

Cyclacel Pharmaceuticals, Inc.

Form 10-Q

November 07, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008
OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
Commission file number 0-50626
CYCLACEL PHARMACEUTICALS, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

91-1707622
(IRS Employer Identification. No.)

200 CONNELL DRIVE, SUITE 1500
BERKELEY HEIGHTS, NJ 07922
(Address of principal executive offices)

Registrant's telephone number, including area code: **(908) 517-7330**

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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting filer
(Do not check if a smaller reporting company)

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

As of November 7, 2008 there were 20,433,129 shares of the issuer's common stock outstanding.

CYCLACEL PHARMACEUTICALS, INC.
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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEETS
(In \$000s, except share amounts)

	December 31, 2007	September 30, 2008 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	30,987	26,723
Short-term investments	27,766	6,998
Inventory	213	571
Prepaid expenses and other current assets	4,811	3,017
Total current assets	63,777	37,309
Property, plant and equipment (net)	3,016	2,288
Deposits and other assets	196	196
Intangible assets (net)	4,305	
Goodwill	4,618	1,832
Total assets	75,912	41,625
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	4,958	1,301
Accrued liabilities	4,015	5,710
Other current liabilities	1,279	1,291
Warrant liability	3,545	224
Current portion of other accrued restructuring charges	905	1,349
Current portion of equipment financing	10	
Total current liabilities	14,712	9,875
Other accrued restructuring charges, net of current	2,090	1,361
Other long term payables	1,141	616
Total liabilities	17,943	11,852
Stockholders equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized at December 31, 2007 and September 30, 2008; 2,046,813 shares issued and outstanding at December 31, 2007 and September 30, 2008. Aggregate preference in liquidation of \$20,673,000 at December 31, 2007 and September 30, 2008	2	2
Common stock, \$0.001 par value; 100,000,000 shares authorized at December 31, 2007 and September 30, 2008; 20,433,129 shares issued and	20	20

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outstanding at December 31, 2007 and September 30, 2008

Additional paid-in capital	222,906	223,186
Accumulated other comprehensive loss	(2,630)	1,337
Deficit accumulated during the development stage	(162,329)	(194,772)
Total stockholders equity	57,969	29,773
Total liabilities and stockholders equity	75,912	41,625

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

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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In \$000s, except share and per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended		Period from August 13, 1996 (inception) to September 30, 2008
	September 30, 2007	2008	September 30, 2007	2008	
Revenues:					
Collaboration and research and development revenue			10		3,000
Product revenue		257		590	590
Grant revenue	33	12	107	36	3,632
Total revenue	33	269	117	626	7,222
Operating expenses:					
Cost of goods sold		120		315	315
Research and development	4,449	4,030	12,742	15,718	157,262
Selling, general and administrative	2,523	3,218	8,022	11,337	59,291
Goodwill and intangibles impairment		6,344		6,344	6,344
Restructuring expenses		489	81	489	2,268
Total operating expenses	6,972	14,201	20,845	34,203	225,480
Operating loss	(6,939)	(13,932)	(20,728)	(33,577)	(218,258)
Other income (expense):					
Costs associated with aborted 2004 IPO					(3,550)
Change in valuation of derivative	(19)		(89)		(308)
Change in valuation of warrants	951	432	2,815	3,321	6,526
Foreign exchange gains/(losses)	459	(4,776)	1,139	(4,638)	(4,180)
Interest income	955	287	2,769	1,184	13,345
Interest expense	(54)	(69)	(154)	(244)	(4,383)
Total other income (expense)	2,292	(4,126)	6,480	(377)	7,450
Loss before taxes	(4,647)	(18,058)	(14,248)	(33,954)	(210,808)
Income tax benefit	433	411	1,549	1,511	16,036
Net loss	(4,214)	(17,647)	(12,699)	(32,443)	(194,772)
Dividends on Preferred Ordinary shares					(38,123)

Net loss applicable to common shareholders		(4,214)	(17,647)	(12,699)	(32,443)	(232,895)
Net loss per share Basic and diluted	\$	(0.21)	\$ (0.86)	\$ (0.65)	\$ (1.59)	
Weighted average common shares outstanding		20,433,129	20,433,129	19,685,457	20,433,129	

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

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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In \$000s)
(Unaudited)

	Nine Months Ended		Period from
	September 30,		August 13,
	2007	2008	1996
			(inception) to
			September 30,
			2008
Cash flows from operating activities:			
Net loss	(12,699)	(32,443)	(194,772)
Adjustments to reconcile net loss to net cash used in operating activities:			
Accretion of deferred consideration payable in common stock related to the acquisition of ALIGN		29	39
Accretion of interest on notes payable, net of amortization of debt premium		59	78
Amortization of investment premiums, net	(220)	(1,273)	(2,146)
Change in valuation of derivative	89		308
Change in valuation of warrants	(2,815)	(3,321)	(6,526)
Depreciation and amortization	707	1,619	11,832
Goodwill and intangibles impairment		6,344	6,344
Foreign exchange (gain) loss	(1,432)	5,184	8,104
Deferred revenue			(98)
Compensation for warrants issued to non employees			1,215
Shares issued for IP rights			446
Gain on disposal of property, plant and equipment			27
Stock based compensation	1,335	1,202	15,089
Provision for restructuring	81	383	2,162
Amortization of issuance costs of Preferred Ordinary C shares			2,517
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,088)	1,184	(3,016)
Accounts payable and other current liabilities	(588)	(2,499)	(1,298)
Net cash used in operating activities	(17,630)	(23,532)	(159,695)
Investing activities:			
Purchase of ALIGN			(3,763)
Purchase of property, plant and equipment	(800)	(354)	(8,796)
Proceeds from sale of property, plant and equipment			26
Purchase of short-term investments	(27,429)	(857)	(154,454)
Redemptions of short-term investments, net of maturities		22,899	153,381
Net cash (used in) provided by investing activities	(28,229)	21,688	(13,606)
Financing activities:			

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Payment of capital lease obligations	(89)	(10)	(3,719)
Proceeds from issuance of ordinary and preferred ordinary shares, net of issuance costs			90,858
Proceeds from issuance of common stock and warrants, net of issuance costs	33,359		75,983
Net proceeds from stock options and warrants exercised	163		163
Payment of preferred stock dividend	(921)	(921)	(3,065)
Repayment of government loan			(455)
Government loan received			414

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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In \$000s)
(Unaudited)

