

PALIGENT INC  
Form 10-Q  
November 12, 2004

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended September 30, 2004

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

For the transition period from to

Commission File Number: 0-21134

**Paligent Inc.**

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*(Exact name of registrant as specified in its charter)*

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**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**04-2893483**  
*(I.R.S. Employer  
Identification No.)*

**10 East 53<sup>rd</sup> Street, New York, New York**  
*(Address of principal executive offices)*

**10022**  
*(zip code)*

**(212) 755-5461**

*Registrant's telephone number, including area code)*

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

YES  NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                          | Outstanding as of November 5, 2004 |
|--------------------------------|------------------------------------|
| Common Stock, \$0.01 par value | 32,490,948                         |

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PALIGENT INC.

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## PALIGENT INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

|   | September 30, 2004<br>(unaudited) | December 31, 2003 |
|---|-----------------------------------|-------------------|
| <b>ASSETS</b>   |                                   |                   |
| Current assets:   |                                   |                   |
| Cash and cash equivalents   | \$ 46,165                         | \$ 41,321         |
| Current portion of subtenant receivable   |                                   | 100,000           |
| Property held for sale  |                                   | 10,000            |
| Prepaid expenses and other current assets   | 27,746                            |                   |
| Total current assets  | 73,911                            | 151,321           |
| Property and equipment, net   | 1,409                             | 2,813             |
| Subtenant receivable  |                                   | 25,000            |
| Security deposits   |                                   | 9,543             |
| Total assets  | \$ 75,320                         | \$ 188,677        |
| <b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>   |                                   |                   |
| Current liabilities:  |                                   |                   |
| Accounts payable and accrued expenses   | \$ 39,046                         | \$ 132,935        |
| Accrued professional services   | 20,300                            | 34,100            |
| Accrued rent  | 33,415                            |                   |
| Due to related party  | 140,000                           | 111,189           |
| Capital lease obligation  |                                   | 10,000            |
| Total current liabilities   | 232,761                           | 288,224           |
| Deferred rent   |                                   | 22,262            |
| Stockholders deficit:   |                                   |                   |
| Common stock, \$.01 par value; 75,000,000 shares authorized; 32,490,948 shares issued and outstanding at September 30, 2004 and December 31, 2003 | 324,910                           | 324,910           |
| Additional paid-in capital  | 154,634,974                       | 154,634,974       |
| Accumulated deficit   | (155,117,325)                     | (155,081,693)     |
| Total stockholders deficit  | (157,441)                         | (121,809)         |
| Total liabilities and stockholders deficit  | \$ 75,320                         | \$ 188,677        |

The accompanying notes are an integral part of the condensed consolidated financial statements.

## PALIGENT INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

|   | Three months ended<br>September 30, |              | Nine months ended<br>September 30, |             |
|---|-------------------------------------|--------------|------------------------------------|-------------|
|   | 2004                                | 2003         | 2004                               | 2003        |
| <b>Revenue:</b>   |                                     |              |                                    |             |
| Interest income   | \$                                  | \$ 118       | \$ 2,250                           | \$ 643      |
| <b>Costs and expenses:</b>                                  |                                     |              |                                    |             |
| General and administrative                                  | 214,137                             | 213,073      | 537,882                            | 539,425     |
| Loss from operations  | (214,137)                           | (212,955)    | (535,632)                          | (538,782)   |
| Other income  | 500,000                             |              | 500,000                            | 500,000     |
| Net income (loss)   | \$ 285,863                          | \$ (212,955) | \$ (35,632)                        | \$ (38,782) |
| Basic and diluted net income (loss) per common share        | \$ 0.01                             | \$ (0.01)    | \$ (0.00)                          | \$ (0.00)   |
| <b>Weighted average number of common shares outstanding</b> |                                     |              |                                    |             |
| Basic and diluted   | 32,490,948                          | 32,490,948   | 32,490,948                         | 32,490,948  |

The accompanying notes are an integral part of the condensed consolidated financial statements.

