990 and the fair value of such shares was recorded as deferred compensation and was amortized over the remaining term of the employment agreements. The contracts also provided for five-year options to purchase 750,000 shares of common stock at \$3.00 per share; options for the purchase of 170,000 shares were exercised on

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June 16, 1988 and the remaining options for the purchase of 580,000 shares expired on September 2, 1992.

During the fiscal year ended July 31, 1988, the Company issued 206,429 shares of common stock for payment of legal and consulting services. The Company also issued 12,500 shares of common stock in connection with the settlement of certain litigation. The fair value of such shares was charged to operations.

During the fiscal year ended July 31, 1988, the Company sold 61,073 shares of common stock to private investors at \$2.92 per share resulting in net proceeds to the Company of approximately \$178,133.

On September 21, 1988, the Company entered into a stipulation of settlement arising from a lawsuit wherein it agreed to pay a total of \$250,000 in 12 monthly installments. Under the agreement, the Company authorized the issuance on September 7, 1988 and October 18, 1988 of 85,000 and 50,000 shares, respectively, to an escrow account to secure payment of the \$250,000 due under the stipulation of settlement. During the fiscal year ended July 31, 1989, the Company issued and sold the 135,000 shares of common stock for \$1,074,838. On February 14, 1989, the Board of Directors authorized the issuance of an additional 50,000 shares. During the year ended July 31, 1990, the shares were sold for \$351,117. The proceeds from the above transactions were used to pay the settlement and related legal costs, reduce loans from and interest due to the Company's Chief Executive Officer, and for working capital.

F-22

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

##### (7) Stockholders' Equity, (Continued)

During the fiscal year ended July 31, 1989, the Company sold 105,840 shares of common stock to private investors at \$3.97 per share resulting in net proceeds to the Company of approximately \$420,000.

During the fiscal year ended July 31, 1990, the Company issued 52,463 shares of common stock for payment of legal and consulting services and 50,000 shares of common stock in connection with the settlement of certain litigation. The fair value of the common stock was charged to operations.

During the fiscal year ended July 31, 1990, the Company sold 89,480 shares of common stock to private investors at \$3.97 per share resulting in net proceeds to the Company of approximately \$355,080.

During the fiscal year ended July 31, 1991, the Company issued 87,000 shares of common stock for payment of legal and consulting services. The fair value of the common stock was charged to operations.

During the fiscal year ended July 31, 1992, the Company sold 70,731 shares of common stock to private investors at \$2.75 to \$3.50 per share resulting in net proceeds to the Company of approximately \$219,900.

During the fiscal year ended July 31, 1992, the Company issued 45,734 shares of common stock as payment for services rendered to the Company. The fair value of the common stock was charged to operations.

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During the fiscal years ended July 31, 1992 and 1990, 94,000 and 50,000 shares of common stock, respectively, were issued to the Company's Chief Executive Officer upon the conversion of outstanding debentures.

During the fiscal year ended July 31, 1993, the Company sold 352,667 shares of common stock to private investors at prices ranging from \$2.00 to \$3.00 per share resulting in net proceeds to the Company of approximately \$735,500. In addition, the private investors were granted options to purchase common stock totaling 587,167 shares at prices ranging from \$3.00 to \$7.00. During the fiscal years ended July 31, 1995 and 1996, 322,500 and 228,833 options expired, respectively. A total of 42,167 options due to expire on July 31, 1995 were extended to July 31, 1996 and their exercise price was reduced to \$2.50. During the fiscal year ended July 31, 1996, 35,834 options were exercised resulting in net proceeds to the Company of approximately \$89,600.

During the fiscal year ended July 31, 1993, the Company issued 54,600 shares of common stock as payment for legal and other services performed for the Company. The fair value of 49,600 shares was charged to operations. The remaining 5,000 shares were recorded as deferred compensation and were amortized over a one-year period, beginning in February 1993, in accordance with the agreement entered into with the recipient.

During the fiscal year ended July 31, 1994, the Company issued 7,000 shares of common stock as payment for services performed for the Company. The fair value of the common stock was charged to operations.

During the fiscal year ended July 31, 1994, the Company sold 25,000 shares of common stock to a private investor at \$2.00 per share resulting in net proceeds to the Company of \$50,000. In addition, the private investor was granted options to purchase common stock totaling 25,000 shares at \$4.00 per common share. These options were exercised in September 1996 resulting in net proceeds to the Company of \$100,000.

During the fiscal year ended July 31, 1994, the Company sold 800,000 shares of common stock to private investors at \$2.50 per share resulting in net proceeds to the Company of \$1,865,791. In addition, the private investors were granted warrants to purchase common stock totaling 800,000 shares at \$5.00 per common share. Warrants for the purchase of 147,450 shares were exercised during fiscal 1997 resulting in net proceeds to the Company of \$737,250. The remaining 652,550 warrants expired during fiscal 1997.

F-23

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued

(7) Stockholders' Equity, (Continued)

During the fiscal year ended July 31, 1994, 400,000 shares of common stock were issued to the Company's Chief Executive Officer upon the conversion of outstanding debentures.

During the fiscal year ended July 31, 1994, 25,400 shares of common stock were issued upon the conversion of other outstanding debentures.

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In September 1994, the Company completed a private placement resulting in the issuance of 288,506 shares of common stock and three-year warrants to purchase 288,506 shares of common stock at an exercise price of \$5.50 per share. The warrants expired during fiscal 1998. The common stock and warrants were sold in units consisting of 20,000 shares of common stock and warrants to purchase 20,000 shares of common stock. The price per unit was \$50,000. The Company received proceeds of approximately \$545,000, net of costs associated with the placement of approximately \$55,000 and the conversion of certain debt by creditors of \$121,265 into equivalent private placement units of 17,600 shares for conversion of short-term borrowings and 30,906 shares issued for services rendered. In October 1994, an additional two units at \$50,000 per unit were sold to a private investor under the same terms as the September 1994 private placement resulting in the issuance of 40,000 shares of common stock and warrants to purchase 40,000 shares of common stock. The warrants expired during fiscal 1998.

During the fiscal year ended July 31, 1995, 185,000 shares of common stock were issued upon the exercise of stock options by unrelated parties, resulting in net proceeds to the Company of \$437,200. The exercise prices of the options ranged from \$2.27 to \$2.50, which had been reduced from \$3.50 and \$5.00, respectively, during fiscal 1995.

During the fiscal year ended July 31, 1995, the Company sold 681,000 shares of common stock to private investors resulting in net proceeds to the Company of approximately \$1,379,000. The shares were sold at prices ranging from \$2.00 to \$2.25.

During the fiscal year ended July 31, 1995, the Company sold 139,080 shares of common stock and 47,405 three-year warrants to purchase shares of common stock at an exercise price of \$4.00 per share to private investors. The stock and warrants were sold at prices ranging from \$2.25 to \$2.73 per share and resulted in net proceeds to the Company of \$343,808, of which \$4,800 was for services rendered. The common shares were issued to the investors subsequent to July 31, 1995.

On August 4, 1995, the Company issued 6,060 shares of common stock as payment for services rendered to the Company. The fair value of the common stock was charged to operations.

On September 29, 1995, the Company completed a private placement resulting in the issuance of 1,925,616 shares of common stock and three-year warrants to purchase an aggregate of 55,945 shares of common stock at an exercise price of \$4.00 per share. Of these shares 1,935 were issued for services rendered to the Company. The common stock was sold alone at per share prices ranging from \$2.00 to \$3.70, and in combination with warrants at per unit prices ranging from \$4.96 to \$10.92, which related to the number of warrants contained in the unit. The Company received proceeds of approximately \$4.1 million, including \$1,723,000 for approximately 820,000 shares received during the fiscal year ended July 31, 1995. The warrants expired in October 1998.

As consideration for the extension of the Company's term loan agreement with its bank, the Company granted the bank a warrant to purchase 10,000 shares of common stock at an exercise price of \$4.19. The warrants were issued as of October 1, 1995 and expired on August 31, 1997.

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ALFACELL CORPORATION  
(A Development Stage Company)

### Notes to Financial Statements, Continued

#### (7) Stockholders' Equity, (Continued)

In June 1996, the Company sold in a private placement 1,515,330 shares of common stock and three-year warrants to purchase 313,800 shares of common stock at an exercise price of \$7.50 per share. Of these shares, 12,000 were issued for services rendered to the Company. The common stock was sold alone at a per share price of \$3.70, in combination with warrants at a per unit price of \$12.52 and warrants were sold alone at a per warrant price of \$1.42. Each unit consisted of three shares of common stock and one warrant. The Company received proceeds of approximately \$5.7 million. The warrants expired during the fiscal 2000.