	Nine Months Ended		Period from
	September 30,		August 13,
	2007	2008	1996
			(inception) to
			September 30,
			2008
Loan received from Cyclacel Group Plc			9,103
Proceeds of committable loan notes issued from shareholders			8,883
Loans received from shareholders			1,645
Cash and cash equivalents assumed on stock purchase			17,915
Costs associated with stock purchase			(1,951)
Net cash provided by (used in) financing activities	32,512	(931)	195,774
Effect of exchange rate changes on cash and cash equivalents	222	(1,489)	4,250
Net (decrease) increase in cash and cash equivalents	(13,347)	(2,775)	22,473
Cash and cash equivalents at beginning of period	44,238	30,987	
Cash and cash equivalents at end of period	31,113	26,723	26,723
Supplemental disclosure of cash flows information:			
Cash received during the period for:			
Interest	1,716	844	11,766
Taxes		2,113	14,997
Cash paid during the period for:			
Interest	(122)	(169)	(1,850)
Schedule of non-cash transactions:			
Acquisitions of equipment purchased through capital leases			3,470
Issuance of Ordinary shares in connection with license agreements			592
Issuance of Ordinary shares on conversion of bridging loan			1,638
Issuance of Preferred Ordinary C shares on conversion of secured convertible loan notes and accrued interest			8,893
Issuance of Ordinary shares in lieu of cash bonus			164
Issuance of other long term payable on ALIGN acquisition			1,122

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

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CYCLACEL PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Cyclacel Pharmaceuticals, Inc. (Cyclacel or the Company) is a development-stage biopharmaceutical company dedicated to the discovery, development and commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious disorders. Cyclacel's strategy is focused on leading edge therapeutic management of cancer patients based on a portfolio of three products marketed by its ALIGN Pharmaceuticals, LLC (ALIGN) subsidiary and a deep development pipeline.

As a result of the recent revised operating plan announced on September 16, 2008, the Company is focusing its clinical development priorities on:

Sapacitabine in acute myeloid leukemia or AML in the elderly;

Sapacitabine in myelodysplastic syndromes or MDS;

Sapacitabine in cutaneous T-cell lymphoma or CTCL; and

Sapacitabine in solid tumor indications

Cyclacel may continue to fund certain additional programs pending the availability of clinical data, at which time the Company will determine the feasibility of pursuing advanced development including:

Seliciclib in nasopharyngeal cancer or NPC;

Seliciclib in non small-cell lung cancer or NSCLC; and

CYC116 in patients with solid tumors

As a development stage company, substantially all efforts of the Company to date have been devoted to performing research and development, conducting clinical trials, developing and acquiring intellectual properties, raising capital and recruiting and training personnel. The Company was incorporated in the state of Delaware in 1996 and is headquartered in Berkeley Heights, New Jersey, with research facilities located in the United Kingdom.

The condensed consolidated balance sheets as of September 30, 2008, the condensed consolidated statements of operations for the three and nine months ended September 30, 2008 and 2007 and the condensed consolidated statements of cash flows for the nine months ended September 30, 2008 and 2007, and related disclosures contained in the accompanying notes are unaudited. The condensed consolidated balance sheet as of December 31, 2007 is derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission (the SEC). The condensed consolidated financial statements are presented on the basis of accounting principles that are generally accepted in the United States for interim financial information and in accordance with the rules and regulations of the SEC. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States for a complete set of financial statements. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the condensed consolidated balance sheet as of September 30, 2008, the results of operations for the three and nine months ended September 30, 2008 and 2007 and the consolidated statements of cash flows for the nine months ended September 30, 2008 and 2007 have been made. The interim results for the nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the year ending December 31, 2008 or for any other year. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the accompanying notes for the year ended December 31, 2007, included in the Company's Annual Report on Form 10-K filed with the SEC.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries for the indicated periods. All significant intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Cyclacel reviews its estimates on an ongoing basis. The estimates were based on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances. Actual results may differ from these estimates. Cyclacel believes the judgments and estimates required by the following accounting policies to be critical in the preparation of the Company's condensed consolidated financial statements.

Cash and Cash Equivalents

Cash equivalents are stated at cost when purchased, which is substantially the same as market value. The Company considers all highly liquid investments with an original maturity of three months or less at the time of initial deposit to be cash equivalents. The objectives of the Company's cash management policy are the safety and preservation of funds, liquidity sufficient to meet Cyclacel's cash flow requirements and attainment of a market rate of return.

Inventory

Cyclacel values inventories at lower of cost or market value. The Company determines cost using the first-in, first-out method. The Company analyzes its inventory levels quarterly and writes-down inventory that becomes obsolete or that has a cost basis in excess of its expected net realizable value. Expired inventory is disposed of and the related carrying amounts are written off. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required in future periods.

Goodwill

Goodwill represents the difference between the purchase price and the fair value of net tangible and identifiable intangible assets acquired in a business combination. Goodwill acquired in a business combination is not amortized, but instead is tested for impairment at least annually in accordance with the provisions of Statement of Financial Accounting Standards (FAS) FAS No. 142, *Goodwill and Other Intangible Asset* (FAS 142).

To test for impairment, the Company must compare the fair value of its reporting units to their respective carrying values, including assigned goodwill. The Company has determined that it has one reportable segment with two reporting units; ALIGN and Xcyte Therapies, Inc. (Xcyte). To the extent the carrying amount of the reporting units exceeds its fair value; Cyclacel would be required to perform the second step of the impairment analysis, as this is an indication that the component of goodwill may be impaired. In this second step, Cyclacel compares the implied fair value of goodwill with its carrying amount. The implied fair value of goodwill is determined by allocating the fair value of the reporting units to all of the assets (recognized and unrecognized) and liabilities of the reporting units in a manner similar to a purchase price allocation, in accordance with FAS No. 141 *Business Combinations*. The residual fair value after this allocation represents the implied fair value of the goodwill. To the extent the implied fair value of goodwill is less than its carrying amount Cyclacel would be required to recognize an impairment loss.

The fair value of the Company's two reporting units is determined in the case of Xcyte by the fair market value of Cyclacel's outstanding common stock, preferred stock and common stock warrants and in the case of ALIGN by using the income based valuation approach with respect to projected product values.

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The Company tested goodwill for impairment for both Xcyte and ALIGN, as of September 30, 2008. The review resulted in an impairment charge of \$2.7 million for the three months ended September 30, 2008 for the Xcyte reporting unit. This was as a result of Cyclacel's market capitalization being lower than the book value of its constituent assets and liabilities as a result of Cyclacel's decreased stock price. For the three months ended September 30, 2007, there was no impairment charge required with regard to Xcyte. For the three months ended September 30, 2008 there was no impairment charge required for the ALIGN reporting unit.