## PALIGENT INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

|   | Nine months ended September 30, |             |
|---|---------------------------------|-------------|
|   | 2004                            | 2003        |
| Cash flows from operating activities:                                       |                                 |             |
| Net loss  | \$ (35,632)                     | \$ (38,782) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                 |             |
| Depreciation and amortization   | 1,404                           | 31,493      |
| Write-off of security deposits  | 9,543                           | 1,910       |
| Write-down of accrued rent  | (81,185)                        |             |
| Reserve for subtenant receivable and accrued interest                       | 77,250                          |             |
| Deferred charges  |                                 | 16,442      |
| Deferred rent   | (22,262)                        | (7,062)     |
| Changes in operating assets and liabilities:                                |                                 |             |
| Prepaid expenses and other current assets                                   | (29,996)                        | (32,160)    |
| Subtenant receivable  | 50,000                          | (65,302)    |
| Accounts payable and accrued expenses                                       | (107,689)                       | (24,800)    |
| Interest payable to related party   | (1,189)                         |             |
| Accrued rent  | 114,600                         |             |
| Net cash used in operating activities                                       | (25,156)                        | (118,261)   |
| Cash flows from investing activities:                                       |                                 |             |
| Proceeds from sale of assets  | 10,000                          |             |
| Net cash provided by investing activities                                   | 10,000                          |             |
| Cash flows from financing activities:                                       |                                 |             |
| Proceeds from related party loan  | 405,000                         | 30,000      |
| Repayment of related party loan   | (375,000)                       | (30,000)    |
| Principal payments on capital lease obligations                             | (10,000)                        | (16,095)    |
| Net cash provided by (used in) financing activities                         | 20,000                          | (16,095)    |
| Net increase (decrease) in cash and cash equivalents                        | 4,844                           | (134,356)   |
| Cash and cash equivalents at beginning of period                            | 41,321                          | 153,046     |
| Cash and cash equivalents at end of period                                  | \$ 46,165                       | \$ 18,690   |

The accompanying notes are an integral part of the condensed consolidated financial statements

**PALIGENT INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**NOTE 1 BASIS OF PRESENTATION**

**Interim Financial Statements**

The condensed consolidated financial statements included herein have been prepared by Paligent Inc. ( Paligent or the Company ) pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the financial position of the Company at September 30, 2004 and the results of its operations and its cash flows for the interim periods ended September 30, 2004 and 2003. The condensed consolidated balance sheet as of December 31, 2003 was derived from audited financial statements but does not include all disclosures required by generally accepted accounting principles. The accompanying condensed consolidated financial statements have been prepared in accordance with accounting standards for interim financial statements and should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company s Form 10-K for the year ended December 31, 2003. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year or any other interim period.

The accompanying consolidated financial statements have been prepared on a going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. The Company has incurred losses from operations since inception, has working capital and stockholders deficits and has limited cash to fund operations in 2004. The Company is presently relying on borrowings from Richard J. Kurtz, its principal stockholder, to fund continuing operations. Mr. Kurtz has made no commitment to continue to make loans to the Company.

While the Company evaluates strategic alternatives, including potential business investments and related financing, the Company s rate of spending could vary from its current estimate. No assurance can be given that the Company will be able to complete a business investment or that such financing will be available to the Company. If the Company is unable to generate significant revenue from acquired operations, obtain additional revenue from its existing out-licensing of its biotechnology assets, secure additional financing for its present operations, obtain financing from its principal stockholder or secure sufficient financing for operations resulting from acquisition or merger, the Company will experience a cash shortage in 2004, the effect of which could result in the discontinuance of operations. If additional funds are raised by issuing equity securities, further dilution to existing stockholders will result and future investors may be granted rights superior to those of existing stockholders.

These circumstances raise substantial doubt about the Company s ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**Reclassification**

Certain prior period amounts have been reclassified to conform to the current period presentation.



**NOTE 2 BASIC AND DILUTED NET INCOME (LOSS) PER SHARE**

Basic earnings per share ( EPS ) excludes dilution and is computed by dividing income (loss) applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS is based upon the weighted average number of common shares outstanding during the period plus the additional weighted average common equivalent shares during the period. Common equivalent shares result from the assumed exercises of outstanding stock options and warrants, the proceeds of which are then assumed to have been used to repurchase outstanding shares of common stock (the treasury stock method ). Common equivalent shares are not included in the per share calculations where the effect of their inclusion would be anti-dilutive. Inherently, stock options and warrants are deemed to be anti-dilutive when the average market price of the common stock during the period exceeds the exercise price of the stock options or warrants.

For the three and nine months ended September 30, 2004 and 2003, the Company had stock options and warrants outstanding that were anti-dilutive. These securities could potentially dilute basic EPS in the future but were not included in the computation of diluted EPS for the periods presented because to do so would have been anti-dilutive. Consequently, there were no differences between basic and diluted EPS for these periods.