In June 1996, the Company issued 10,000 five-year stock options as payment for services rendered. The options vested immediately and had an exercise price of \$4.95 per share. The Company recorded research and development expense of \$28,260, which was the fair value of the stock options on the date of issuance. The options expired during the fiscal year ended July 31, 2001.

During the fiscal year ended July 31, 1996, 207,316 shares of common stock were sold from October 1995 to April 1996 at per share prices ranging from \$3.60 to \$4.24 resulting in proceeds of approximately \$808,000.

During the fiscal year ended July 31, 1996, 656,334 stock options were exercised by both related and unrelated parties resulting in net proceeds of approximately \$1.9 million to the Company. Of these shares, 89,634 were issued subsequent to July 31, 1996. The exercise prices of the options ranged from \$2.50 to \$3.87 per share.

In August 1996, the Company issued 10,000 stock options with an exercise price of \$4.69 per share exercisable for five years as payment for services to be rendered. An equal portion of these options vested monthly for one year commencing September 1, 1996. The Company recorded general and administrative expense of \$27,900, which was the fair value of the stock options on the date of issuance. The options expired during the fiscal year ended July 31, 2002.

In March 1997, the Company issued 112,000 shares of common stock at \$4.50 per share in a private placement to an investor resulting in net proceeds of \$504,000 to the Company.

In May 1997, the Company issued 100,000 stock options to Dr. Stephen Carter, a director, with an exercise price of \$5.20 per share as payment for serving as Chairman of the Scientific Advisory Board (the "SAB"). These options vested as follows: 10,000 vested immediately, 10,000 after one full calendar year, 10,000 annually for each of the following three years and 50,000 on May 13, 2002. The Company recorded a total research and development expense of \$353,400, which was the fair value on the date of issuance of that portion of the stock options that had vested as of July 31, 2002. Of these options, 40,000 expired as of the fiscal year ended July 31, 2005.

During the fiscal year ended July 31, 1997, 639,500 stock options were exercised by both related and unrelated parties resulting in net proceeds of approximately \$2.6 million to the Company. The exercise prices of the options ranged from \$2.45 to \$4.00 per share.



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During the fiscal year ended July 31, 1997, 147,450 warrants were exercised by both related and unrelated parties resulting in net proceeds of approximately \$737,250 to the Company. The exercise price of the warrants was \$5.00 per share.

In October 1997, the Company issued 75,000 stock options to a director with an exercise price of \$3.66 per share as payment for non-board related services to be rendered. These options vested as follows: 10,000 vested immediately; 10,000 after one full calendar year; 10,000 annually for each of the following three years; and 25,000 on October 31, 2002. A total general and administrative expense of \$185,600 was amortized on a straight-line basis over a five-year period, which commenced in October 1997. Of these options, 30,000 expired as of the fiscal year ended July 31, 2005.

F-25

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

##### (7) Stockholders' Equity, (Continued)

In October 1997, the Company issued 12,000 five-year stock options to a consultant with an exercise price of \$3.91 per share as payment for services to be rendered. An equal portion of these options vested monthly and were amortized over a one-year period which commenced in October 1997. In May 1998, the Company terminated the services of the consultant, which resulted in the cancellation of 5,000 options. The Company recorded a total research and development expense for the remaining 7,000 options in the amount of \$15,800, based upon the fair value of such options on the date of issuance, amortized on a straight-line basis over the vesting period of the grant. These options expired during the fiscal year ended July 31, 2003.

On December 9, 1997, the stockholders authorized the amendment of the Company's Certificate of Incorporation to increase the number of authorized shares of common stock, par value \$.001 from 25,000,000 shares to 40,000,000 shares.

On December 9, 1997, the stockholders approved the 1997 Stock Option Plan (the "1997 Plan"). The total number of shares of common stock authorized for issuance upon exercise of options granted under the 1997 Plan was 2,000,000. Options are granted at fair market value on the date of the grant and generally are exercisable in 20% increments annually over five years starting one year after the date of grant and terminate five years from their initial exercise date.

On January 23, 1998, the Securities and Exchange Commission (the "SEC") declared effective a registration statement on Form S-3 for the offer and sale by certain stockholders of up to 3,734,541 shares of common stock. Of these shares (i) an aggregate of 2,737,480 shares were issued to private placement investors in private placement transactions which were completed during the period from March 1994 through March 1997 (the "Earlier Private Placements"), (ii) an aggregate of 409,745 shares were issuable upon exercise of warrants which were issued to private placement investors in the Earlier Private Placements and (iii) an aggregate of 587,316 shares may be issued, or have been issued, upon exercise of options which were issued to option holders in certain other private transactions. As a result of the delisting of the Company's Common Stock from the Nasdaq

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SmallCap Market, the Company no longer qualified for the use of a Form S-3 registration statement for this offering when it filed its Annual Report on Form 10-K for the fiscal year ended July 31, 1999 and thus, this registration statement was no longer effective. The Company filed a registration statement on Form S-1 to register these shares, which was declared effective in February 2002.

In February 1998, the Company completed a Private Placement primarily to institutional investors, which resulted in the issuance of 1,168,575 units at a unit price of \$4.00. Each unit consisted of two (2) shares of the Company's common stock, par value \$.001 per share and one (1) three-year warrant to purchase one (1) share of common stock at an exercise price of \$2.50 per share. The Company received net proceeds of approximately \$4,202,000. The placement agent received warrants to purchase an additional 116,858 units comprised of the same securities sold to investors at an exercise price of \$4.40 per unit as part of its compensation. In May 2001, the expiration date of these warrants was extended from May 19, 2001 to August 17, 2001. The warrants expired on August 17, 2001.

In March 1998, the Company converted an outstanding payable into 50,000 shares of the Company's Common Stock. The fair value of the Common Stock approximated the outstanding payable amount of \$100,000.

In March 1998, the Company issued 75,000 stock options to a director with an exercise price of \$2.80 per share as payment for non-board related services rendered. These options vested as follows: 10,000 vested immediately; 10,000 after one full calendar year; 10,000 annually for each of the following three years; and 25,000 on March 24, 2003. A total general and administrative expense of \$138,100 was amortized on a straight-line basis over a five-year period, which commenced in March 1998. As of July 31, 2003, the expense was fully. Of these options, 10,000 expired during the fiscal year ended July 31, 2003 and 65,000 were exercised during the fiscal year ended July 31, 2004.

F-26

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

##### (7) Stockholders' Equity, (Continued)

On April 20, 1998 the SEC declared effective a registration statement on Form S-3 for the offer and sale by certain stockholders of up to 3,918,299 shares of common stock. Of these shares (i) an aggregate of 2,337,150 shares of common stock were issued to the private placement investors in the February 1998 Private Placement, (ii) an aggregate of 1,168,575 shares may be issued upon exercise of the Warrants which were issued to the private placement investors in the February 1998 Private Placement, (iii) 350,574 shares may be issued upon the exercise of the Placement Agent Warrant which was issued to the placement agent in the February 1998 Private Placement and the Warrants issuable upon exercise of the Placement Agent Warrant, (iv) 50,000 shares of common stock were issued to a Supplier in connection with conversion of an outstanding accounts payable, and (v) 12,000 shares may be issued upon the exercise of options which were issued as payment for services to be rendered. As a result of the delisting of the Company's common stock from the Nasdaq SmallCap Market, the Company no longer qualified for the use of a Form S-3 registration

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statement for this offering when it filed its Annual Report on Form 10-K for the fiscal year ended July 31, 1999 and thus, this registration statement was no longer effective. The Company filed a registration statement on Form S-1 to register these shares, which was declared effective in February 2002.

During the fiscal year ended July 31, 1998, the Company issued 833 three-year stock options as payment for services rendered in August 1997. The options vested thirty days from the issuance date and had an exercise price of \$4.47 per share. The total general and administrative expense recorded for these options was \$1,700, based upon the fair value of such options on the date of issuance. These options expired in August 2000.

During the fiscal year ended July 31, 1998, the Company issued 15,000 three-year stock options with an exercise price of \$4.15 per share as payment for services. An equal portion of these options vested monthly and a total general and administrative expense of \$30,000 was amortized over a one-year period which commenced September 1997. The Company also issued 5,000 three-year stock options with an exercise price of \$4.15 per share as payment for services. Of these options, 833 vested monthly for five months commencing September 30, 1997 and 835 vested on the last day of the sixth month. Total general and administrative expense of \$9,700 was amortized over a six-month period which commenced September 1997. As of July 31, 1998, the Company recorded general and administrative expense of \$37,100, based upon the fair value of the 20,000 stock options on the date of the issuance, amortized on a straight-line basis over the vesting periods of the grants. These options expired three years after they vested.