Intangibles

As part of the acquisition of ALIGN, (see Note 5), the Company acquired rights to a license agreement with Sinclair Pharma PLC (Sinclair) as well as to various customer relationships. The license agreement allows Cyclacel to exclusively sell and distribute Xclair® Cream, Numoisyn Liquid and Numoisyn Lozenges in the United States. The Company amortizes the license agreement and customer relationship intangible assets over the remaining life of the contract of approximately seven years. The fair values ascribed to the license agreements and customer relationships on October 5, 2007, the acquisition date, were \$3.0 million and \$0.5 million, respectively. For the three months ended September 30, 2008, the Company amortized approximately \$0.1 million and \$17,000 for the license agreement and customer relationships, respectively. For the nine months ended September 30, 2008, the Company amortized approximately \$0.3 million and \$0.1 million for the license agreement and customer relationships, respectively. The Company expects to amortize \$0.5 million annually for these intangible assets until June 2015.

As part of the acquisition of ALIGN, the Company assumed all rights to the ALIGN trade name, as well as non-compete agreements signed between ALIGN and its senior managers and a beneficial contract pricing arrangement. The Company amortizes the fair values of these assets acquired in the ALIGN acquisition over 2 years, which represents the approximate time period that the non-compete agreements will remain in effect based on the employment contracts of the existing ALIGN management team. The fair value ascribed to the non-compete agreements, trade name and beneficial contract pricing arrangement on October 5, 2007 was \$0.4 million, \$0.1 million and \$0.5 million, respectively. During the three months ended September 30, 2008, the Company amortized approximately \$49,000 for the non-compete agreements, \$13,000 for the trade name and approximately \$59,000 for the beneficial pricing contract. During the nine months ended September 30, 2008, the Company amortized approximately \$0.1 million for the non-compete agreements, \$38,000 for the trade name and \$0.2 million for the beneficial pricing contract.

As part of the Company's annual impairment analysis during the third quarter of 2008, it was determined that the intangible assets described above, when treated as an asset group in accordance with FAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144), were not recoverable as the sum of the undiscounted cash flows was lower than the carrying value and therefore should be impaired. Consequently the fair value of these assets was determined by using the income based valuation methodology. This resulted in the requirement to recognize an impairment charge of \$3.6 million. There will be no further amortization with respect to the intangible assets ascribed in the asset acquisition of ALIGN.

Impairment of Long-lived Assets

In accordance with the provisions of FAS 144, the Company reviews long-lived assets, including intangibles, property, plant and equipment, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Under FAS 144, impairment occurs when undiscounted estimated identifiable future cash flows expected to result from the use of the asset and its eventual dispositions are less than its carrying amount. An impairment loss, if any, is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

As a result of the Company announcing a restructuring plan in September 2008, the Company identified that certain research and development assets at its Cambridge, UK facility will no longer be utilized (see footnote 2 Restructuring Expenses). For the three months ended September 30, 2008, the Company recorded an asset impairment of \$0.1 million in respect to these assets and it was included as part of restructuring costs on the consolidated statement of operations in accordance with FAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (FAS 146).

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Revenue Recognition

Product sales

The Company recognizes revenue from product sales when persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the selling price is fixed and determinable; and collectability is reasonably assured.

The Company offers a general right of return on these product sales, and has considered the guidance in FAS No. 48, *Revenue Recognition When Right of Return Exists* (FAS 48) and Staff Accounting Bulletin No. 104 *Revenue Recognition* (SAB 104). Under these pronouncements, the Company accounts for all product sales using the sell-through method. Under the sell-through method, revenue is not recognized upon shipment of product to distributors. Instead, the Company records deferred revenue at gross invoice sales price and deferred cost of sales at the cost at which those goods were held in inventory. The Company recognizes revenue when such inventory is sold through to the end user based upon prescriptions filled. To estimate product sold through to end users, the Company relies on third-party information, including information obtained from third-party market research data as well as from distributors with respect to their inventory levels and sell-through to customers.

Collaboration, research and development, and grant revenue

Certain of the Company's revenues are earned from collaborative agreements. The Company recognizes revenue when persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the fee is fixed and determinable; and collectability is reasonably assured. Determination of whether these criteria have been met is based on management's judgments regarding the nature of the research performed, the substance of the milestones met relative to those the Company must still perform, and the collectability of any related fees. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

Research and development revenues, which are earned under agreements with third parties for contract research and development activities, are recorded as the related services are performed. Milestone payments are non-refundable and recognized as revenue when earned, as evidenced by achievement of the specified milestones and the absence of ongoing performance obligations. Any amounts received in advance of performance are recorded as deferred revenue. None of the revenues recognized to date are refundable if the relevant research effort is not successful.

Grant revenues from government agencies and private research foundations are recognized as the related qualified research and development costs are incurred, up to the limit of the prior approval funding amounts. Grant revenues are not refundable.

Clinical Trials Accounting

Data management and monitoring of all of the Company's clinical trials are performed by contract research organizations (CROs) or clinical research associates (CRAs) in accordance with the Company's standard operating procedures. Typically, CROs and some CRAs bill monthly for services performed, and others bill based upon milestones achieved. For outstanding amounts, the Company accrues unbilled clinical trial expenses based on estimates of the level of services performed each period. Costs of setting up clinical trial sites for participation in the trials are expensed immediately as research and development expenses. Clinical trial site costs related to patient enrollment are accrued as patients are entered into the trial and any initial payment made to the clinical trial site is recognized upon execution of the clinical trial agreements and expensed as research and development expenses.

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Research and development expenses consist primarily of clinical trial costs associated with the Company's product candidates, milestones, compensation and other expenses for research and development personnel, supplies and development materials, costs for consultants and related contract research, facility costs, amortization of purchased technology and depreciation. Expenditures relating to research and development are expensed as incurred.

Foreign Currency

The results of operations for our one foreign subsidiary, located in the United Kingdom, are maintained in the local currency and translated using the average exchange rates during the period. Assets and liabilities are translated to U.S. dollars using the exchange rate in effect at the balance sheet date. The resulting translation adjustments are reflected on the consolidated balance sheet in stockholders' equity as a cumulative foreign currency translation adjustment, a component of accumulated other comprehensive income (loss). Gains and losses from foreign currency transactions are included in the accompanying consolidated statements of operations.

For the three months ended September 30, 2008, a foreign exchange loss of \$4.8 million was recorded on intercompany loans due to the strength of the US dollar against the British pound and is shown on the consolidated statement of operations under other income (expense). In prior years the foreign exchange gain or loss was shown as selling, general and administrative expense. The Company re-classified the foreign exchange loss due to the loan being of a financing nature rather than it being related to the operating activities of the business and also the magnitude of the charges. For the three months ended September 30, 2007, the Company recorded foreign exchange gain of \$0.5 million.

