Cyclacel Pharmaceuticals, Inc.
Form 424B3
November 16, 2012

PROSPECTUS SUPPLEMENT NO. 4
(TO PROSPECTUS DATED APRIL 26, 2012)

Filed pursuant to Rule 424(b)(3)
under the Securities Act of 1933
in connection with Registration
Statement No. 333-140034

453,166 Shares of Common Stock

of

CYCLACEL PHARMACEUTICALS, INC.

Issuable Upon Exercise of Outstanding Warrants
Issued in Registered Direct Offerings

This Prospectus Supplement No. 4 supplements and amends the prospectus dated April 26, 2012 (the **Prospectus**), as supplemented by the Prospectus Supplement No. 1 dated May 16, 2012, Prospectus Supplement No. 2 dated August 14, 2012, and Prospectus Supplement No. 3 dated August 24, 2012, relating to the registration of 453,166 shares of common stock, par value $0.001 per share, of Cyclacel Pharmaceuticals, Inc. (**we** , **us**, **our company**, or **the Company**), which we may issue upon exercise of warrants to purchase common stock we issued as part of registered direct offerings, as follows: (i) warrants to purchase up to 151,773 shares of common stock at an exercise price of $59.08 per share we issued on February 16, 2007, such warrants expiring on February 16, 2014. We refer to these warrants as the February 2007 Warrants; (ii) warrants to purchase up to 98,893 shares of common stock at an exercise price of $7.00 per share we issued on July 29, 2009, such warrants expiring on July 29, 2014. We refer to these warrants as July 2009 Warrants; (iii) warrants to purchase up to 101,785 shares of common stock at an exercise price of $22.82 per share we issued on January 13, 2010, such warrants expiring on January 13, 2015. We refer to these warrants as the January 13, 2010 Warrants; and (iv) warrants to purchase up to 100,714 shares of common stock at an exercise price of $19.95 per share we issued on January 25, 2010, such warrants expiring on January 25, 2015. We refer to these warrants as the January 25, 2010 Warrants, and collectively with the February 2007 Warrants, July 2009 Warrants and the January 13, 2010 Warrants, the **outstanding registered direct warrants** .

To the extent any holder of our outstanding registered direct warrants determines to exercise its warrants, we will receive the payment of the exercise price in connection with such exercise. We will not receive any proceeds from the sale of the common stock issuable upon exercise of the outstanding registered direct warrants by the holders of the outstanding registered direct warrants.

This prospectus supplement should be read in conjunction with the Prospectus, including any supplements or amendments to it. This prospectus supplement is not complete without, and may not be delivered or utilized except in connection with, the Prospectus, including any supplements or amendments to it. The share amounts and prices included herein give effect to the 1-for-7 reverse stock split of our common stock which became effective on August 24, 2012.

On November 16, 2012, we filed our Quarterly Report on Form 10-Q for the quarter ended September 30, 2012. That Quarterly Report on Form 10-Q, without exhibits, is attached hereto.

Investing in our common stock involves risks. See Risk Factors beginning on page 19 of the Prospectus, as well as the section entitled Risk Factors included in our recent quarterly and annual reports filed with the Securities and Exchange Commission.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the Prospectus to which it relates are truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is November 16, 2012.

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

OR

o 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	**91-1707622**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
200 Connell Drive, Suite 1500	
Berkeley Heights, New Jersey	**07922**
(Address of principal executive offices)	(Zip Code)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

As of November 14, 2012 there were 8,434,811 shares of the registrant s common stock outstanding.

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.

