HYSEQ INC
Form 10-Q/A
July 22, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number 000-22873

HYSEQ, INC.

(Exact name of Registrant as specified in its charter)

NEVADA	36-3855489
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

670 ALMANOR AVENUE, SUNNYVALE, CA 94085
(Address of principal executive offices, including zip code)

408-524-8100
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

COMMON STOCK OUTSTANDING ON MAY 14, 2002: 22,960,297

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A revises Note 5 of the Notes to the Consolidated Financial Statements and Exhibit 10.28 of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2002 that was originally filed on May 15, 2002 (the "Original Filing") to respond to comments we received from the Securities and Exchange Commission.

This report revises the disclosure under Note 5 of the Notes to the Consolidated Financial Statements to disclose additional information with respect to our collaboration agreement with Amgen, including milestone and delay payments that we may be obligated to pay. This report also revises Exhibit 10.28 filed as an exhibit to the Original Filing to disclose additional portions of Exhibit 10.28 for which we had originally requested confidential treatment. Other than this amendment, the Notes to the Consolidated Financial Statements remain in the same form as initially filed.

This report continues to speak as of the date of the Original Filing, and we have not updated the disclosure in this report to speak as of a later date. All information contained in this report and the Original Filing is subject to updating and supplementing as provided in our periodic reports filed with the Securities and Exchange Commission.

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HYSEQ PHARMACEUTICALS, INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2002

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ITEM 1. FINANCIAL STATEMENTS

HYSEQ PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	MARCH 31, 2002	DECEMBER 31, 2001
ASSETS		
Current Assets:		
Cash	$ 6,486	$ 12,329
Accounts receivable	16	53
Other current assets	2,957	3,919
Total Current Assets	9,459	16,301
Cash on deposit	1,606	1,606
Equipment, leasehold improvements and capitalized software, net	18,446	18,988
Patents, licenses and other assets, net	2,895	3,009
Total Assets	$ 32,406	$ 39,904
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 1,876	$ 3,210
Accrued professional fees	564	928
Line of credit	4,000	
Other current liabilities	8,333	7,672
Deferred revenue	2,668	3,702
Current portion of capital lease and loan obligations	2,187	2,506
Total Current Liabilities	19,628	18,018
Noncurrent portion of capital lease and loan obligations	1,916	2,228
Other noncurrent liabilities	125	125
Note payable	4,000	4,000
Total Liabilities	25,669	24,371
Commitments and contingencies		
Minority interest		112
Stockholders Equity:		
Preferred stock, par value $0.001; 8,000,000 shares authorized; none issued and outstanding as of March 31, 2002 and December 31, 2001		
Common stock, par value $0.001; 100,000,000 shares authorized; 19,373,993 and 19,307,735 issued and outstanding as of March 31, 2002 and December 31, 2001, respectively	19	19
Additional paid-in capital	134,079	123,849
Deferred stock compensation	(10)	(53)
Accumulated deficit	(127,351)	(108,394)
Total stockholders equity	6,737	15,421

Total liabilities and stockholders equity	$ 32,406	$ 39,904

See accompanying notes to condensed consolidated financial statements.

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HYSEQ PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	THREE MONTHS ENDED MARCH 31,	
	2002	**2001**
Contract revenues	$ 5,232	$ 5,668
Operating expenses:		
Research and development	21,014	9,051
General and administrative	3,058	3,003
Total operating expenses	24,072	12,054
Loss from operations	(18,840)	(6,386)
Interest income	30	64
Interest expense	(259)	(357)
Net loss before minority interest	(19,069)	(6,679)
Loss attributable to minority interest	112	
Net loss	$(18,957)	$ (6,679)
Basic and diluted net loss per share	$ (1.01)	$ (0.49)
Shares used in computing basic and diluted net loss per share	18,725	13,739

See accompanying notes to condensed consolidated financial statements.