Segments

The Company is organized and managed as a single operating segment.

Supplemental Financial Information:**Loss per Share**

Basic and diluted loss per share is computed by dividing loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted weighted average shares outstanding excludes shares underlying stock options; convertible preferred stock; make-whole dividend payments of common stock on convertible preferred stock and common stock warrants, since the effects would be anti-dilutive. Accordingly, basic and diluted loss per share is the same. Such excluded shares are summarized as follows:

	September 30, 2007	September 30, 2008
Stock options	1,968,915	2,743,963
Convertible preferred stock	870,980	870,980
Make-whole dividend payments of common stock on convertible preferred stock	190,608	
Common stock warrants	3,634,703	3,809,272
Total shares excluded from calculation	6,665,206	7,424,215

Other Comprehensive Loss

In accordance with FAS No. 130, *Reporting Comprehensive Income*, all components of comprehensive income (loss), including net income (loss), are reported in the financial statements in the period in which they are recognized. Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Net income (loss) and other comprehensive income (loss), including foreign currency translation adjustments and changes in the fair value of available-for-sale securities, are reported, net of any related tax effect, to arrive at comprehensive income (loss).

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The following is a summary of short-term investments at December 31, 2007 and September 30, 2008:

	December 31, 2007			Fair value \$000
	Gross amortized cost \$000	Gross unrealized gains \$000	Gross unrealized losses \$000	
Federal agency obligations & municipal bonds	9,354			9,354
Corporate bonds & commercial paper	18,390	24	(2)	18,412
	27,744	24	(2)	27,766

	September 30, 2008			Fair value \$000
	Gross amortized cost \$000	Gross unrealized gains \$000	Gross unrealized losses \$000	
Federal agency obligations & municipal bonds	500			500
Corporate bonds & commercial paper	6,499	3	(4)	6,498
	6,999	3	(4)	6,998

For investments that are in an unrealized loss position, the Company has evaluated the nature of the investments, the duration of the impairments and concluded that the impairments are not other-than-temporary.

At September 30, 2008, all investments have contractual maturities due within one year. At December 31, 2007 investments of \$1.5 million had maturities greater than one year.

Fair value measurements

On January 1, 2008, the Company adopted FAS No. 157, *Fair Value Measurements* (FAS 157), for its financial assets and liabilities. The Company's adoption of FAS 157 did not materially affect the Company's financial position, results of operations or liquidity. In accordance with FASB Staff Position No. 157-2, *Effective Date of FAS 157*, the Company elected to defer until January 1, 2009 the adoption of FAS 157 for all non-financial assets and non-financial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. As defined in FAS 157, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, FAS 157 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

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In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

Financial assets and liabilities carried at fair value as of September 30, 2008 are classified in the table below in one of the three categories described above:

	Level 1 \$000	Level 2 \$000	Level 3 \$000	Total \$000
U.S. Government Agency Securities		500		500
Commercial Paper		2,991		2,991
Municipal Notes				
Corporate Bonds		3,507		3,507
Total assets at fair value		6,998		6,998
Warrants		(224)		(224)
Total liabilities at fair value		(224)		(224)

Prepaid expenses and other current assets:

Prepaid expenses and other current assets consist of the following:

	December 31, 2007	September 30, 2008 (\$000s)
Research and development tax credit receivable	2,467	1,644
Prepayments	1,741	1,234
Other current assets	603	139
Total prepaid expenses and other current assets	4,811	3,017

Table of Contents**Accrued Liabilities and Other Current Liabilities:**

Accrued liabilities consist of the following:

	December 31, 2007	September 30, 2008
	(\$000s)	
Accrued research and development	3,681	4,449
Other accrued liabilities	334	1,261
Total accrued liabilities	4,015	5,710

Other current liabilities consist of the following:

	December 31, 2007	September 30, 2008
	(\$000s)	
Payroll provision	308	114
Preferred stock dividends declared	307	307
Deferred consideration payable in common stock	250	279
Other short term payables		585
Other current liabilities	414	6
Total other current liabilities	1,279	1,291

Restructuring Expense

The Company records costs and liabilities associated with exit and disposal activities, when certain criteria have been met in accordance with FAS 146, at fair value in the period the liability is incurred. The Company's restructuring and integration plan is subject to continued future refinement as additional information becomes available.

On September 16, 2008, the Company announced a revision of its operating plan and that it plans to concentrate its resources on the advancement of its lead drug, sapacitabine, while maintaining the Company's core competency in drug discovery and cell cycle biology. The plan reduced the workforce across all locations by 25 people. For the three months ended September 30, 2008, the Company recorded an accrual of approximately \$0.4 million for severance payments. As part of the plan the Company will vacate its laboratory facility in Cambridge, England, whose lease terminates in January 2011. For the three months ended September 30, 2008, the rent expense was \$32,000.

An asset impairment amounting to \$0.1 million was also charged to the consolidated statement of operations as a result of assets being identified that would no longer be utilized.

3. STOCK BASED COMPENSATION

At the Company's annual shareholder meeting on May 14, 2008, the stockholders approved and amended the number of shares reserved under the 2006 Equity Incentive Plan (2006 Plan) to 5,200,000 shares of the Company's common stock (up from 3,000,000 shares). The shares reserved under the 2006 Plan have a maximum maturity of 10 years and generally vest over a four-year period from the date of grant.

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A summary of activity for the options under the Company's 2006 Plan for the nine months ended September 30, 2008 is as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in \$000s)
Options outstanding at December 31, 2007	2,592,246	\$ 6.39	9.1	
Granted	325,000	\$ 3.79		
Exercised				
Expired				
Cancelled / forfeited	(173,283)	\$ 6.03		
Options outstanding at September 30, 2008	2,743,963	\$ 6.09	8.44	
Unvested at September 30, 2008	1,531,254	\$ 5.60	8.91	
Vested and exercisable at September 30, 2008	1,212,709	\$ 6.72	7.85	

The Company accounts for all share-based payment transactions under FASB, Statement No. 123R, *Share-Based Payment* (FAS 123R). FAS 123R requires the Company to measure all share-based payment awards, including those with employees, granted, modified, repurchased or cancelled after, or that were unvested as of, January 1, 2006 at fair value. Under FAS 123R, the fair value of stock options and other equity-based compensation must be recognized as compensation cost in the financial statements over the requisite service period of each award.