**NOTE 3 SIGNIFICANT EVENTS**

On July 28, 2004, the Company executed a letter of intent to acquire privately held SoyToy LLC ( SoyToy ). Mr. Kurtz holds a 50% membership interest in SoyToy. The letter of intent contemplated the acquisition by the Company of all of the issued and outstanding membership interests of SoyToy in consideration of the issuance of shares of common stock of the Company such that the present stockholders of Paligent and equity holders of SoyToy would each own 50% of the outstanding stock of the post-acquisition company, subject to adjustment for future issuances. In addition, the letter of intent contemplated that approximately one-half of the existing related party debt of SoyToy would be converted at the closing into convertible preferred stock of the Company, the terms of which were to be mutually acceptable to the Company and Mr. Kurtz, the holder of the related party debt. The letter of intent provided that the proposed acquisition would be subject, among other things, to the execution of definitive acquisition documentation and the approval by the holders of a majority of shares of Paligent common stock that are not owned by Mr. Kurtz or his affiliates. The Company estimated that approximately \$1.5 million would be needed to fund the initial phase of SoyToy s business plan, which the Company and SoyToy anticipated financing, at least in part, prior to the completion of the business combination. SoyToy s progress in developing its business plan has been proceeding at a slower pace than initially envisioned. While the letter of intent expired on September 26, 2004, the Company has continued discussing the potential transaction with SoyToy. However, due to the lack of progress, the Company has begun to consider pursuing alternative transactions.

On September 27, 2004, Indevus Pharmaceuticals, Inc. ( Indevus ) exercised a second option pursuant to an amendment dated April 11, 2003 (the PRO 2000 Amendment ) to the license agreement dated June 14, 2000 (the PRO 2000 License ). Under the PRO 2000 License, Indevus holds the exclusive, worldwide rights to develop and market PRO 2000 Gel. The PRO 2000 Amendment granted Indevus a second option, upon which exercise, Indevus would acquire all of the Company s rights, title and interest to PRO 2000 Gel as set forth in the PRO 2000 License, provided that such second option was exercised before September 30, 2004. Upon the exercise of the second option on September 27, 2004, Indevus paid to the Company \$500,000, as provided in the PRO 2000 Amendment.

#### **NOTE 4 RELATED PARTIES**

On October 8, 2003, in anticipation of completing a business combination with Digital Products of Delaware, Inc. ( Digital ), or another entity, the Company executed a promissory note (the Promissory Note ) with Mr. Kurtz under which the Company received, and expects to continue to receive, loans that will enable it to meet its anticipated cash operating needs. Mr. Kurtz is also the principal shareholder of Digital. The Promissory Note bears interest at 8% per annum and contemplates repayment upon the occurrence of the earlier of (i) the first anniversary of the making of the first loan; and (ii) the first funding of debt and/or equity capital subsequent to the completion of the proposed business combination between the Company and Digital that results in aggregate net proceeds to the Company of not less than \$1 million. On January 16, 2004 the Company announced that the contemplated Digital acquisition was being indefinitely postponed. On July 28, 2004, the Company executed a letter of intent to acquire privately held SoyToy LLC, of which Mr. Kurtz holds a 50% membership interest. See Note 3 Significant Events for a further discussion of the potential SoyToy transaction.

Through September 2004, Mr. Kurtz had loaned the Company an aggregate of \$515,000 to fund its continuing operations. On September 30, 2004, the Company paid \$394,418 to Mr. Kurtz, comprising \$375,000 in principal plus \$19,418 of accrued interest.

#### **NOTE 5 SUBTENANT RECEIVABLE**

On December 31, 2003, the Company executed a Surrender Agreement and Promissory Note with its former subtenant (the Subtenant ) pursuant to which the Company received cash and a promissory note approximately equivalent to the aggregate amount due as of December 31, 2003. The Promissory Note, in the original amount of \$75,000, bears interest at the rate of 6% per annum and was to be payable in three installments of \$25,000, plus accrued interest, on June 30, 2004, December 31, 2004 and June 30, 2005. The Company did not receive from the Subtenant the installment payment that was due on June 30, 2004. Despite the verbal indication of the Subtenant's management to the Company in July that it was expecting to receive sufficient funds to cure its default of the Promissory Note by the close of the third quarter of 2004, the Company did not receive payment of the past due installment. Accordingly, on September 14, 2004, the Company filed an action in the Supreme Court of the State of New York, New York County, alleging that the Subtenant had defaulted on its obligations under the Promissory Note. The Company's motion for summary judgment in lieu of complaint is presently pending a hearing before the Court. Since the likelihood of collecting the past due installment or any future installment cannot be reasonably assured, the Company discontinued accruing interest income as of June 30, 2004, and has recorded a reserve of \$77,250 in the quarter ended September 30, 2004, representing the full amount of principal and interest outstanding due at June 30, 2004.