During the fiscal year ended July 31, 1998, 4,950 shares of common stock were issued upon the exercise of warrants by unrelated parties, resulting in net proceeds of approximately \$11,100 to the Company. The exercise prices of the warrants ranged from \$2.20 to \$2.50 per share.

On October 1, 1998 (the "Effective Date"), the Company entered into an agreement with a consultant (the "Agreement"), resulting in the issuance of 200,000 five-year stock options with an exercise price of \$1.00 per share as payment for services to be rendered. These options vested as follows: an aggregate of 20,000 vested on October 1, 1999; an aggregate of 2,500 of such options vested on the last day of each month over the first twelve months after the Effective Date of the Agreement; the remaining 150,000 options vested on the third anniversary of the Effective Date of the Agreement. The Company recorded approximately \$49,300 of general and administrative expense based upon the fair value of the vested options through July 31, 2000. During the fiscal year ended July 31, 2000, the Agreement was terminated which resulted in the cancellation of 150,000 options. The remaining 50,000 options were exercised during the fiscal year ended July 31, 2004, which resulted in gross proceeds of \$50,000 to the Company.

During the fiscal year ended July 31, 1999, the Company issued 5,000 three-year stock options as payment for services rendered. The total general and administrative expense recorded for these options was \$4,200, based upon the fair value of such options on the date of issuance. These options were exercised during the fiscal year ended July 31, 2000, which resulted in gross proceeds of \$7,150 to the Company.

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(A Development Stage Company)

## Notes to Financial Statements, Continued

### (7) Stockholders' Equity, (Continued)

During the fiscal year ended July 31, 1999, the Company issued 40,701 shares of common stock for payment of legal services. The fair value of the common stock in the amount of \$16,631 was charged to operations.

During the fiscal year ended July 31, 1999, the Company issued 6,000 shares of common stock for payment of services rendered. The fair value of the common stock in the amount of \$2,460 was charged to operations.

During the fiscal year ended July 31, 2000, the Company issued 174,965 shares of common stock for payment of services rendered. The fair value of the common stock in the amount of \$92,184 was charged to operations.

During the fiscal year ended July 31, 2000, the Company issued 95,000 shares of common stock upon the exercise of stock options by unrelated parties, which resulted in gross proceeds of \$45,850 to the Company. The exercise prices of the options ranged from \$0.43 to \$1.43.

During the fiscal year ended July 31, 2000, the Company sold an aggregate of 875,000 shares of common stock to private investors at prices ranging from \$0.50 to \$1.00 per share resulting in net proceeds of \$548,300 to the Company. In addition, the private investors were granted warrants to purchase an aggregate of 875,000 shares of common stock, inclusive of additional warrants issued so that all investors in the private placements received substantially the same securities, at per share exercise prices ranging from \$1.03 to \$4.55. These warrants expired in May 2003 and May 2005.

During the fiscal year ended July 31, 2001, the Company issued 11,800 shares of common stock for payment of services rendered. The fair value of the common stock in the amount of \$10,030 was charged to operations.

During the fiscal year ended July 31, 2001, the Company sold an aggregate of 863,331 shares of common stock to private investors at prices ranging from \$0.90 to \$1.50 per share resulting in net proceeds of \$956,000 to the Company. In addition, the private investors were granted warrants to purchase an aggregate of 696,665 shares of common stock at per share exercise prices ranging from \$1.50 to \$3.00. The warrants will expire during the period commencing July 2004 and ending in October 2006. As of July 31, 2006, 166,666 of these warrants expired and 222,222 were exercised.

During the fiscal year ended July 31, 2001, the Company issued 165,555 shares of common stock upon the exercise of stock options by related parties, which resulted in gross proceeds of \$83,700 to the Company. The per share exercise prices of the options ranged from \$0.29 to \$0.85.

During the fiscal year ended July 31, 2001, the Company issued 50,000 five-year stock options to a director as payment for non-board related services. These options vested immediately and had an exercise price of \$0.90 per share. The Company recorded general and administrative expense of \$31,600, which was the fair market value of the options using the Black-Scholes options-pricing model on the date of issuance. These options were exercised during the fiscal year ended July 31, 2004.

During the fiscal year ended July 31, 2001, the Company issued 330,000 shares of common stock upon the conversion of convertible notes from

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related parties at \$0.90 per share. In addition, upon conversion, the related parties were granted three-year warrants to purchase an aggregate of 330,000 shares of common stock at an exercise price of \$2.50 per share. The estimated value of these warrants in the amount of \$108,900 was recorded by the Company as interest expense during the fiscal year ended July 31, 2001. In October 2001, the board of directors approved a change of the 330,000 warrants from three-year warrants to five-year warrants and the exercise price from \$2.50 per share to \$1.50 per share to conform with private placements to unrelated parties. These warrants were exercised as of July 31, 2006.

F-28

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

#### (7) Stockholders' Equity, (Continued)

During the fiscal year ended July 31, 2002, the Company issued 72,214 shares of common stock upon the conversion of convertible notes from unrelated parties at \$0.90 per share. In addition, upon conversion, the unrelated parties were granted five-year warrants to purchase an aggregate of 72,214 shares of common stock at an exercise price of \$1.50 per share. The estimated value of these warrants in the amount of \$32,200 was recorded by the Company as interest expense during the fiscal year ended July 31, 2002.

During the fiscal year ended July 31, 2002, the Company issued 78,340 shares of common stock in settlement of accounts payable in the amount of \$64,126. In addition, one of the vendors was granted five-year warrants to purchase 55,556 shares of common stock at an exercise price of \$1.50 per share. The settled accounts payable amount was credited to equity as the value of the common stock and warrants.

During the fiscal year ended July 31, 2002, the Company issued an aggregate of 85,221 five-year stock options as payment for services rendered. The options vested immediately and had a per share exercise prices of \$0.75 as to 70,000 stock options and \$0.94 as to 15,221 stock options. The Company recorded an aggregate total of \$40,747 non-cash expenses for these options, based upon the fair value on the date of the issuance as estimated by the Black-Scholes options-pricing model. These options were exercised as of July 31, 2005.

During the fiscal year ended July 31, 2002, the Company sold an aggregate of 2,622,122 shares of common stock to private investors at prices ranging from \$0.35 to \$0.90 per share resulting in net proceeds of \$1,050,000 to the Company. In addition, the private investors were granted warrants to purchase an aggregate of 2,673,422 shares of common stock at per share exercise prices ranging from \$0.75 to \$1.50. The warrants will expire during the period commencing August 2006 and ending in June 2007. As of July 31, 2006, 1,032,819 of these warrants were exercised.

During the fiscal year ended July 31, 2002, the Company issued warrants to purchase 1,500,000 shares of common stock to Roan Meyers Associates L.P. for an aggregate warrant purchase price of \$1,500 in connection with the engagement of Roan Meyers to render advisory services. Of these warrants, 250,000 were exercisable at \$.50 per share, 650,000 were exercisable at \$1.00 per share and 600,000 were exercisable at \$1.50 per share. In

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February 2002, the Company recorded an expense equal to the fair market value of the first 500,000 warrants which vested immediately, based upon the fair value of such warrants as estimated by Black-Scholes pricing model (\$153,300), less the \$1,500 received from the sale of the warrants. The remaining 1,000,000 warrants were to become exercisable if Roan Meyers was successful in helping the Company raise capital. However, Roan Meyers was not successful in raising additional capital from a third party. During the fiscal year ended July 31, 2002, Roan Meyers exercised warrants to purchase an aggregate of 186,000 shares of common stock, at an exercise price of \$0.50 per share, resulting in aggregate gross proceeds of \$93,000 to the Company. During the fiscal year ended July 31, 2003, the vesting of the 600,000 warrants was amended to vest immediately and the exercise price was amended from \$1.50 to \$0.50 per share due to the price change of the Company's common stock. Roan Meyers exercised these warrants and was issued 600,000 shares of common stock. The Company also issued 40,000 shares of common stock upon the exercise of warrants by Roan Meyers at an exercise price of \$.50 per share. The Company realized aggregate gross proceeds of \$320,000 from these capital raising transactions. During the fiscal year ended July 31, 2004, the exercise price of 250,000 warrants was amended from \$1.00 to \$0.50 per share due to the price change of the Company's common stock and the vesting of the 400,000 warrants was amended to vest immediately. Roan Meyers exercised the remaining 674,000 warrants which resulted in the issuance of 674,000 shares of common stock by the Company. The Company realized gross proceeds of \$537,000 in this capital raising transaction.