INDEX

Table of Contents

EXPLANATORY NOTE

In filing this Quarterly Report on Form 10-Q for the period ended September 30, 2012 (this Report), Cyclacel Pharmaceuticals, Inc. (the Company) has relied upon the order of the Securities and Exchange Commission, dated November 14, 2012, providing regulatory relief to publicly traded companies affected by Hurricane Sandy. The Company s headquarters is located in New Jersey, where it lacked power, telephone and internet service as a result of Hurricane Sandy. As a result, management required additional time to prepare, substantiate and verify the accuracy of certain disclosures in this Report, which could not be completed without incurring undue hardship and expense

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEETS

(In $000s, except share amounts)

	December 31, 2011	September 30, 2012 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 24,449	$ 17,837
Prepaid expenses and other current assets	1,069	1,235
Current assets of discontinued operations	313	881
Total current assets	25,831	19,953
Property, plant and equipment (net)	167	140
Long-term assets of discontinued operations		433
Total assets	$ 25,998	$ 20,526
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,717	$ 1,642
Accrued liabilities and other current liabilities	4,183	4,127
Economic rights		1,070
Other liabilities measured at fair value	71	20
Current liabilities of discontinued operations	527	438
Total current liabilities	6,498	7,297
Total liabilities	6,498	7,297
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized at December 31, 2011 and September 30, 2012; 1,213,142 shares issued and outstanding at December 31, 2011 and September 30, 2012. Aggregate preference in liquidation of $13,708,505 and $14,254,419 at December 31, 2011 and September 30, 2012, respectively	1	1
Common stock, $0.001 par value; 100,000,000 shares authorized at December 31, 2011 and September 30, 2012; 7,745,779 and 8,434,292 shares issued and outstanding at December 31, 2011 and September 30, 2012, respectively	8	8
Additional paid-in capital	276,498	278,655
Accumulated other comprehensive loss	57	51
Deficit accumulated during the development stage	(257,064)	(265,486)
Total stockholders equity	19,500	13,229
Total liabilities and stockholders equity	$ 25,998	$ 20,526

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

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In $000s, except share and per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		Period from August 13, 1996 (inception) to September 30,
	2011	2012	2011	2012	2012
Revenues:					
Collaboration and research and development revenue	$	$	$	$	$ 3,100
Grant revenue		38		64	3,712
Total revenues		38		64	6,812
Operating expenses:					
Research and development	2,066	1,532	7,005	4,596	190,395
General and administrative	1,814	2,028	5,136	5,917	86,748
Goodwill and intangible impairment					2,747
Restructuring costs					2,634
Total operating expenses	3,880	3,560	12,141	10,513	282,524
Operating loss	(3,880)	(3,522)	(12,141)	(10,449)	(275,712)
Other income (expense):					
Costs associated with aborted 2004 IPO					(3,550)
Payment under guarantee					(1,652)
Change in valuation of Economic Rights		(63)		27	27
Change in valuation of other liabilities measured at fair value	440	1	643	51	6,378
Foreign exchange (losses)/gains	28	6	(59)	237	(4,060)
Interest income	9	5	33	17	13,742
Interest expense					(4,567)
Other income		1		77	77
Total other income (expense)	477	(50)	617	409	6,395
Loss from continuing operations before taxes	(3,403)	(3,572)	(11,524)	(10,040)	(269,317)
Income tax benefit	126	419	443	714	19,158
Net loss from continuing operations	(3,277)	(3,153)	(11,081)	(9,326)	(250,159)
Discontinued operations:					
Income (loss) from discontinued operations, net of tax of $0 for all periods presented	(168)	1,263	(504)	904	(11,812)
Net loss	(3,445)	(1,890)	(11,585)	(8,422)	(261,971)
Dividends on preferred ordinary shares					(38,123)
Deemed dividend on convertible exchangeable preferred shares					(3,515)
Dividend on convertible exchangeable preferred shares	(182)	(182)	(546)	(546)	(4,203)
Net loss applicable to common shareholders	$ (3,627)	$ (2,072)	$ (12,131)	$ (8,968)	$ (307,812)
Net loss per share, continuing operations					
Basic and diluted	$ (0.43)	$ (0.37)	$ (1.58)	$ (1.13)	
	$ (0.02)	$ 0.15	$ (0.07)	$ 0.11	

Net income (loss) per share, discontinued operations Basic and diluted					
Net loss per share	Basic and diluted	$ (0.47)	$ (0.25)	$ (1.73)	$ (1.09)
Weighted average common shares outstanding		**7,673,096**	**8,429,269**	**6,997,391**	**8,227,721**