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HYSEQ PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	THREE MONTHS ENDED MARCH 31,	
	2002	**2001**
NET CASH USED IN OPERATING ACTIVITIES	(8,398)	(4,761)
Cash flows from investing activities:		
Purchases of property and equipment	(1,068)	(2,807)
NET CASH USED IN INVESTING ACTIVITIES	(1,068)	(2,807)
Cash flows from financing activities:		
Payment on capital lease and loan obligations	(630)	(560)
Proceeds from drawdown on line of credit	4,000	20,000
Proceeds from issuance of common stock upon exercise of options/ESPP	253	243
NET CASH PROVIDED BY FINANCING ACTIVITIES	3,623	19,683
Net increase (decrease) in cash and cash equivalents	(5,843)	12,115
Cash at beginning of period	12,329	2,699
Cash at end of period	$ 6,486	$14,814

See accompanying notes to condensed consolidated financial statements.

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HYSEQ PHARMACEUTICALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2002
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by Hyseq, Inc. (Hyseq, the Company, we, us, or our) in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The condensed consolidated balance sheet as of March 31, 2002, the statements of operations for the three months ended March 31, 2002 and 2001, and the statements of cash flows for the three months ended March 31, 2002 and 2001 are unaudited, but include all adjustments (consisting of normal recurring adjustments) which the Company considers necessary for a fair presentation of the financial position, operating results and cash flows for the periods presented. The condensed consolidated balance sheet as of December 31, 2001 is derived from the Company s audited financial statements. The condensed consolidated financial statements include the accounts of the Company s majority-owned subsidiary Callida Genomics, Inc. The results of operations for the interim period shown herein are not necessarily indicative of operating results expected for the entire year.

2. Transactions with related parties

Line of credit

In August 2001, the Company received a commitment from the Chairman of its Board of Directors, Dr. George Rathmann, to provide a second line of credit of up to $20.0 million. The line of credit agreement was executed on August 6, 2001, and makes available the principal amount of $20.0 million, for draw down through August 5, 2003. The line of credit agreement was amended and restated as of April 3, 2002, and this description refers to the agreement as so amended and restated. Amounts outstanding under the line of credit are evidenced by a promissory note which bears interest at a rate equal to one percent (1%) above the prime rate, and will be payable in 48 equal monthly installments beginning August 5, 2003. The promissory note issued pursuant to the line of credit is convertible by mutual agreement by us and Dr. Rathmann into either (a) that number of shares of our common stock as shall equal the quotient obtained by dividing the aggregate principal and interest then outstanding under the note (i) by the average closing price of our common stock on the Nasdaq National Market as reported in The Wall Street Journal for the twenty trading days ending on the second trading day immediately prior to the day of such conversion, or (ii) in connection with an offering of our equity securities, by the per share price of the common stock at which such equity securities shall be offered for sale by us or (b) if within one month of the closing of any equity financing by us for aggregate gross proceeds in excess of $10,000,000, the same equity securities issued by us in the financing, at the same purchase price, with the same exercise price, if any, at the same discount, if any, and otherwise on substantially the same terms and conditions. Under certain specified conditions, including (1) a change in control (based on a 50% ownership test), (2) insolvency or bankruptcy, or (3) a material adverse effect on our business, properties, assets or condition, we may not be able to borrow any further amounts under the line of credit. If any of the following events of default occur, all payments under the promissory note may be accelerated; we shall fail to make payments within five business days of the date due; the breach by us of a representation or warranty made to Dr. Rathmann; the uncured breach by us of an obligation under the credit agreement; a material default by us under any other agreement with Dr. Rathmann; and customary defaults related to our bankruptcy or insolvency. In February 2002, we drew down $4.0 million of the $20.0 million line of credit, and as of March 31, 2002, $16.0 million was available under this line of credit.