During the fiscal year ended July 31, 2002, the Company issued an aggregate of 75,000 five-year stock options to unrelated parties as an incentive for lending the Company an aggregate of \$75,000, which was repaid during the quarter. The options vested immediately and have an exercise price of \$1.50 per share. The total non-cash interest expense recorded for these options was \$25,615, based upon the fair value of such option on the date of issuance as estimated by the Black-Scholes options-pricing model. As of July 31, 2005, 25,000 of these options were exercised.

F-29

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

##### (7) Stockholders' Equity, (Continued)

During the fiscal year ended July 31, 2002, the Company issued a note payable to an unrelated party in an aggregate amount of \$300,000. The note was due in thirty days bearing interest at 8% per annum. In addition, the lender received warrants to purchase 300,000 shares of common stock at an exercise price of \$0.60 per share. The total non-cash interest expense recorded for these warrants was \$40,690, based upon the fair value of such option on the date of issuance as estimated by the Black-Scholes options-pricing model. The notes were extended for eighteen months at a conversion price of \$0.40 per share plus a five-year warrant for each share of the Company's common stock issued upon conversion at an exercise price of \$1.00 per share. These notes were converted into shares of the Company's common stock and warrants in fiscal year 2004.

During the fiscal year ended July 31, 2003, the Company issued an aggregate of 764,000 shares of common stock upon the exercise of warrants

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and stock options by unrelated parties which resulted in gross proceeds of approximately \$378,000 to the Company.

During the fiscal year ended July 31, 2003, the Company issued an aggregate 186,208 shares of common stock in settlement of accounts payable in the aggregate amount of \$94,223. In addition, one of the vendors was granted five-year options to purchase 50,000 shares of common stock at an exercise price of \$1.25 per share. The Company recorded \$17,581 non-cash research and development expenses for these options, based upon the fair value on the date of the issuance as estimated by the Black-Scholes options-pricing model. The settled accounts payable amount was credited to equity as the value of the common stock and options.

During the fiscal year ended July 31, 2003, the Company issued 25,000 five-year stock options to an unrelated party as an incentive for lending the Company an aggregate of \$25,000, which was fully paid as of April 30, 2003. The stock options vested immediately and have an exercise price of \$0.23 per share. The total non-cash interest expense recorded for these stock options was \$2,503. In addition, the Company issued 140,000 five-year stock options for services rendered. These stock options vested immediately and have exercise prices of \$0.84 and \$1.25 per share. The total non-cash charge relating to these options was \$55,437. The total value of these options was based upon the fair value of such options on the date of issuance as estimated by the Black-Scholes options-pricing model. Of these options, 20,000 were exercised during the fiscal year ended July 31, 2004.

During the fiscal year ended July 31, 2003, the Company issued 8% convertible notes payable to unrelated parties with principal balances totaling an aggregate of \$915,000. These notes payable were due to mature on various dates from April 2004 through May 2005 and were convertible into the Company's common stock at conversion prices ranging from \$0.20 to \$0.50 per share and an equal number of five year warrants with an exercise price of \$1.00 per share. With the issuance of the notes payable, the Company issued to the unrelated parties five year warrants to purchase an aggregate of 665,000 shares of the Company's common stock, at an exercise price of \$0.60 per share. In addition, the Company issued on the due date of the notes payable five year warrants to purchase an aggregate of 915,000 shares of the Company's common stock at per share exercise prices of \$1.00 and \$1.10. The Company valued these warrants at a total of \$219,259 based on the fair value determined by using the Black-Scholes method relative to the fair value of the notes payable. At the issuance dates of the notes payable, the fair market values of the Company's shares exceeded the effective conversion prices. Accordingly, the Company initially increased additional paid-in capital by \$219,259 for the relative fair value of the warrants and reduced the carrying value of the notes payable for the same amount for the debt discount attributable to the fair value of the warrants. The Company also increased its additional paid-in capital and debt discount by \$374,960 for beneficial conversion rights issued in connection with the issuances of these notes.

F-30

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued

(7) Stockholders' Equity, (Continued)

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During the fiscal year ended July 31, 2003, the Company sold an aggregate of 1,315,000 shares of common stock to private investors at prices ranging from \$0.20 to \$0.73 per share resulting in net proceeds of \$653,627 to the Company. In addition, the private investors were granted warrants to purchase an aggregate of 1,315,000 shares of common stock at per share exercise prices ranging from \$1.00 to \$1.50. The warrants will expire during the period commencing January 2008 and ending in October 2008. As of July 31, 2006, 820,000 of these warrants were exercised.

On January 14, 2004, at the Company's annual meeting of stockholders, the Company's stockholders approved an amendment to the Company's Certificate of Incorporation, as amended, to increase the number of shares of common stock authorized from 40,000,000 to 100,000,000. Since no notes payable had been converted as of such date, the terms of the Company's notes payable relating to conversion and exercise which were amended to authorize conversion to Series A Preferred Stock because there were an insufficient number of authorized shares of common stock available for issuance upon conversion, reverted to their original terms so that they were again convertible into shares of common stock, rather than shares of Series A Preferred Stock.

On January 14, 2004, at the Company's annual meeting of stockholders, the Company's stockholders approved the 2004 Stock Incentive Plan (the "2004 Plan"). The total number of shares of common stock authorized for issuance under the 2004 Plan is 8,500,000.

During the fiscal year ended July 31, 2004, the Company issued an aggregate of 120,000 shares of common stock to private investors resulting in aggregate gross proceeds of \$60,000 to the Company. In addition, the private investors were granted five-year warrants to purchase 120,000 shares of common stock at an exercise price of \$1.25 per share.

During the fiscal year ended July 31, 2004, the Company issued 3,996 five-year stock options to a consultant as payment for services rendered. The options vested immediately and have a per share exercise price of \$0.60. The Company recorded a total of \$5,235 of non-cash expenses for these options, based upon the fair value on the date of the issuance as estimated by the Black-Scholes options pricing model. These options were exercised during the fiscal year ended July 31, 2004 resulting in gross proceeds of \$2,398 to the Company.

During the fiscal year ended July 31, 2004, the Company entered into a two-part financing agreement with SF Capital Partners, Ltd. for the private placement of 1,704,546 shares of common stock and warrants to purchase 852,273 shares of common stock, at an exercise price of \$1.50 per share. As consideration, the Company received \$1,500,000. In addition, the Company granted SF Capital Partners, Ltd. a warrant to invest an additional \$1,500,000 to purchase the Company's common stock at an exercise price based upon a 20-day trailing average of the closing price per share of the Company's common stock (the "Additional Warrants"). During the fiscal year ended July 31, 2004, SF Capital Partners, Ltd. exercised the Additional Warrants at a 20-day trailing average exercise price of \$3.96 which resulted in gross proceeds of \$1,500,000 and the issuance of 379,170 shares of common stock and an Exercise Warrant to purchase an additional 189,585 shares of common stock at a per share exercise price of \$4.75. The Company also issued an aggregate of 53,876 shares of restricted common stock to a third party as finder's fee. During the fiscal year ended July 31, 2006, the exercise price of the Exercise Warrant to purchase an additional 189,585 shares of common stock was reduced from \$4.75 to \$2.88 per share. As of July 31, 2006, none of these options were exercised.



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During the fiscal year ended July 31, 2004, the Company issued 25,000 five-year stock options to a board member as payment for non-board related services and 110,000 five-year stock options to various consultants for services rendered. The options vested immediately and have a per share exercise price of \$3.46. The Company recorded a total of \$275,377 non-cash expenses for these options, based upon the fair value on the date of the issuance as estimated by the Black-Scholes options pricing model. As of July 31, 2006, 5,000 of these options were exercised.

F-31

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

#### (7) Stockholders' Equity, (Continued)

During the fiscal year ended July 31, 2004, the Company issued an aggregate of 14,703 restricted shares of common stock as payment of accounts payable in the amount of \$52,176.

During the fiscal year ended July 31, 2004, the Company issued an aggregate of 75,000 restricted shares of common stock as payment for services rendered in an aggregate amount of \$288,500.

During the fiscal year ended July 31, 2004, the Company issued 1,210,654 shares of common stock to an existing institutional investor, resulting in gross proceeds of \$10,000,000 to the Company. In addition, the institutional investor was granted five-year warrants to purchase 1,210,654 shares of Common Stock at an exercise price of \$12.39 per share. The Company paid a 5% finder's fee to a third party in connection with the private placement, which included a five-year warrant to purchase 60,533 shares of common stock at an exercise price of \$12.39 per share. During the fiscal year ended July 31, 2006, the exercise price of the warrants to purchase an aggregate of 1,185,000 shares of common stock was reduced from \$12.39 to \$2.88 per share.