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

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In $000s, except share and per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		Period from August 13, 1996 (inception) to September 30,
	2011	2012	2011	2012	2012
Comprehensive loss	(3,435)	(1,917)	(11,567)	(8,428)	(261,920)

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

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In $000s)
(Unaudited)

	Nine Months Ended September 30,		Period from August 13, 1996 (inception) to September 30,
	2011	2012	2012
Cash flows from operating activities:			
Net loss	$ (11,585)	$ (8,422)	$ (261,971)
Adjustments to reconcile net loss to net cash used in operating activities:			
Accretion of interest on notes payable, net of amortization of debt premium			100
Amortization of investment premiums, net			(2,297)
Change in valuation of Economic Rights		(27)	(27)
Change in valuation of other liabilities measured at fair value	(643)	(51)	(6,378)
Depreciation and amortization	250	45	12,600
Amortization of intangible assets			886
Fixed asset impairment			221
Unrealized foreign exchange loss	(29)		7,747
Deferred revenue			(98)
Compensation for warrants issued to non-employees			1,215
Shares issued for IP rights			446
(Gain) loss on disposal of property, plant and equipment		(62)	38
Goodwill and intangibles impairment			7,934
Stock based compensation	677	287	19,310
Provision for restructuring			1,779
Amortization of issuance costs of Preferred Ordinary C shares			2,517
Transaction costs on sale of Economic Rights		33	33
Gain on termination of distribution agreement		(1,192)	(1,192)
Changes in operating assets and liabilities:			
Prepaid expenses, inventory and other current assets	450	25	(33)
Accounts payable, accrued liabilities and other current liabilities	162	(220)	(5,533)
Net cash used in operating activities	(10,718)	(9,584)	(222,703)
Investing activities:			
Purchase of ALIGN			(3,763)
Purchase of property, plant and equipment	(6)	(12)	(8,849)
Proceeds from sale of property, plant and equipment		62	225
Purchase of short-term investments			(156,657)
Redemptions of short-term investments, net of maturities			162,729
Net cash provided by (used in) investing activities	(6)	50	(6,315)
Financing activities:			
Payment of capital lease obligations			(3,719)
Proceeds from issuance of ordinary and preferred ordinary shares, net of issuance costs			121,678
Proceeds from issuance of common stock, warrants and economic rights, net of issuance costs	9,258	2,886	94,557
Net proceeds from stock options and warrants exercised	3	48	221

Payment of preferred stock dividend	(364)	(1,898)
Repayment of government loan		(455)

Table of Contents

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

	Nine Months Ended September 30,		Period from August 13, 1996 (inception) to September 30,
	2011	2012	2012
Government loan received			414
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 (used in) provided by financing activities	8,897	2,934	246,393
Effect of exchange rate changes on cash and cash equivalents	7	(12)	462
Net increase (decrease) in cash and cash equivalents	(1,820)	(6,612)	17,837
Cash and cash equivalents at beginning of period	29,495	24,449	
Cash and cash equivalents at end of period	$ 27,675	$ 17,837	$ 17,837
Supplemental disclosure of cash flows information:			
Cash received during the period for:			
Interest	20	10	11,756
Taxes	688	556	18,763
Cash paid during the period for:			
Interest			(1,914)
Schedule of non-cash transactions:			
Acquisitions of equipment purchased through capital leases			3,470
Issuance of common 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 condensed consolidated financial statements.

Table of Contents

CYCLACEL PHARMACEUTICALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

Cyclacel Pharmaceuticals, Inc. (Cyclacel or the Company) is a development-stage biopharmaceutical company dedicated to the development ar commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious diseases. Cyclacel s strategy is to build a diversified biopharmaceutical business focused in hematology and oncology based on a development pipeline of novel drug candidates.

Cyclacel s clinical development priorities are focused on sapacitabine, an orally available, cell cycle modulating nucleoside analogue.