#### **NOTE 6 ACCRUED RENT**

On January 16, 2004, the Company voluntarily vacated its office at 369 Lexington Avenue, New York, New York (the Lexington Office ). The commitment under the lease for the Lexington Office (the Lexington Lease ) requires the Company to pay monthly base rent and an allocable percentage of operating costs and property taxes throughout the remaining term of the Lexington Lease, which expires on April 30, 2005.

Pursuant to Statement of Financial Accounting Standards No. ( FAS ) 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the Company recognizes January 16, 2004, the date that it vacated the Lexington Office, as the cease-use date. Accordingly, a liability for costs that continue to be incurred under the Lexington Lease for the remaining term was recognized and measured at their fair



value at that time. The fair value was determined based on remaining lease rentals reduced by estimated sublease rentals that could be reasonably obtained for the property.

As of June 30, 2004, the liability for accrued rent was \$63,414. In July 2004, the Company reached a negotiated settlement with the landlord under the Lexington Lease (the Lexington Landlord) for amounts due through March 30, 2004, the date that the Lexington Landlord sold the building. The settlement amount of \$30,000 was paid to the Lexington Landlord on July 23, 2004. After reviewing all relevant factors, the Company did not make any other adjustment to its estimate of the fair value of costs to be incurred under the Lexington Lease during the three month period ended September 30, 2004. Accordingly, the balance of liability for accrued rent at September 30, 2004 was \$33,414.

**NOTE 7 STOCK-BASED COMPENSATION**

The Company complies with FAS 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FAS 123. This statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation.

The Company applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, in accounting for its stock-based compensation plans. Accordingly, no compensation cost has been recognized for its stock option plan. Had compensation cost for the Company's stock-based compensation plan been determined based on the fair value at the grant dates for awards under those plans consistent with FAS 123, the Company's net income (loss) and net income (loss) per share would have been adjusted to the pro forma amounts indicated below:

|  | Three months ended September 30,<br>2004 |         | 2003 |           | Nine months ended September 30,<br>2004 |          | 2003 |          |
|--|--|---------|------|-----------|---|----------|------|----------|
| Net income (loss) as reported  | \$                                       | 285,863 | \$   | (212,955) | \$                                      | (35,632) | \$   | (38,782) |
| Adjustment to net income (loss) for pro forma stock-based compensation expense |  |         |      | (17,030)  |   | (27,089) |      | (51,090) |
| Net income (loss) pro forma  | \$                                       | 285,863 | \$   | (229,985) | \$                                      | (62,721) | \$   | (89,872) |
| Basic and diluted net income (loss) per common share as reported               | \$                                       | 0.01    | \$   | (0.01)    | \$                                      | (0.00)   | \$   | (0.00)   |
| Basic and diluted net income (loss) per common share pro forma                 | \$                                       | 0.01    | \$   | (0.01)    | \$                                      | (0.00)   | \$   | (0.00)   |

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

***Note Regarding Forward-Looking Statements***

*Statements in this Form 10-Q that are not statements or descriptions of historical facts are forward-looking statements under Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995 and are subject to numerous risks and uncertainties. These forward-looking statements can generally be identified by the use of such terms as anticipate, believe, continue, expect, may, should, or similar variations or the negative thereof. These forward looking statements involve risks and uncertainties, many of which are out of the Company's control and which may affect its future business plans. Factors that may affect the Company's future business plans include: (i) its ability to identify, complete and integrate an acquisition of an operating business; (ii) the viability of the Company's business strategy in connection with an acquisition and its ability to implement such strategy; (iii) its ability to secure financing for its current and potential future operations; and (iv) its ability to generate revenues sufficient to meet its operating costs. Such statements reflect the current view of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. In addition, the Company's business, operations and financial condition are subject to the risks, uncertainties and assumptions that are described in the Company's reports and statements filed from time to time with the Securities and Exchange Commission. Should one or more of those risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those discussed herein. The descriptions of the risks, uncertainties and assumptions to which the Company's business, operations and financial condition are subject are as of the date of this report. The Company assumes no obligation to update any such forward-looking statements.*

**Overview**

Since 2001, Paligent Inc., together with its subsidiaries (collectively, the Company), has been engaged in seeking business opportunities to maximize value for its stockholders. The Company has evaluated various strategic alternatives, including acquisitions of new operating businesses and technologies as well as potential merger opportunities.