During the fiscal year ended July 31, 2004, the Company increased its outstanding shares by 40,000 shares of common stock for replacement of previously issued stock.

During the fiscal year ended July 31, 2004, the Company issued an aggregate of 3,042,817 shares of restricted common stock and five-year warrants to purchase 3,733,839 shares of common stock with exercise prices ranging from \$1.00 to \$1.10 per share upon the conversion of notes payable and accrued interest in the amount of approximately \$927,872.

During the fiscal year ended July 31, 2004, the Company issued an aggregate of 2,676,994 shares of common stock upon the exercise of warrants by unrelated parties and stock options by unrelated parties, employees, a director and former director at per share exercise prices ranging from \$0.26 to \$4.74. The Company realized aggregate gross proceeds of \$2,656,099 from these exercises.

During the fiscal year ended July 31, 2004, the Company incurred an aggregate of \$824,022 of costs relating to various private placements.

During the fiscal year ended July 31, 2005, the Company issued an aggregate of 1,744,978 shares of common stock and five-year warrants to

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purchase an aggregate of 2,044,978 shares of common stock with an exercise price of \$1.00 per share upon the conversion of notes payable and its accrued interest in an aggregate amount of \$464,499.

During the fiscal year ended July 31, 2005, the Company issued an aggregate of 438,372 shares of common stock upon the exercise of stock options and warrants by unrelated parties, employees and a director at per share exercise prices ranging from \$0.26 to \$1.91. The Company realized aggregate net proceeds of \$307,155 from these exercises.

During the fiscal year ended July 31, 2005, the Company issued 3,000 shares of restricted common stock as payment for services rendered. A non-cash expense of \$13,500 was recorded by the Company for these shares, based upon the fair value of the common stock at the date of issuance.

During the fiscal year ended July 31, 2005, the Company issued 12,500 warrants to a vendor in consideration for services to be rendered. 5,000 of these warrants which vested immediately have an exercise price of \$2.50 per share and 7,500 warrants which vested on the 91st day from the grant date have an exercise price of \$3.50 per share. These warrants will expire 24 months from the date the registration statement registering the shares underlying the warrants is declared effective or 36 months from the date of grant, whichever comes first. The Company recorded a total of \$13,552 of non-cash expense for these warrants, based upon the fair value at July 31, 2005 as estimated by the Black-Scholes option pricing model.

F-32

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

##### (7) Stockholders' Equity, (Continued)

During the fiscal year ended July 31, 2005, the Company issued an aggregate of 20,000 ten-year stock options to consultants as payment for continuing services. The options will vest 25% each year starting on the first anniversary of the commencement of the services of the consultants provided they remain as consultants on the relevant vesting dates. The stock options have an exercise price of \$2.05 per share. The Company recorded a total of \$3,237 of non-cash expense for these options, based upon the fair value at July 31, 2005 as estimated by the Black-Scholes option pricing model. During the fiscal year ended July 31, 2006, the Company recorded under EITF 96-18, a total of \$15,066 of non-cash expense for these options.

During the fiscal year ended July 31, 2006, the Company issued an aggregate of 1,122,827 shares of common stock upon the exercise of warrants and stock options by unrelated parties, consultants, employees, directors and an executive officer at per share exercise prices ranging from \$0.26 to \$3.46. The Company realized aggregate gross proceeds of \$1,348,324 from these exercises.

During the fiscal year ended July 31, 2006, the Company issued 25,000 ten-year stock options to a consultant as payment for services rendered. The options vested immediately and have an exercise price of \$1.32 per share. The Company recorded a total of \$23,166 of non-cash expense for these options.

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During the fiscal year ended July 31, 2006, the Company issued 50,000 five-year stock options to a consultant as payment for services to be rendered. These options vest over a one year period, 50% of which vested immediately and 12.5% will vest equally for the next four quarters following the grant date. The stock options have an exercise price of \$2.04 per share and are subject to variable accounting under EITF 96-18. The fair value of these options is being expensed over the service period. During the fiscal year ended July 31, 2006, the Company recorded a total of \$74,253 of non-cash expense for these options.

During the fiscal year ended July 31, 2006, the Company issued 25,000 ten-year stock options to a consultant as payment for services rendered. The options vested immediately and have an exercise price of \$3.37 per share. The Company recorded a total of \$58,387 of non-cash expense for these options.

During the fiscal year ended July 31, 2006, the Company issued 174,927 shares of restricted common stock to a private investor resulting in gross proceeds of \$600,000 to the Company for a purchase price of \$3.43 per share.

During the fiscal year ended July 31, 2006, the Company completed a private placement to various institutional investors which resulted in the issuance of an aggregate of 6,457,172 shares of restricted common stock for a purchase price of \$1.75 per share. The institutional investors also received warrants to purchase up to an additional 6,457,172 shares of common stock of the Company. The fair value of the warrants at the grant date was approximately \$12,962,000 as estimated using the Black-Scholes options pricing model. The warrants have a term of five years and were issued in two separate series. The first series of warrants (to purchase 3,228,590 shares of common stock) are exercisable beginning on January 19, 2007, and the second series of warrants (to purchase 3,228,582 shares of common stock) are also exercisable beginning on January 19, 2007. Both sets of warrants have an exercise price equal to \$2.88 per share. If the Company enters into a strategic corporate collaboration as outlined in the second series of warrants by December 31, 2006, the second series of warrants will be cancelled upon notification by the Company to the holders of the warrants that it has entered into such an agreement prior to such date. The Company received net proceeds of approximately \$10,384,000 from this private placement. The Company filed a registration statement on Form S-3 to register the resale of the shares and the shares issuable upon exercise of the warrants, which was declared effective in August 2006. If the Company had failed to file the registration statement, request effectiveness of the registration statement, respond to comments of the Securities and Exchange Commission, or cause the registration statement to be declared effective in a timely manner in accordance with the provisions of the registration rights agreement between the Company and the investors, or if the registration statement ceases to remain effective, or the investors are otherwise not permitted to utilize the prospectus in the registration statement to resell the

F-33

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued

(7) Stockholders' Equity, (Continued)

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securities for more than 15 consecutive calendar days or more than an aggregate of 25 calendar days during any 12-month period (which need not be consecutive calendar days), then the Company must pay to each investor an amount, in cash, as partial liquidated damages and not as a penalty, equal to 2% of the aggregate purchase price paid by such investor for any securities registered on the registration statement that are then held by such investor monthly until the failure is cured. However, the Company shall not be required to pay partial liquidated damages to the investor in excess of 10% of the purchase price such investor paid for the registered securities. If the Company fails to pay any partial liquidated damages in full within seven days after the date payable, the Company will pay interest thereon to the investor at a rate of 18% per annum (or such lesser maximum amount that is permitted to be paid by applicable law), accruing daily from the date such partial liquidated damages are due until such amounts, plus all such interest thereon, are paid in full.

### (8) Common Stock Warrants

During the fiscal years 1988 and 1991, the Board of Directors granted stock purchase warrants to acquire a maximum of 400,000 shares of common stock at \$5.00 per share which were not exercised and have since expired.