Sapacitabine is being evaluated in the SEAMLESS Phase 3 trial being conducted under a Special Protocol Assessment (SPA) agreement with the US Food and Drug Administration (FDA) for the front-line treatment of acute myeloid leukemia (AML) in the elderly and in Phase 2 studies for AML, myelodysplastic syndromes (MDS), non-small cell lung cancer (NSCLC) and chronic lymphocytic leukemia. Sapacitabine is also being evaluated in a Phase1/2 study in combination with seliciclib, our second clinical candidate.

The Company has ongoing clinical programs with seliciclib in NSCLC and nasopharyngeal cancer (NPC) and once data becomes available and is reviewed, the Company will determine the feasibility of pursuing further development and/or partnering these assets.

In addition, until September 30, 2012 the Company marketed directly in the United States Xclair® Cream for radiation dermatitis and Numoisyn® Liquid and Numoisyn® Lozenges for xerostomia pursuant to a distribution agreement with Sinclair Pharmaceuticals Limited (Sinclair). On August 10, 2012, the Company entered into an agreement with Sinclair to terminate these distribution agreements, effective September 30, 2012. See *Recent Developments* below and *Note 3 Discontinued Operations* for further details.

As a development stage enterprise, substantially all efforts of the Company to date have been devoted to performing research and development, conducting clinical trials, developing and acquiring intellectual property, raising capital and recruiting and training personnel. The Company currently anticipates that its cash and cash equivalents of approximately $17.8 million as of September 30, 2012 are sufficient to meet its anticipated short-term working capital needs and to fund its on-going sapacitabine clinical trials for at least the next twelve months. However, the Company cannot be certain that it will be able to raise sufficient funds to complete the development and commercialize any of its product candidates currently in clinical development, should they succeed.

Basis of Presentation

The condensed consolidated balance sheet as of September 30, 2012, the condensed consolidated statements of operations and comprehensive loss for the three and nine months ended September 30, 2012 and 2011, the condensed consolidated statement of cash flows for the nine months ended September 30, 2012 and 2011 and the condensed consolidated statement of operations, comprehensive loss and cash flows for the period from August 13, 1996 (inception) to September 30, 2012, and all related disclosures contained in the accompanying notes are unaudited. The condensed consolidated balance sheet as of December 31, 2011 is derived from the audited consolidated financial statements included in the 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC). The condensed consolidated financial statements are presented on the basis of accounting principles that are generally accepted in the United States (GAAP) 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

Table of Contents

the opinion of management, all adjustments, which include normal recurring adjustments necessary to present fairly the condensed consolidated balance sheet as of September 30, 2012, and the results of operations, comprehensive loss for the three and nine months ended September 30, 2012 and 2011 and for the period from August 13, 1996 (inception) to September 30, 2012, and the consolidated statements of cash flows for the nine months ended September 30, 2012 and 2011 and for the period from August 13, 1996 (inception) to September 30, 2012, have been made. The interim results for the three months ended September 30, 2012 are not necessarily indicative of the results to be expected for the year ending December 31, 2012 or for any other year. Certain prior period amounts have been reclassified to conform to current period presentation. 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, 2011, included in the Company s Annual Report on Form 10-K filed with the SEC.

Recent Developments

Reverse Stock Split

On August 24, 2012, the Company effected a 1-for-7 reverse stock split of its shares of common stock in order to increase the per share trading price of the Company s shares of common stock to satisfy the $1.00 minimum bid price requirement for continued listing on the NASDAQ Global Market. The Company received notification from NASDAQ that as of September 11, 2012, the Company evidenced a closing bid price of its common stock price in excess of the $1.00 minimum requirement for at least 10 consecutive trading days. Accordingly, the Company has regained compliance with Listing Rule 5450(a)(1). All share and per share information presented in this Form 10-Q gives effect to the reverse stock split.

Termination and Settlement Agreement

On August 10, 2012, the Company entered into an agreement with Sinclair to terminate, effective September 30, 2012, the distribution agreements relating to the promotion and sale of Xclair®, Numoisyn® Lozenges and Numoisyn® Liquid. The termination agreement includes a minimum royalty arrangement based on future net revenues, under which Sinclair will pay the Company a minimum of approximately $1.0 million in quarterly installments over the three years ending on September 30, 2015. The operating results associated with the promotion and sale of Xclair®, Numoisyn® Liquid and Numoisyn® Lozenges are classified within Income (loss) from discontinued operations, net of tax in the consolidated statements of operations for all periods presented, and the associated assets and liabilities are classified within current assets of discontinued operations, long-term assets of discontinued operations, and current liabilities of discontinued operations, as appropriate, in the condensed consolidated balance sheets for all applicable periods presented. See *Note 3 Discontinued Operations* for further details.