3. Per share data

In the third quarter of 2001, the Company completed a private placement of approximately 3.04 million newly issued shares of common stock and warrants to purchase approximately 1.52 million shares of common stock. Of the newly issued shares of common stock in the private placement, 614,298 shares of common stock were issued to its Chairman and senior management, which the Company s stockholders will be asked to ratify at the Company s 2002 annual meeting of stockholders. These shares are excluded from weighted-average shares outstanding in the earning per share calculation.

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4. Segment Information

In October 2001, the Company created majority-owned subsidiary Callida Genomics, Inc. to develop and commercialize the Company s sequencing-by-hybridization (SBH) technology, including a high-speed DNA sequencing chip, in collaboration with Affymetrix, Inc. Management has chosen to organize Callida as a separate entity to provide solutions useful to businesses engaged in the genomic sciences. This stands in contrast to the business goal of Hyseq Pharmaceuticals, which is to develop and market therapeutic drugs for the treatment of human diseases. The Company anticipates that in the future the two segments will grow in different business directions, requiring different skills of their key employees, different business practices, and exist within different regulatory environments.

In the first quarter of 2002, the Company began reporting Callida as a separate segment for internal management reporting purposes. Total assets for Callida as of March 31, 2002 were $12.0 million, compared with $14.1 million as of December 31, 2001. Restatement of the quarter ended March 31, 2001 is irrelevant.

RECONCILIATION OF REPORTABLE SEGMENTS FINANCIAL INFORMATION
(in thousands)

	THREE MONTHS ENDED MARCH 31, 2002		
	Hyseq	**Callida**	**Total**
Contract revenues	$ 5,217	$ 15	$ 5,232
Loss from operations	(17,268)	(1,572)	(18,840)
Net loss	$(17,385)	$(1,572)	$(18,957)

5. Collaboration to develop the drug Alfimeprase with Amgen, Inc

We are currently focusing on the development of alfimeprase, an early stage clinical product candidate that we began developing in collaboration with Amgen, Inc. in January 2002. Alfimeprase is thrombolytic agent that dissolves blood clots. It was originally identified through Amgen s research program and is a novel recombinant derivative of fibrolase, a naturally occurring enzyme. Unlike other thrombolytic plasminogen activators, alfimeprase can directly and rapidly degrade the network of fibrin protein that captures red blood cells to form blood clots. The first target medical indication is Peripheral Arterial Occlusion (or PAO). In PAO, a clot blocks blood flow to a distant body part, usually in the leg. It is estimated that more than 100,000 cases of PAO are reported in the United States per year. Pre-clinical studies indicate that alfimeprase is a promising agent for dissolving clots (clot lysis), and may be particularly well suited for the PAO indication. An IND has been filed in the PAO indication and we plan to begin Phase I human studies in the second quarter of 2002. If the early safety profile alfimeprase is acceptable after the phase I study, alfimeprase will proceed to phase II human studies in 2003 to gather additional safety data and to evaluate preliminary efficacy and dosages, to be followed by phase III studies to provide the statistical proof of efficacy and safety required by regulatory agencies.

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Under the terms of the collaboration agreement with Amgen, we will lead development and be responsible for all clinical development activities, while Amgen will be responsible for manufacturing activities. Amgen will have the option to lead commercialization efforts in which both companies may participate. We will fund all development costs up to an agreed amount, after which costs as well as eventual profits will be shared equally. We can terminate the agreement at any time with notice. For a limited time period, Amgen may opt out of the collaboration by converting it to an exclusive licensing arrangement. Amgen also has the right to terminate the agreement if we do not begin human clinical trials within a certain time period upon our uncured material breach or material default upon a materially adverse clinical development, or upon our bankruptcy. In the first quarter ended March 31, 2002, the Company recorded a $10.0 million non-cash charge as research and development expense for the fair value of warrants granted to Amgen under the terms of the agreement. No cash has changed hands to date under the agreement.