The following table summarizes the activity of common stock warrants issued in connection with the private placements and conversion of notes payable completed in fiscal years 1994 through 2006:

	Warrants -----	Exercise Price -----	
Sold in March 1994 Private Placement	800,000	\$ 5.00	3/21
Outstanding at July 31, 1994	800,000	5.00	3/21
Sold in September 1994 Private Placement	288,506	5.50	12/9
Sold in October 1994 Private Placement	40,000	5.50	
Sold in September 1995 Private Placement	47,405	4.00	
Outstanding and exercisable at July 31, 1995	1,175,911	4.00 - 5.50	3/21
Issued to bank in connection with an amendment to the Company's term loan	10,000	4.19	
Sold in September 1995 Private Placement	8,540	4.00	
Sold in June 1996 Private Placement	313,800	7.50	8/29
Outstanding and exercisable at July 31, 1996	1,508,251	4.00 - 7.50	3/21
Exercised	(147,450)	5.00	3/21
Expired	(652,550)	5.00	3/21
Outstanding and exercisable at July 31, 1997	708,251	4.00 - 7.50	12/9
Sold in February 1998 Private Placement	1,168,575	2.50	
Issued to the Placement Agent in connection with the February 1998 Private placement	350,574	2.20 - 2.50	
Exercised	(4,950)	2.20 - 2.50	
Expired	(338,506)	4.19 - 5.50	8/31
Outstanding and exercisable at July 31, 1998	1,883,944	2.20 - 7.50	10/1
Expired	(55,945)	4.00	
Sold in February 2000 Private Placement	875,000	1.03 - 4.55	5/28
Expired	(313,800)	7.50	8/30
Outstanding and exercisable at July 31, 2000	2,389,199	1.03 - 4.55	5/19
Sold in various private placements	696,665	1.50 - 3.00	7/07

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Issued to related parties upon conversion of note payable	330,000	1.50	
	-----		
Outstanding and exercisable at July 31, 2001	3,415,864	1.03 - 4.55	8/17

F-34

## ALFACELL CORPORATION (A Development Stage Company)

### Notes to Financial Statements, Continued

#### (8) Common Stock Warrants, (Continued)

	Warrants	Exercise Price	
	-----	-----	
Expired	(1,514,199)	2.20 - 2.50	
Sold in various private placements	2,673,422	0.75 - 1.50	11/0
Issued to vendor upon settlement of accounts payable	55,556	1.50	
Issued to unrelated party for advisory services	1,500,000	0.50 - 1.50	
Exercised	(186,000)	0.50	
Issued to unrelated parties upon conversion of notes payable	72,214	1.50	
Issued to unrelated parties in connection with notes payable	300,000	0.60	11/1
	-----		
Outstanding and exercisable at July 31, 2002	6,316,857	0.50 - 4.55	5/28
Expired	(437,500)	1.03 - 3.25	
Sold in various private placements	1,315,000	1.00 - 1.50	1/24
Exercised	(640,000)	0.50	
Issued to unrelated parties in connection with notes payable	665,000	0.60	9/6
	-----		
Outstanding and exercisable at July 31, 2003	7,219,357	0.50 - 4.55	5/28
Sold in various private placements	2,372,512	1.25 - 12.39	9/3
Exercised	(2,014,273)	0.50 - 1.50	2/6/
Issued to third party as finder's fee	60,533	12.39	
Issued to unrelated parties in connection with conversion of notes payable	3,733,839	1.00 - 1.10	12/4
	-----		
Outstanding and exercisable at July 31, 2004	11,371,968	0.60 - 12.39	5/28
Exercised	(247,272)	0.75 - 1.25	7/1
Expired	(437,500)	2.50 - 4.55	
Issued to unrelated parties in connection with conversion of notes payable	2,044,978	1.00	9/1
Issued to a vendor in connection with services rendered	12,500	2.50 - 3.50	
	-----		
Outstanding and exercisable at July 31, 2005	12,744,674	0.60 - 12.39	11/2
Exercised	(915,582)	0.75 - 1.50	7/7
Expired	(166,666)	3.00	11/2
Sold in a private placement	6,457,172	2.88	
	-----		

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Outstanding at July 31, 2006	18,119,598	\$0.60 - \$12.39	10/7
	=====	=====	=====
Exercisable at July 31, 2006	11,662,426	\$0.60 - \$12.39	10/
	=====	=====	=====

### (9) Stock Options

#### 2004 Stock Incentive Plan

The Company's stockholders approved the 2004 Stock Incentive Plan (the "2004 Plan") for the issuance of up to 8,500,000 shares, which provides that common stock and stock options may be granted to employees, directors and consultants. The 2004 Plan provides for the granting of stock options, stock appreciation rights, restricted shares, or other share based awards to eligible employees and directors, as defined in the 2004 Plan. Options granted under the 2004 Plan will have an exercise price equal to the market value of the Company's

F-35

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

### (9) Stock Options, (Continued)

common stock on the date of the grant. The term, vesting period and time and method of exercise of options granted under the 2004 Plan are fixed by the Board of Directors or a committee thereof.

#### 1997 Stock Option Plan

The Company's stockholders approved the 1997 stock option plan for the issuance of options for up to 2,000,000 shares, which provides that options may be granted to employees, directors and consultants. Options are granted at market value on the date of the grant and generally are exercisable in 20% increments annually over five years starting one year after the date of grant and terminate five years from their initial exercise date.

#### 1993 Stock Option Plan

The Company's stockholders approved the 1993 stock option plan for the issuance of options for up to 3,000,000 shares, which provides that options may be granted to employees, directors and consultants. Options are granted at market value on the date of the grant and generally are exercisable in 20% increments annually over five years starting one year after the date of grant and terminate five years from their initial exercise date. This plan expired in November 2003 except to the extent there are outstanding options.

#### Option Activity

As of July 31, 1994, 1,703,159 options were granted and outstanding under the 1993 stock option plan.

The following table summarizes stock option activity for the period August 1, 1994 to July 31, 2006:

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	Shares Available for Grant	Options Outstanding	Weighted Average Exercise Price Per Share
	-----	-----	-----
Balance August 1, 1994	1,926,841	5,935,337	\$ 3.76
Granted	(818,850)	818,850	2.60
Exercised	--	(185,000)	2.36
Canceled/Expired	--	(1,897,500)	4.30
	-----	-----	
Balance August 1, 1995	1,107,991	4,671,687	3.39
Granted	(296,205)	296,205	3.99
Exercised	--	(656,334)	2.92
Canceled/Expired	6,500	(235,333)	4.89
	-----	-----	
Balance July 31, 1996	818,286	4,076,225	3.43
Authorized by 1997 Plan	2,000,000	--	--
Granted	(932,500)	932,500	4.90
Exercised	--	(639,500)	3.82
Canceled/Expired	484,845	(484,845)	4.70
	-----	-----	
Balance July 31, 1997	2,370,631	3,884,380	3.56
Granted	(234,333)	234,333	3.31
Canceled/Expired	91,100	(91,100)	3.81
	-----	-----	
Balance July 31, 1998	2,227,398	4,027,613	3.54
Granted	(595,000)	595,000	0.62
Canceled/Expired	443,934	(555,737)	3.97
	-----	-----	
Balance July 31, 1999	2,076,332	4,066,876	3.05
Granted	(827,000)	827,000	0.52
Exercised	--	(95,000)	0.48
Canceled/Expired	638,395	(1,031,880)	2.73
	-----	-----	
Balance July 31, 2000	1,887,727	3,766,996	2.65

F-36

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued

(9) Stock Options, (Continued)

	Shares Available for Grant	Options Outstanding	Weighted Average Exercise Price Per Share
	-----	-----	-----
Granted	(447,000)	447,000	0.85
Exercised	--	(165,555)	0.51
Canceled/Expired	774,315	(1,018,557)	3.42
	-----	-----	
Balance July 31, 2001	2,215,042	3,029,884	2.24
Granted	(544,221)	544,221	0.69

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Canceled/Expired	655,840	(900,081)	2.31
	-----	-----	
Balance July 31, 2002	2,326,661	2,674,024	1.90
Granted	(630,000)	630,000	0.50
Exercised	--	(124,000)	0.47
Canceled/Expired	485,118	(736,358)	3.09
	-----	-----	
Balance July 31, 2003	2,181,779	2,443,666	1.26
Authorized by 2004 Stock			
Incentive Plan	8,500,000	--	--
Granted	(1,388,996)	1,388,996	5.03
Exercised	--	(666,717)	0.98
Canceled/Expired	(262,783)	(208,500)	3.20
	-----	-----	
Balance July 31, 2004	9,030,000	2,957,445	2.95
Granted	(1,073,000)	1,073,000	4.36
Exercised	--	(191,100)	0.75
Canceled/Expired	290,500	(341,500)	4.57
	-----	-----	
Balance July 31, 2005	8,247,500	3,497,845	3.35
Granted	(745,000)	745,000	1.76
Exercised	--	(207,245)	0.90
Canceled/Expired	171,250	(205,250)	4.67
	-----	-----	
Balance July 31, 2006	7,673,750	3,830,350	\$ 3.10
	=====	=====	=====

The options outstanding at July 31, 2006 will expire between August 21, 2006 and March 7, 2016 and the weighted average remaining contractual term is 5.61 years. The options exercisable at July 31, 2006 are 2,212,150 shares, the weighted average exercise price per share is \$3.11 per share and the weighted average remaining contractual term is 3.84 years.

At July 31, 2006 and 2005, the aggregate intrinsic value of stock options outstanding was approximately \$1,801,000 and \$2,036,000, respectively and the aggregate intrinsic value of stock options exercisable was approximately \$1,396,000 and \$1,540,000, respectively. Total intrinsic value of options exercised during the fiscal years ended July 31, 2006, 2005 and 2004 was approximately \$320,000, \$517,000 and \$2,538,000, respectively.