The Company used the Black-Scholes option-pricing model with the following assumptions for stock option grants to employees and directors for the nine months ended September 30, 2007 and 2008:

	For the Nine Months Ended September 30,			
	2007		2008	
Expected term	4.25	6 Yrs	1	6 Yrs
Risk free interest rate	4.25	5.07%	2.15	3.76%
Expected volatility	70	80%	45	75%
Expected dividend yield over expected term				
Resulting weighted average grant fair value	\$4.05		\$2.11	

The expected term assumption was estimated using past history of early exercise behavior and expectations about future behavior.

The forfeiture rates have been reviewed and updated to reflect a representative level of employee turnover given market conditions and the current business climate.

The expected volatility assumption was based on the historical volatility of the Company's common stock since the merger with Xcyte on March 27, 2006 together with an analysis of the historical volatilities of a peer group of similar biotechnology companies.

The weighted average risk-free interest rate represents interest rate for treasury constant maturities published by the Federal Reserve Board. If the term of available treasury constant maturity instruments is not equal to the expected term of an employee option, the Company uses the weighted average of the two Federal Reserve securities closest to the expected term of the employee option.

Dividend yield has been assumed to be zero as (a) the Company has never declared or paid any dividends and (b) does not currently anticipate paying any cash dividends on its outstanding shares of common stock in the foreseeable future.

There were no exercises of stock options during the three and nine months ended September 30, 2008. The Company received \$0.2 million from the exercise of 25,508 stock options during the second quarter of 2007. As the Company presently has tax loss carry forwards from prior periods and expects to incur tax losses in 2008, the Company is not able to benefit from the deduction for exercised stock options in the current reporting period.

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Cash used to settle equity instruments granted under share-based payment arrangements amounted to \$0 during all periods presented.

In accordance with the terms of a retirement agreement with a former employee, the Company agreed to extend the period during which he would be entitled to exercise vested stock options to purchase Cyclacel's common stock from 30 (thirty) days following the effective date of his retirement, January 8, 2008, to 36 (thirty six) months following such effective date. The Company recorded a one time compensation expense related to the modification of the exercise period of \$0.1 million for the three months ended March 31, 2008.

The following table summarizes the components of the Company's stock based compensation for the three and nine months ended September 30, 2007 and 2008:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2008	2007	2008
	(\$000s)		(\$000s)	
Research and development	120	127	622	548
General and administrative	199	127	713	654
Stock-based compensation costs before income taxes	319	254	1,335	1,202

4. COMMITMENTS AND CONTINGENCIES

In 2005, the Company recorded an accrued restructuring liability associated with abandoning the facility in Bothell, Washington. The lease term on this space expires December 2010. The Bothell restructuring liability was computed as the present value of the difference between the remaining lease payments due less the estimate of net sublease income and expenses. The accrual balance was adjusted in 2006 to reflect a change in estimate due to continued deterioration in the local real estate market. As of September 30, 2008, the Bothell accrued restructuring liability was \$2.3 million. This represents the Company's best estimate of the fair value of the liability. Subsequent changes in the liability due to accretion, or changes in estimates of sublease assumptions, etc. will be recognized as adjustments to restructuring charges in future periods.

The Company records payments of rent related to the Bothell facility as a reduction in the amount of the accrued restructuring liability. Accretion expense is recognized due to the passage of time, which is also reflected as a restructuring charge. Based on our current projections of estimated sublease income and a discount rate of 7.8%, the Company expects to record additional accretion expense of approximately \$0.2 million over the remaining term of the lease.

As a result of the Company announcing a restructuring plan in September 2008 it created an additional restructuring accrual of \$0.4 million was recorded in connection with the severance payments that it made during October 2008. (see Restructuring Expense under footnote 2) The total restructuring accrual can be summarized at September 30, 2008 as follows:

	\$000s
Restructuring provision at June 30, 2008	2,554
Restructuring expense for the current period	383
Payments made in the period	(227)
As of September 30, 2008	2,710

Less: amounts due within one year	1,349
Other accrued restructuring charges long term	1,361

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In connection with the abandonment of the Bothell facility and the related sale of assets in late 2005, the Company has been subjected to a State sales tax audit by the Department of Revenue of the State of Washington. As a result of the potential State sales tax assessment, the Company recorded a liability of \$0.3 million during 2006. There has been no change in the Company's assessment of the liability during the three months ended September 30, 2008.

5. ACQUISITIONS**Acquisition of ALIGN**

On October 5, 2007, the Company purchased certain net assets of ALIGN Pharmaceuticals, LLC or ALIGN. As part of the asset purchase, the Company acquired the sellers' exclusive rights to sell and distribute three products in the United States used primarily to manage the effects of radiation or chemotherapy in cancer patients: Xclair® Cream, Numoisyn Liquid and Numoisyn Lozenges. The acquired business provides Cyclacel with the foundation to build a commercial organization focused on cancer that is complementary to Cyclacel's oncology/hematology products in development and is part of Cyclacel's strategy to build a diversified biopharmaceutical business.

Under the terms of the asset purchase agreement, the Company (i) paid approximately \$3.3 million in cash to the sellers at closing, plus approximately \$0.5 million to be used to pay certain creditors of the sellers, and (ii) agreed to issue up to a maximum aggregate of 184,176 shares of the Company's common stock, or the Stock Consideration, as consideration for the asset purchase. 46,044 shares of the Stock Consideration are issuable on the first anniversary of the closing date, and the balance is issuable in two tranches upon achievement of certain operational and financial milestones (in all cases, subject to satisfaction of any outstanding indemnification obligations of the sellers). The Company has already determined that 46,044 shares of the Stock Consideration will not be issued due to the seller's failure to achieve the first of the two milestones. The Company is reviewing certain indemnity issues which may be satisfied pursuant to the terms of the asset purchase agreement. The final 92,088 shares of the Stock Consideration is issuable if the sellers meet certain financial milestones as of December 31, 2008. The Company is also committed, as part of securing long term supply arrangements, to make future payments of approximately \$0.6 million in 2009 and \$0.7 million in 2010. The present value of these commitments has been reported as other short term payables and other long term payables on the condensed consolidated balance sheets as of September 30, 2008.

The transaction was accounted for as a business combination and the consolidated results of operations of Cyclacel include the results of operations of ALIGN from October 5, 2007. The assets and certain agreed liabilities of ALIGN have been recorded, as of the closing date, at their estimated fair values.