Under the collaboration agreement, we may be obligated to make a one-time milestone payment of $10 million upon obtaining regulatory approval for the collaboration product in a major market. If Amgen exercises its license option pursuant to the collaboration, we may, upon the occurrence of specified conditions, be obligated to make milestone payments in an aggregate amount of up to $40 million. The $10 million regulatory approval milestone payment is creditable against the $40 million aggregate milestone payments under the license agreement described above. We may also be obligated to pay Amgen an amount of up to $10 million in the event that a clinical trial is not timely commenced.

We expect research and development costs for our Alfimeprase clinical studies to be approximately $3.0 million in 2002. We expect our research and development expenses to increase substantially in 2003 and beyond if we proceed beyond Phase I clinical trials with Alfimeprase. It is not unusual for the clinical development of these types of products to take in excess of 5 years and to cost well in excess of $100 million. The time and cost of completing the clinical development of any product candidate will depend on a number of factors, including the disease or medical condition to be treated, clinical trial design and endpoints, availability of patients to participate in trials and the relative efficacy of the product versus treatments already approved. Due to these many uncertainties, we are unable to estimate the length of time or the costs that will be required to complete the development of this product candidate.

6. Subsequent Events

On April 5, 2002 the Company completed a private placement with gross proceeds of approximately $15.0 million ($14.2 million, net of offering expenses). Investors in the private placement included select new and existing institutional investors. Under the terms of the financing, the Company sold 3,575,691 shares of newly issued common stock at $4.20 per share to accredited investors. The Company also issued warrants to the investors to purchase approximately 893,927 shares of common stock at $5.67 per share, a 35% premium to the per unit purchase price. The Company may seek to raise funds through additional private placements in the future but cannot guarantee that it will be successful.

On May 14, 2002, the Company and BASF agreed to amend the collaboration agreement between the two parties. Under this amendment, both Hyseq s agricultural gene discovery activities and BASF Plant Science s payment schedule will accelerate with early completion scheduled for January 2003, resulting in a cost savings to both parties. The royalties due to the Company from BASF will also be reduced. The collaboration retains its original termination date of June 2003 but will not be renewable for any additional terms.

In May 2002, the Company also began an internal restructuring that includes a realignment of research groups and a reduction of 79 employees, primarily in the area of agricultural gene discovery. The reduction is being implemented over the next eight months, and the Company expects to have reduced the Company s workforce to approximately 125 employees by the end of 2002.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit Number	Description
4.11	Warrant to Purchase 1,491,544 Shares of Common Stock of Hyseq, Inc., dated as of January 8, 2002(1)
10.28	Collaboration Agreement, dated of January 8, 2002, by and between Hyseq, Inc. and Amgen, Inc.(2)
10.29	Warrant Purchase Agreement, dated as of January 8, 2002, by and between Hyseq, Inc. and Amgen, Inc.(1)

(1) Previously filed as an exhibit to and incorporated herein by reference from our Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 15, 2002.

(2) Previously filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 15, 2002. Pursuant to a confidential treatment request filed with the Commission, certain portions of this exhibit were omitted from our prior filing. The current filing reflects comments of the Commission regarding our confidential treatment request.

Reports on Form 8-K

DATE OF FILING	SUBJECT
January 11, 2002	Form 8-K, Item 5, collaboration by Amgen, Inc. and Hyseq Pharmaceuticals to develop and commercialize alfimeprase for the treatment of peripheral arterial occlusions and other cardiovascular indications.
January 28, 2002	Form 8-K, Item 5, collaboration by Intel Corporation and Callida Genomics to develop technology for the detection, identification, and analysis of DNA or other biomolecules.

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SIGNATURE

Pursuant to the requirements 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.

Hyseq, Inc. (Registrant)
d/b/a Hyseq Pharmaceuticals, Inc.

By: /s/ Peter S. Garcia

Peter S. Garcia
Senior Vice President and Chief Financial Officer

Date: July 22, 2002

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