Stock option activity prior to adoption of SFAS 123 (see Note 1) is as follows:

## 1981 Non-Qualified Stock Option Plan

In 1981, the Board of Directors adopted a non-qualified stock option plan and had reserved 300,000 shares for issuance to key employees or consultants. Options were nontransferable and expired if not exercised within five years. Option grants of 60,000 shares expired unexercised by July 31, 1991.

F-37

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued



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### (9) Stock Options, (Continued)

#### Non-Qualified Stock Options

The Board of Directors issued non-qualified stock options which were not part of the 1981 non-qualified stock option plan or the 1989 Stock Plan as follows:

	Shares -----	Price Range -----
Granted	1,782,000	\$ 3.00-3.87
Exercised	(276,989)	3.00-3.50
Canceled	(106,000)	3.00-3.50
Expired	(649,011)	3.00-3.50
Granted pursuant to conversion of certain liabilities:		
Related party	1,324,014	3.20
Unrelated party	73,804	3.20
Repurchased stock options	(102,807)	3.20
	-----	
Balance at July 31, 1994	2,045,011	\$ 3.20-3.87
	=====	=====

In connection with certain private placements, the Board of Directors had included in the agreements, options to purchase additional shares of the Company's common stock as follows:

	Shares -----	Price Range -----
Granted (42,167 options were repriced and extended)	894,887	\$ 2.50-7.00
Exercised	(81,000)	3.97-6.50
Expired	(201,720)	3.97-6.50
	-----	
Balance at July 31, 1994	612,167	\$ 2.50-7.00
	=====	=====

All of the above options expired as of July 31, 2001.

#### 1989 Stock Plan

On February 14, 1989, the Company adopted the Alfacell Corporation 1989 Stock Plan (the "1989 Stock Plan"), pursuant to which the Board of Directors could issue awards, options and grants.

No more options are being granted pursuant to this plan. The per share option exercise price was determined by the Board of Directors. All options and shares issued upon exercise were nontransferable and forfeitable in the event employment was terminated within two years of the date of hire. In the event the option was exercised and said shares were forfeited, the Company would return to the optionee the lesser of the current market value of the securities or the exercise price paid.

The stock option activity is as follows:

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	Shares -----	Price Range -----
Granted, February 14, 1989	3,460,000	\$ 3.50-5.00
Options issued in connection with share purchase	36,365	2.75
Expired	(1,911,365)	2.75-5.00
Canceled	(10,000)	5.00
	-----	
Balance at July 31, 1994	1,575,000	\$ 3.50-5.00
	=====	=====

F-38

## ALFACELL CORPORATION (A Development Stage Company)

### Notes to Financial Statements, Continued

#### (10) Stock Grant and Compensation Plans

The Company had adopted a stock grant program effective September 1, 1981, and pursuant to said program, had reserved 375,000 shares of its common stock for issuance to key employees. The stock grant program was superseded by the 1989 Stock Plan, and no further grants will be given pursuant to the grant plan. The following stock transactions occurred under the Company's stock grant program:

Year ended July 31, -----	Shares -----	Fair Value -----	Amount of Compensation -----
1983	20,000	\$ 5.50	\$110,000
1984	19,750	5.125	101,219
1985	48,332	5.125-15.00	478,105
1986	11,250	5.125-15.00	107,032
1988	19,000	3.50	6,500

On January 26, 1984, the Company adopted a stock bonus plan for directors and consultants. The plan was amended on October 6, 1986 to reserve 500,000 shares for issuance under the plan and to clarify a requirement that stock issued under the Plan could not be transferred until three years after the date of the grant. The stock bonus plan for directors and consultants was superseded by the 1989 Stock Plan and no further grants will be given pursuant to the stock bonus plan for directors and consultants. The following stock transactions occurred under the Company's stock bonus plan:

Year ended July 31, -----	Shares -----	Fair Value -----	Amount of Compensation -----
1984	130,250	\$ 2.50-3.88	\$385,917
1985	99,163	3.50-15.00	879,478
1985	(42,500)	2.50	(105,825) *
1986	15,394	9.65-15.00	215,400
1987	5,000	15.00	75,000

\* Shares granted in 1984 were renegotiated in 1985 and canceled as a

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result of the recipient's termination.

### 1989 Stock Plan

Under the 1989 Stock Plan, one million shares of the Company's common stock were reserved for issuance as awards to employees. The 1989 Stock Plan also provided for the granting of options to purchase common stock of the Company. In addition, the 1989 Stock Plan provided for the issuance of 1,000,000 shares of the Company's common stock as grants. To be eligible for a grant, grantees must have made substantial contributions and shown loyal dedication to the Company.

Awards and grants were authorized under the 1989 Stock Plan during the following fiscal years:

Year ended July 31, -----	Shares -----	Fair Value -----	Amount of Compensation -----
1989	30,000	\$5.00	\$150,000
1990	56,000	6.00	336,000
1991	119,000	4.00	476,000
1992	104,000	2.75	286,000
1993	117,000	2.00	234,000
1994	5,000	3.00	15,000

F-39

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

#### (10) Stock Grant and Compensation Plans, (Continued)

Compensation expense was recorded for the fair value of all stock awards and grants over the vesting period. The 1994 stock award was immediately vested. There were no stock awards in fiscal year ended 1999 and the plan expired in 1999.

#### (11) Income Taxes

The Company accounts for income taxes under the provisions of SFAS 109. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect for all years in which the temporary differences are expected to reverse.

New Jersey has enacted legislation permitting certain corporations located in New Jersey to sell a portion of its state tax loss carryforwards and state research and development credits in order to obtain tax benefits. For the state fiscal year 2006 (July 1, 2005 to June 30, 2006), the Company had approximately \$1,903,000 total available tax benefits that were saleable; of which New Jersey permitted the Company to sell approximately \$356,000. In December 2005, the Company received approximately \$317,000 from the sale of the \$356,000 of tax benefits, which the Company recognized as tax benefits for the fiscal year ended July 31, 2006.

For the state fiscal year 2005 (July 1, 2004 to June 30, 2005), the Company had approximately \$1,335,000 total available tax benefits that

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were saleable; of which New Jersey permitted the Company to sell approximately \$339,000. In December 2004, the Company received approximately \$288,000 from the sale of the \$339,000 of tax benefits, which the Company recognized as tax benefits for the fiscal year ended July 31, 2005.

For the state fiscal year 2004 (July 1, 2003 to June 30, 2004), the Company had approximately \$1,378,000 total available tax benefits that were saleable; of which New Jersey permitted the Company to sell approximately \$261,000. In December 2003, the Company received approximately \$222,000 from the sale of the \$261,000 of tax benefits, which the Company recognized as tax benefits for the fiscal year ended July 31, 2004.

If still available under New Jersey law, the Company will attempt to sell the remaining \$1,547,000 of its tax benefits between July 1, 2006 and June 30, 2007 (state fiscal year 2007). This amount, which is a carryover of its remaining tax benefits from state fiscal year 2006 and earlier, may increase if the Company incurs additional tax losses during state fiscal year 2007. The Company can not estimate, however, what percentage of its saleable tax benefits New Jersey will permit it to sell, how much money it will receive in connection with the sale, if it will be able to find a buyer for its tax benefits or if such funds will be available in a timely manner.

At July 31, 2006 and 2005, the tax effects of temporary differences that give rise to the deferred tax assets are as follows:

	2006 ----	2005 ----
Deferred tax assets:		
Excess of book over tax depreciation and amortization	\$ 20,141	\$ 27,499
Stock options	598,872	--
Temporary differences	282,712	167,324
Federal and state net operating loss carryforwards	21,015,985*	19,413,740*
Research and experimentation credit carryforwards	2,187,683*	1,955,172*
	-----	-----
Total gross deferred tax assets	24,105,393	21,563,735
Valuation allowance	(24,105,393)	(21,563,735)
	-----	-----
Net deferred tax assets	\$ --	\$ --
	=====	=====

\* Net of amount sold pursuant to New Jersey state tax legislation.

F-40

ALFACELL CORPORATION  
(A Development Stage Company)

Notes to Financial Statements, Continued

### (11) Income Taxes, (Continued)

A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The

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tax benefit assumed using the federal statutory tax rate of 34% has been reduced to the actual benefits reflected on the statements of operations due principally to the aforementioned valuation allowance. In 2006, 2005 and 2004 the valuation allowance increased by \$2,542,000, \$2,668,000, and \$2,837,000, respectively.