Acquisition Purchase Price

The purchase price paid to acquire the Sellers' assets was calculated as follows (in thousands):

Cash and equity	\$	3,571
Acquisition costs		432
Total purchase price	\$	4,003

Table of Contents*Acquisition Purchase Price Allocation*

As part of the acquisition, the following net assets were acquired (in thousands):

Current assets	\$	199
Property, plant and equipment		10
Intangible assets		4,495
Current liabilities		(1,409)
Non-current liabilities		(1,122)
Goodwill		1,830
	\$	4,003

Pro Forma Results of Operations

The results of operations of ALIGN are included in Cyclacel's condensed consolidated financial statements from the date of the business combination transaction as of October 5, 2007. The following table presents pro forma results of operations and gives effect to the business combination transaction as if the business combination was consummated at January 1, 2007. The unaudited pro forma results of operations are not necessarily indicative of what would have occurred had the business combination been completed at the beginning of the retrospective periods or of the results that may occur in the future.

	For the Three Months Ended September 30, 2007 (000s)	For the Nine Months Ended September 30, 2007 (000s)
Revenue	218	754
Loss before taxes	(5,463)	(16,620)
Net loss applicable to ordinary shareholders	(5,030)	(15,071)
Net loss per share-basic and diluted	\$ (0.25)	\$ (0.77)
Weighted average shares	20,433,129	19,685,457

Acquisition of Xcyte Therapies Inc.

On March 27, 2006, Xcyte Therapies Inc. ("Xcyte") completed a Stock Purchase Agreement (the "Stock Purchase Agreement") with Cyclacel Group plc ("Group"), a public company organized under the laws of England and Wales in which Xcyte agreed to purchase from Group all of the capital stock of Cyclacel Limited ("Limited"), a private limited company organized under the laws of England and Wales and a wholly-owned subsidiary of Group (the "Stock Purchase"). For more information please see the Company's Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the SEC.

6. STOCKHOLDERS' EQUITY**Preferred stock**

On November 3, 2004, the Company completed a public offering of 2,990,000 shares of its 6% convertible exchangeable preferred stock (the "Preferred Stock") at \$10.00 per share, including the shares sold to the underwriters pursuant to the over-allotment option granted in connection with the offering. Net proceeds from the offering, after deducting underwriting discounts and offering-related expenses, totaled \$27.5 million.

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Dividends on the Preferred Stock are cumulative from the date of original issue at the annual rate of 6% of the liquidation preference of the Preferred Stock, payable quarterly on the first day of February, May, August and November, commencing February 1, 2005. Any dividends must be declared by the Company's board of directors and must come from funds that are legally available for dividend payments. The Preferred Stock has a liquidation preference of \$10 per share, plus accrued and unpaid dividends. In December 2007 as well as April and July 2008 the Company's Board of Directors declared quarterly dividends in the amount of \$0.15 per share of Preferred Stock, which were paid on the first business day in February, May and August 2008, respectively. Each quarterly dividend distribution totaled \$0.3 million and was paid to holders of record as of the close of business on January 18, April 18, and July 8, 2008 respectively. On September 4, 2008 a dividend was declared and subsequently paid on October 31, 2008.

The Preferred Stock is convertible at the option of the holder at any time into the Company's common stock at a conversion rate of approximately 0.42553 shares of common stock for each share of Preferred Stock, based on a conversion price of approximately \$23.50. The Company has reserved 870,980 shares of common stock for issuance upon conversion of the remaining shares of Preferred Stock outstanding as of September 30, 2008. In each of the three month periods ended September 30, 2007 and 2008, no shares of preferred stock were converted into common stock. The Company may automatically convert the Preferred Stock into common stock if the closing price of the Company's common stock has exceeded \$35.30, which is 150% of the conversion price of the Preferred Stock, for at least 20 trading days during any 30-day trading period, ending within five trading days prior to notice of automatic conversion. The Company and the holders elected not to automatically convert some or all of the Preferred Stock into common stock prior to November 3, 2007. If they had done so, the Company would have made an additional payment on the Preferred Stock equal to the aggregate amount of dividends that would have been payable on the Preferred Stock through November 3, 2007, less any dividends already paid on the Preferred Stock. This additional payment would have been payable in cash or, at the Company's option, in shares of the Company's common stock, or a combination of cash and shares of common stock. As of September 30, 2008, the Company issued 81,927 shares of common stock to converting holders in satisfaction of this additional payment. During the three months ended September 30, 2008, no shares of the Company's common stock were issued.

In accordance with FASB 133, *Accounting for Derivative Instruments* (FAS 133), the Company was required to separate and account for, as an embedded derivative, the dividend make-whole payment feature of the Preferred Stock. As an embedded derivative instrument, the dividend make-whole payment feature was measured at fair value and reflected as a liability. Changes in the fair value of the derivative were recognized in the condensed consolidated statement of operations as a component of other income (expense). The derivative liability was reduced to \$0 as of November 2, 2007, the last date of possible conversion. During the three and nine months ended September 30, 2007, the Company recorded a charge of \$19,000 and \$0.1 million, respectively, on the consolidated statement of operations as other expense.

The Company may elect to redeem the Preferred Stock at declining redemption prices on or after November 6, 2007. The Preferred Stock is exchangeable, in whole but not in part, at the option of the Company on any dividend payment date beginning on November 1, 2005 (the Exchange Date) for the Company's 6% Convertible Subordinated Debentures (Debentures) at the rate of \$10 principal amount of Debentures for each share of Preferred Stock. The Debentures, if issued, will mature 25 years after the Exchange Date and have terms substantially similar to those of the Preferred Stock.

In order to conserve cash, the company may elect not to pay the quarterly preference dividend relating to the preference stock in future periods. The dividend would continue to be accrued within the financial statements but would result in annualized cash savings of approximately \$1.2 million. If the Company implemented this course of action then the preference stock holders would have the right to appoint two non executives to the Board after non payment of dividends in two consecutive quarters.

The Preferred Stock has no maturity date and no voting rights prior to conversion into common stock, except under limited circumstances.

Table of Contents***Common Stock and warrants******February 2007 Registered Direct Offering***

On February 16, 2007, the Company raised \$36.0 million in gross proceeds, before deducting placement agent fees and offering expenses of \$2.6 million, in a registered direct offering through the sale of shares of the Company's common stock and warrants. The Company entered into subscription agreements with these investors pursuant to which it sold approximately 4.2 million units, each unit consisting of one share of common stock and a seven-year warrant to purchase 0.25 shares of common stock, at a purchase price of \$8.47125 per unit. The purchase price for the shares and the exercise price for the warrants was \$8.44 per share, the closing bid price for the Company's common stock on February 12, 2007. Investors paid \$0.125 per warrant. The Company issued 4,249,668 shares of common stock and warrants to purchase 1,062,412 shares of common stock.