From its inception in 1985 through 1999, the Company operated as a biotechnology company engaged in the development and commercialization of novel drugs with a product portfolio focused on infectious diseases and oncology. During 1999, the Company's principal efforts were devoted to drug development and human clinical trials focusing on two biotechnology compounds, PRO 2000 Gel and O6-Benzylguanine (O6-BG). During fiscal 2000, the Company closed its research facilities and out-licensed PRO 2000 Gel and O6-BG. In September 2004, the Company transferred all of its rights, title and interest to PRO 2000 Gel pursuant to an option duly exercised by its sublicensee. Under terms of its remaining out-licensing agreement, the Company retains certain future rights, including the right to receive certain agreed-upon payments upon the achievement of certain milestones as well as royalties from commercial sales, if any.

**Results of Operations**

From inception through September 30, 2004, the Company has generated no revenues from product sales or services and has not been profitable. As the Company evaluates various strategic alternatives in its quest for new growth areas that will maximize value to existing stockholders, the Company expects to incur additional losses.



*Three and nine months ended September 30, 2004 as compared to the three and nine months ended September 30, 2003*

During the three months ended September 30, 2004, the Company reported net income of \$286,000, or \$0.01 per share, as compared to a net loss of \$213,000, or \$0.01 per share, in the comparable period in 2003. For the nine months ended September 30, 2004, the Company reported a net loss of \$36,000, or \$0.00 per share, as compared to a net loss of \$39,000, or \$0.00 per share, for the similar period in 2003.

The Company's total revenue, which is derived from interest income, was \$0 and \$2,250, respectively, for the three and nine month periods ended September 30, 2004, as compared to \$118 and \$643, respectively, for the comparable three and nine month periods in 2003. Interest income in fiscal 2004 is attributable to the accrual of interest earnings on the subtenant note receivable. Due to the default by the maker of this note on June 30, 2004, the Company discontinued accruing interest income as of that date. Interest income for fiscal 2003 was derived from interest earnings on available balances.

The Company's total operating expenses, consisting of general and administrative costs, were \$214,000 and \$538,000, respectively, for the three and nine month periods ended September 30, 2004 as compared to \$213,000 and \$539,000, respectively, for the comparable periods in 2003. During the three and nine months ended September 30, 2004, the reserve recorded against the subtenant receivable resulted in an increase of \$77,000 in general and administrative expenses, which increases were offset by reductions in professional fees of \$68,000 and \$112,000, respectively, for the comparable three and nine month periods. Results of operations for the nine month period ended September 30, 2004 also reflects a net increase of \$46,000 in facilities charges, primarily relating to the accrual of the fair value of costs to be incurred under the Lexington Lease.

During the three and nine months ended September 30, 2004, the Company received proceeds of \$500,000 in connection with the exercise of an option by Indevus pursuant to the PRO 2000 Amendment. During the nine months ended September 30, 2003, the Company received proceeds of \$500,000 in connection with its execution of the PRO 2000 Amendment. These amounts were recorded as other income.

**Liquidity and Capital Resources**

At September 30, 2004, the Company's aggregate cash and cash equivalents were \$46,000, a net increase of \$5,000 from the end of the prior year. During the nine month period ended September 30, 2004, the Company received \$500,000 in connection with the PRO 2000 Amendment, \$50,000 from the collection of a portion of the subtenant receivable, \$30,000 in net borrowings under the related party note payable and \$10,000 from the sale of assets. These receipts were offset by cash payments of \$466,000 for operating activities, \$109,000 for satisfaction of accounts payable and accrued expenses and \$10,000 for the settlement of its remaining capital lease.

The Company has incurred losses since inception, has working capital and stockholders' deficits and has limited cash to fund its operations. The Company is presently relying on borrowings from its principal stockholder to fund continuing operations. While the Company pursues strategic alternatives, including potential business combination and related financing, the Company expects to finance its continuing operations through further borrowings from its principal stockholder. The stockholder has made no commitment to continue to make loans to the Company. No assurance can be given that the Company will be able to complete a business combination or that such financing from its principal stockholder will continue to be available to the Company. If the Company is unable to generate significant revenue from acquired operations, obtain additional revenue from its existing out-licensing of its biotechnology assets, secure additional financing for its present operations, obtain financing from its principal stockholder or





secure sufficient financing for operations resulting from acquisition or merger, the Company will experience a cash shortage, the effect of which could result in the discontinuance of operations. If additional funds are raised by issuing equity securities, further dilution to existing stockholders will result and future investors may be granted rights superior to those of existing stockholders.