At July 31, 2006, the Company has federal net operating loss carryforwards of approximately \$57,122,000 that expire in the years 2007 to 2026 (approximately \$8,195,000 expires in the years 2007 to 2011) and state net operating loss carryforwards of approximately \$26,577,000 that expire in years 2010 to 2015. The Company also has federal research and experimentation tax credit carryforwards of approximately \$1,510,000 that expire in the years 2007 to 2026 (approximately \$260,000 expires in the years 2007 to 2011) and state research and experimentation tax credits of approximately \$678,000 that expire in the years 2014 to 2021. Ultimate utilization/availability of such net operating losses and credits is dependent upon the Company's ability to generate taxable income in future periods and may be significantly curtailed if a significant change in ownership occurs in accordance with the provisions of the Tax Reform Act of 1986. For federal income tax purposes, the federal research tax credit expired on December 31, 2005 for new research tax credits.

### (12) Other Financial Information

Accrued expenses as of July 31, consist of the following:

	2006	2005
	----	----
Payroll and payroll taxes	\$ 87,935	\$ 85,181
Professional fees	217,764	123,200
Clinical trial	758,267	609,382
Pre-clinical studies	240,322	460,859
Other	2,967	5,069
	-----	-----
	\$1,307,255	\$ 1,283,691
	=====	=====

### (13) Commitments and Contingencies

On July 23, 1991, the Board of Directors authorized the Company to pay Kuslima Shogen, the Company's CEO, an amount equal to 15% of any gross royalties which may be paid to the Company from any license(s) with respect to the Company's principal product, ONCONASE(R), or any other products derived from amphibian source extract, produced either as a natural, synthesized, and/or genetically engineered drug for which the Company is the owner or co-owner of the patents, or acquires such rights in the future, for a period not to exceed the life of the patents. If the Company manufactures and markets its own drugs, then the Company will pay an amount equal to 5% of net sales from any products sold during the life of the patents. On April 16, 2001, this agreement was amended and clarified to provide that Ms. Shogen would receive the 15% royalty payment relating to licensees or the 5% fee relating to sales but not both, unless the Company and the licensee both market the licensed product.

The Company has product liability insurance coverage for clinical trials in the U.S. Additionally, the Company also maintains product liability insurance in Europe, in Australia and in Romania. No product liability claims have been filed against the Company. If a claim arises and the Company is found liable in an amount that significantly exceeds the policy limits, it may have a material adverse effect upon the financial condition of the Company.

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The Company is, from time to time, involved in litigation as both defendant and plaintiff arising in the ordinary course of business. In the opinion of management, the results of any pending litigation should not have a material adverse effect on the Company's financial position or operating results.

F-41

## ALFACELL CORPORATION (A Development Stage Company)

### Notes to Financial Statements, Continued

#### (13) Commitments and Contingencies, (Continued)

Below is a table that presents our contractual obligations and commercial commitments as of July 31, 2006:

		Payments Due by Fiscal Year						20
	Total	2007	2008	2009	2010	2011		The
	-----	----	----	----				----
Operating lease	\$ 61,392	\$16,743	\$16,743	\$16,743	\$11,163	\$ --	\$	
	-----	-----	-----	-----	-----	-----		
Total contractual cash obligations	\$ 61,392	\$16,743	\$16,743	\$16,743	\$11,163	\$ --	\$	
	=====	=====	=====	=====	=====	=====		

#### (14) 401(k) Savings Plan

Effective October 1, 1998, the Company adopted a 401(k) Savings Plan (the "Plan"). Qualified employees may participate by contributing to the Plan subject to certain Internal Revenue Service restrictions. The Company will match an amount equal to 50% of the first 6% of each participant's contribution. The Company's contribution is subject to a vesting schedule of 0%, 25%, 50%, 75% and 100% for employment of less than one year, one year, two years, three years and four years, respectively, except for existing employees which vesting schedule was based from the date the Plan was adopted. For the fiscal years ended July 31, 2006, 2005 and 2004, the Company's contributions to the Plan amounted to \$27,810, \$29,231 and \$15,690, respectively.

#### (15) Unaudited Quarterly Financial Data

In connection with its audit of the Company's financial statements for the fiscal year ended July 31, 2006, the Company's independent registered public accounting firm brought to the attention of management that the Company's estimate of the impact of forfeitures on non-cash compensation cost was, as a percentage, significantly higher than the historical rate of such forfeitures and that the true-up of the value of options vesting during the reporting period was not recorded. After reviewing the matter, management agreed to calculate the forfeiture rate using primarily historical experience and record the value of the options that vested

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during the reporting period. The original computation had understated non-cash compensation costs and net losses in the Company's unaudited condensed financial statements included in Forms 10-Q for the quarters ended October 31, 2005, January 31, 2006 and April 30, 2006. Management believes that the adjustment to the amount of non-cash compensation expense in each of the affected quarterly periods is not material and that the quarterly reports for those periods do not require restatement. The Company recorded a charge of approximately \$388,900 at year end to reflect the adjustment to the interim cost of non-cash compensation expense in the fourth quarter and fiscal year ended July 31, 2006. Additionally, during the fourth quarter and fiscal year ended July 31, 2006, the Company changed its estimated forfeiture rate on performance based stock options issued during the fiscal year which resulted in the reduction of approximately \$213,400 in non-cash compensation expense for the fourth quarter and fiscal year ended July 31, 2006.

Although management believes that the changes in each of the affected quarterly reports are not material, the Company is presenting certain restated unaudited statement of operations information. Presented in the following table are the total costs and expenses, the net loss and the loss per basic and diluted common share as originally reported and the adjusted amounts for each quarter.

F-42

### ALFACELL CORPORATION (A Development Stage Company)

#### Notes to Financial Statements, Continued

#### (15) Unaudited Quarterly Financial Data, (Continued)

Quarter Ended October 31, 2005	As Originally Reported for the Three Months Ended October 31, 2005		As Restated Three Months Ended October 31, 2005
	-----		-----
Statement of Operations:			
Total costs and expenses	\$ 1,749,000		\$ 1,749,000
Net loss	( 1,400,000)		(1,400,000)
Loss per basic and diluted common share	\$ (0.04)		\$ (0.04)
Quarter Ended January 31, 2006	Three Months Ended January 31, 2006		Six Months Ended January 31, 2006
	-----		-----
	As Originally Reported	As Restated	As Originally Reported
	-----	-----	-----
Statement of Operations:			
Total costs and expenses	\$ 2,310,000	\$ 2,468,000	\$ 4,059,000
Net loss	(2,286,000)	(2,444,000)	(3,686,000)
Loss per basic and diluted common share	\$ (0.06)	\$ (0.07)	\$ (0.10)

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Quarter Ended April 30, 2006	Three Months Ended April 30, 2006		Nine April
	As Originally Reported	As Restated	As Original Reported
Statement of Operations:			
Total costs and expenses	\$ 1,658,000	\$ 1,750,000	\$ 5,717,000
Net loss	(1,638,000)	(1,730,000)	(5,323,000)
Loss per basic and diluted common share	\$ (0.04)	\$ (0.05)	\$ (0.14)

Below is the quarterly data for the two year period ended July 31, 2006. Amounts for the first, second and third quarters of 2006 have been restated as described above.

(In thousands, except per share amounts)

	2006					First	S
	First	Second	Third	Fourth	Totals		
Investment income	\$ 32.0	\$ 24.0	\$ 20.1	\$ 31.3	\$ 107.4	\$ 29.2	\$
Other income	--	--	--	--	--	--	
Operating loss	(1,856.4)	(2,443.8)	(1,729.6)	(2,486.8)	(8,127.6)	(1,368.8)	(
Net loss (a)	(1,539.0)	(2,443.8)	(1,729.6)	(2,486.8)	(7,810.2)	(1,080.8)	(
Loss per share							
- basic and diluted	\$ (0.04)	\$ (0.07)	\$ (0.05)	\$ (0.07)	\$ (0.21)	\$ (0.03)	\$

	2005	
	Fourth	Totals
Investment income	\$ 37.8	\$ 141.7
Other income	--	9.8
Operating loss	(1,751.2)	(6,749.9)



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Net loss (a)	(1,751.2)	(6,461.9)
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Loss per share

- basic and

diluted	\$	(0.05)	\$	(0.18)
---------	----	--------	----	--------

-----

- (a) Included in the net loss of \$1,539.0 and \$1,080.8 for first quarter of 2006 and 2005 is net of tax benefits of \$317.4 and \$288.0, respectively, related to the sale of certain state tax operating loss carryforwards.

F-43