The warrants issued to the investors are being accounted for as a liability in accordance with Emerging Issues Task Force (EITF) 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* (EITF 00-19). At the date of the transaction, the fair value of the warrants of \$6.8 million was determined utilizing the Black-Scholes option pricing model utilizing the following assumptions: risk free interest rate 4.58%, expected volatility 85%, expected dividend yield 0%, and a remaining contractual life of 6.88 years. The value of the warrant shares is being marked to market each reporting period as a derivative gain or loss on the consolidated statement of operations until exercised or expiration. At September 30, 2008, the fair value of the warrants was \$0.2 million. For the three months ended September 30, 2007 and 2008, the Company recognized the change in the value of warrants of approximately \$1.0 million and \$0.4 million, respectively, as a gain on the consolidated statement of operations. For the nine months ended September 30, 2007 and 2008, the Company recognized the change in the value of warrants of approximately \$2.8 million and \$3.3 million, respectively, as a gain on the consolidated statement of operations. Since the date of the transaction, the Company recognized the change in the value of warrants of approximately \$6.5 million.

December 2007 Committed Equity Financing Facility

On December 10, 2007, Cyclacel entered into a Committed Equity Financing Facility or CEFF, with Kingsbridge Capital Limited or Kingsbridge, a private investment group, in which Kingsbridge committed to purchase the lesser of 4,084,590 shares of common stock or \$60 million of common stock from Cyclacel capital during the next three years. Under the terms of the agreement, Cyclacel will determine the exact timing and amount of any CEFF financings, subject to certain conditions. All amounts drawn down under the CEFF will be settled via the issuance of registered shares of Cyclacel's common stock. Cyclacel may access capital under the CEFF in tranches of either (a) 2% of Cyclacel's market capitalization at the time of the draw down or (b) the lesser of (i) 3% of Cyclacel's market capitalization at the time of the draw down and (ii) an alternative draw down amount based on the product of (A) the average trading volume of the 30-day trading period preceding the draw down excluding the five highest and five lowest trading days during such period, (B) the volume-weighted average trading price (VWAP) on the trading day prior to the notice of draw down, (C) the number of days during the draw down period and (D) 85%, subject to certain conditions. Each tranche will be issued and priced over an eight-day pricing period. Kingsbridge will purchase shares of common stock pursuant to the CEFF at discounts ranging from 6% to 10% depending on the average market price of the common stock during the eight-day pricing period, provided that the minimum acceptable purchase price for any shares to be issued to Kingsbridge during the eight-day period is determined by the higher of \$2.50 or 90% of Cyclacel's common stock closing price the day before the commencement of each draw down. Cyclacel currently is unable to draw down on the CEFF because the Company's common stock is trading below the \$2.50 per share floor price set forth in the CEFF.

In connection with the CEFF, Cyclacel issued a warrant to Kingsbridge to purchase up to 175,000 shares of common stock at an exercise price of \$7.17 per share which represents a 30% premium over the average of the closing bid prices of Cyclacel's common stock during the 5 trading days preceding the signing of the agreement. The warrant will become exercisable six months from the date of the agreement and will remain exercisable, subject to certain exceptions, for a period of five years thereafter. As of September 30, 2008, the warrants issued to the investors have been classified as equity in accordance with EITF 00-19. The transaction date fair value of the warrants of \$0.6 million was determined utilizing the Black-Scholes option pricing model utilizing the following assumptions:

risk free interest rate 3.605%, expected volatility 70%, expected dividend yield 0%, and a remaining contractual life of 5.5 years.

Table of Contents*Common Stock Warrants*

The following table summarizes information about warrants outstanding at September 30, 2008:

Issued in Connection With	Expiration Date	Common Shares Issuable	Weighted Average Exercise Price
Acquisition of Xcyte March 2006	2009	431	15.29
March 2006 stock issuance	2014	2,571,429	7.00
February 2007 stock issuance	2014	1,062,412	8.44
December 2007 CEFF	2012	175,000	7.17
Total		3,809,272	\$ 7.41

Exercise of Stock Options

There were no stock option exercises during the nine months ended September 30, 2008. During the three months ended June 30, 2007, 25,508 shares of the Company's common stock were issued from the exercise of stock options resulting in proceeds of \$0.2 million.

7. INCOME TAXES

The Company accounts for income taxes under the liability method. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

The Company applies FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48) in accounting for uncertainty in income taxes recognized in a company's financial statements. FIN 48 prescribes a minimum probability threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods as well as disclosure and transition.

Credit is taken in the accounting period for research and development tax credits, which will be claimed from H. M. Revenue & Customs, the United Kingdom's taxation and customs authority, in respect of qualifying research and development costs incurred in the same accounting period.

8. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. FAS 159 was effective on January 1, 2008 and the adoption of FAS 159 did not have a material impact on the Company's condensed consolidated financial statements.

In December 2007, FASB ratified the consensus reached by Emerging Issues Task Force on (EITF) Issue 07-1, *Accounting for Collaborative Arrangements* or (EITF 07-1). EITF 07-1 requires collaborators to present the results of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable Generally Accepted Accounting Principles (GAAP) or, in the absence of other applicable GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. Further, EITF 07-1 clarified that the determination of whether transactions within a collaborative arrangement are part of a vendor-customer (or analogous) relationship subject to EITF 01-9,

Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products). EITF 07-1 was effective on January 1, 2008. The adoption of EITF 07-1 did not have a material impact on the Company's consolidated financial statements.

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In November 2007, the FASB issued FAS No. 141 (revised 2007), Business Combination (FAS 141(R)) and FAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS 160). FAS 141(R) will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. FAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. FAS 141(R) and FAS 160 are effective for both public and private companies for fiscal years beginning on or after December 15, 2008 (January 1, 2009 for the Company). FAS 141(R) will be applied prospectively. FAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of FAS 160 will be applied prospectively. Early adoption is prohibited for both standards. The Company believes that the adoption of FAS 141(R) and FAS 160 will not have a material impact on its consolidated financial statements.

In June 2007, FASB ratified the consensus reached by the EITF on EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* or (EITF 07-3). EITF 07-3 addresses the diversity that exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under EITF 07-3, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-3 is effective for the Company beginning on January 1, 2008 and must be adopted on a prospective basis. Given a review of our current contracts and arrangements the adoption of EITF 07-3 did not have a material effect on the Company's consolidated financial statements.

On March 19, 2008, FASB issued FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (FAS 161). FAS 161 requires enhanced financial disclosure about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. FAS 161 achieves these improvements by requiring disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also provides more information about an entity's liquidity by requiring disclosure of derivative features that are credit risk related. Finally, it requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company believes that the adoption of FAS 161 will not have a material impact on its consolidated financial statements.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including, without limitation, Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). We intend the forward-looking statements to be covered by the safe harbor for forward-looking statements in such sections of the Exchange Act. The forward-looking information is based on various factors and was derived using numerous assumptions. All statements, other than statements of historical fact, that address activities, events or developments that we intend, expect, project, believe or anticipate will or may occur in the future are forward-looking statements. Such statements are based upon certain assumptions and assessments made by our management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. These forward-looking statements are usually accompanied by words such as believe, anticipate, plan, seek, expect, intend and similar expressions.