These circumstances raise substantial doubt about the Company's ability to continue as a going concern.

### **Proposed Acquisition**

On July 28, 2004, the Company executed a letter of intent to acquire privately held SoyToy LLC (SoyToy). Richard J. Kurtz, a director and the principal stockholder of the Company, holds a 50% membership interest in SoyToy. The letter of intent contemplated the acquisition by the Company of all of the issued and outstanding membership interests of SoyToy in consideration of the issuance of shares of common stock of the Company such that the present stockholders of Paligent and equity holders of SoyToy would each own 50% of the outstanding stock of the post-acquisition company, subject to adjustment for future issuances. In addition, the letter of intent contemplated that approximately one-half of the existing related party debt of SoyToy would be converted at the closing into convertible preferred stock of the Company, the terms of which were to be mutually acceptable to the Company and Mr. Kurtz, the holder of the related party debt. The letter of intent provided that the proposed acquisition would be subject, among other things, to the execution of definitive acquisition documentation and the approval by the holders of a majority of shares of Paligent common stock that are not owned by Mr. Kurtz or his affiliates. The Company estimated that approximately \$1.5 million would be needed to fund the initial phase of SoyToy's business plan, which the Company and SoyToy anticipated financing, at least in part, prior to the completion of the business combination. SoyToy's progress in developing its business plan has been proceeding at a slower pace than initially envisioned. While the letter of intent expired on September 26, 2004, the Company has continued discussing the potential transaction with SoyToy. However, due to the lack of progress, the Company has begun to consider pursuing alternative transactions.

**Item 3. Quantitative and Qualitative Disclosure About Market Risk.**

In January 1997, the Securities and Exchange Commission issued Financial Reporting Release 48 ( FRR 48 ), Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments, and Disclosure of Quantitative and Qualitative Information About Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments. FRR 48 required disclosure of qualitative and quantitative information about market risk inherent in derivative financial instruments, other financial instruments, and derivative commodity instruments beyond those already required under generally accepted accounting principles. The Company is not a party to any of the instruments discussed in FRR 48 and considers its market risk to be minimal.

**Item 4. Controls and Procedures**

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was performed under the supervision of the Company's Chief Executive Officer and Principal Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. In addition, there were no changes in the Company's internal control over financial reporting during the quarter ended September 30, 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

On or about May 28, 2004, the Company's landlord under the Lexington Lease (the Lexington Landlord) brought an action against the Company in Civil Court of the City of New York, New York County (the Action). The Action alleged that the Company failed to pay its rent beginning in October 2003 and was in default under the Lexington Lease. The Action sought payment of rent through March 30, 2004, the date the Lexington Landlord sold the building. The net amount claimed due and owing by the Lexington Landlord of \$50,000 reflected a total lease obligation through March 30, 2004 of \$125,000 less an offset of \$75,000 from the application of the Company's security deposit. On July 23, 2004, the Company and the Lexington Landlord reached a negotiated settlement in the amount of \$30,000, pursuant to which the Action was fully and completely resolved.

On September 14, 2004, the Company filed an action in the Supreme Court of the State of New York, New York County, alleging that its former subtenant (the Subtenant) had defaulted on its obligations under the Promissory Note dated December 31, 2003. The Promissory Note, in the original amount of \$75,000, bears interest at the rate of 6% per annum and was to be payable in three installments of \$25,000, plus accrued interest, on June 30, 2004, December 31, 2004 and June 30, 2005. The Company did not receive from the Subtenant the installment payment that was due on June 30, 2004. This Company's motion for summary judgment in lieu of complaint is pending a hearing before the Court.

### Item 6. Exhibits and Reports on Form 8-K.

#### (a) Exhibits.

- |      |   |
|------|---|
| 31.1 | Certification of Chief Executive Officer and Principal Financial Officer Required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith. |
| 32.1 | Certification of Chief Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed herewith.  |

#### (b) Reports on Form 8-K.

Current Report on Form 8-K filed with the Securities and Exchange Commission on July 30, 2004.

**SIGNATURES**

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.

PALIGENT INC.  
(Registrant)

Date: November 12, 2004

by:

/s/ Salvatore A. Bucci  
Salvatore A. Bucci  
President and Chief Executive Officer

**EXHIBIT INDEX**

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