Forward-looking statements necessarily involve risks and uncertainties, and our actual results could differ materially from those anticipated in the forward looking statements due to a number of factors, including those set forth in Part I, Item 1A Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2007, as updated and supplemented by Part II, Item 1A Risk Factors of this Quarterly Report on Form 10-Q, and elsewhere in this report. These factors as well as other cautionary statements made in this Quarterly Report on Form 10-Q, should be read and understood as being applicable to all related forward-looking statements wherever they appear herein. The forward-looking statements contained in this Quarterly Report on Form 10-Q represent our judgment as of the date hereof. We encourage you to read those descriptions carefully. We caution you not to place undue reliance on the forward-looking statements contained in this report. These statements, like all statements in this report, speak only as of the date of this report (unless an earlier date is indicated) and we undertake no obligation to update or revise the statements except as required by law. Such forward-looking statements are not guarantees of future performance and actual results will likely differ, perhaps materially, from those suggested by such forward-looking statements. In this report, Cyclacel, the Company, we, us, and our refer to Cyclacel Pharmaceuticals, Inc.

Overview

We are a development stage biopharmaceutical company dedicated to the discovery, development and commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious disorders. Our strategy is focused on leading edge therapeutic management of cancer patients based on a portfolio of three products marketed by ALIGN Pharmaceuticals, LLC ALIGN, our subsidiary, and a deep development pipeline.

We market directly in the United States Xclair® Cream for radiation dermatitis and Numoisyn™ Liquid and Numoisyn™ Lozenges for xerostomia.

As a result of the recent revised operating plan announced on September 16, 2008, we are focusing its clinical development priorities on:

Sapacitabine in acute myeloid leukemia in the elderly or AML;

Sapacitabine in myelodysplastic syndromes or MDS;

Sapacitabine in cutaneous T-cell lymphoma or CTCL; and

Sapacitabine in solid tumor indications

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Cyclacel may continue to fund certain additional programs pending the availability of clinical data, at which time the Company will determine the feasibility of pursuing advanced development including:

Seliciclib in nasopharyngeal cancer or NPC;

Seliciclib in non small-cell lung cancer or NSCLC; and

CYC116 in patients with solid tumors

We focus primarily on the discovery and development of orally available anticancer agents that target the cell cycle with the aim of slowing the progression or shrinking the size of tumors, and enhancing the quality of life and improving survival rates of cancer patients. We are generating several families of anticancer drugs that act on the cell cycle including nucleoside analogues, cyclin dependent kinase or CDK inhibitors and Aurora kinase/Vascular Endothelial Growth Factor Receptor 2 or AK/VEGFR2 inhibitors. Although a number of pharmaceutical and biotechnology companies are currently attempting to develop nucleoside analogues, CDK inhibitor and AK inhibitor drugs, we believe that our drug candidates are differentiated in that they are orally available and have unique target profiles or mechanisms of action. For example, we believe that our sapacitabine is the only orally available nucleoside analogue presently being tested in Phase 2 trials in AML, seliciclib is the only orally available CDK inhibitor currently in Phase 2 trials and CYC116 is the only dual Aurora A and Aurora B kinase inhibitor in clinical trials that also interacts with VEGFR2 and has anti-angiogenic activity.

Our corporate headquarters is located in Berkeley Heights, New Jersey, with research facilities located in the United Kingdom. From our inception in 1996 through September 30, 2008, we have devoted substantially all our efforts and resources to our research and development activities. We have incurred significant net losses since inception. As of September 30, 2008, our accumulated deficit during the development stage was \$194.8 million. We expect to continue incurring substantial losses for the next several years as we continue to develop our clinical, pre-clinical and other drugs currently in development and build our commercialization capability. Our operating expenses are primarily comprised of research and development expenses and selling, general and administrative costs.

On September 16, 2008, the Company announced a revision of its operating plan to concentrate its resources on the advancement of its lead drug, sapacitabine, while maintaining the Company's core competency in drug discovery and cell cycle biology. The plan reduced the workforce across all locations by 25 people. For the three months ended September 30, 2008, the Company recorded a restructuring charge of \$0.5 million.

As of September 30, 2008, we have not generated significant product revenue but have financed our operations and internal growth through private placements, licensing revenue, interest on investments, government grants and research and development tax credits. Our revenue has consisted of collaboration and grant revenue. Beginning in 2008, our revenue now includes product sales following the ALIGN acquisition.

Acquisition of ALIGN Pharmaceuticals, LLC and ALIGN Holdings, LLC

On October 5, 2007, the Company purchased certain net assets of ALIGN Pharmaceuticals, LLC or ALIGN. As part of the asset purchase, the Company acquired the sellers' exclusive rights to sell and distribute three products in the United States used primarily to manage the effects of radiation or chemotherapy in cancer patients: Xclair[®] Cream, Numoisyn Liquid and Numoisyn Lozenges. The acquired business provides Cyclacel with the foundation to build a commercial organization focused on cancer that is complementary to Cyclacel's oncology/hematology products in development and is part of Cyclacel's strategy to build a diversified biopharmaceutical business.

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Under the terms of the asset purchase agreement, the Company (i) paid approximately \$3.3 million in cash to the sellers at closing, plus approximately \$0.5 million to be used to pay certain creditors of the sellers, and (ii) agreed to issue up to a maximum aggregate of 184,176 shares of the Company's common stock, or the Stock Consideration, as consideration for the asset purchase. 46,044 shares of the Stock Consideration are issuable on the first anniversary of the closing date, and the balance is issuable in two tranches upon achievement of certain operational and financial milestones (in all cases, subject to satisfaction of any outstanding indemnification obligations of the sellers). The Company has already determined that 46,044 shares of the Stock Consideration will not be issued due to the seller's failure to achieve the first of the two milestones. The Company is reviewing certain indemnity issues which may be satisfied pursuant to the terms of the asset purchase agreement. The final 92,088 shares of the Stock Consideration is issuable if the sellers meet certain financial milestones as of December 31, 2008. The Company is also committed, as part of securing long term supply arrangements, to make future payments of approximately \$0.6 million in 2009 and \$0.7 million in 2010. The present value of these commitments has been reported as other short term payables and other long term payables on the condensed consolidated balance