Preferred Stock Dividend

On September 12, 2012, the Company s Board of Directors decided not to declare a quarterly cash dividend on the Company s 6% Convertible Exchangeable Preferred Stock (Preferred Stock) with respect to the third quarter of 2012 that would have otherwise been payable on November 1, 2012.

Subsequent Developments

Grant Award

In November 2012, the Company was awarded a grant of approximately $1.9 million from the UK Government s Biomedical Catalyst to complete an Investigational New Drug (IND) directed preclinical development of CYC065, a novel orally available, second generation, CDK inhibitor.

Table of Contents

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 United States GAAP 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. Critical estimates include estimated levels of product returns, and inputs used to determine stock-based compensation expense and the fair value of financial instruments, such as Economic Rights and other liabilities measured at fair value. Cyclacel reviews its estimates on an ongoing basis. The estimates are 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.

Cash and Cash Equivalents

Cash equivalents are stated at cost, which is substantially the same as fair value. The Company considers all highly liquid investments with an original maturity of three months or less at the time of initial purchase to be cash equivalents. The objectives of the Company s cash management policy are to safeguard and preserve funds, to maintain liquidity sufficient to meet Cyclacel s cash flow requirements and to attain a market rate of return. Cash and cash equivalents includes cash, money market funds and commercial paper.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, Economic Rights, and other liabilities measured at fair value. The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their respective fair values due to the nature of the accounts, notably their short maturities. Economic Rights and other liabilities measured at fair value employ applicable inputs as described in *Note 4 - Fair Value Measurements* .

Revenue Recognition

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 or 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. The Company had no such collaboration revenues for the three and nine months ended September 30, 2011 and 2012.

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 previously recognized are refundable if the relevant research effort is not successful. The Company had no such research and development revenue for the three and nine months ended September 30, 2011 and 2012.

Table of Contents

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. All grants earned and received are not refundable. The Company had deferred grant revenue of approximately $10,000, which is included in accrued liabilities and other current liabilities, as of September 30, 2012. The Company had no such deferred revenue at December 31, 2011.

Clinical Trial Accounting

Data management and monitoring of the Company s clinical trials are performed with the assistance of 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 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.

Research and Development Expenditures

Research and development expenses consist primarily of costs associated with developing the Company s product candidates, including upfront fees and milestones paid to parties from whom the Company licenses certain intellectual property, 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 and currency translation

Transactions that are denominated in a foreign currency are remeasured into the functional currency at the current exchange rate on the date of the transaction. Any foreign currency-denominated monetary assets and liabilities are subsequently remeasured at current exchange rates, with gains or losses recognized as foreign exchange (losses)/gains in the statement of operations.

The assets and liabilities of the Company s international subsidiary are translated from its functional currency into United States dollars at exchange rates prevailing at the balance sheet date. Average rates of exchange during the period are used to translate the statement of operations, while historical rates of exchange are used to translate any equity transactions.

Translation adjustments arising on consolidation due to differences between average rates and balance sheet rates, as well as unrealized foreign exchange gains or losses arising from remeasurement of foreign-currency denominated intercompany loans that are of a long-term-investment nature, are recorded in other comprehensive income.

Fair Value Measurements

Inputs used to determine fair value of financial and non-financial assets and liabilities are categorized using a fair value hierarchy that prioritizes observable and unobservable inputs into three broad levels, from Level 1, for quoted prices (unadjusted) in active markets for identical assets or liabilities, to Level 3, for unobservable inputs (see *Note 4 - Fair Value Measurements*). Management reviews the categorization of fair value inputs on a periodic basis and may determine that it is necessary to transfer an input from one level of the fair value hierarchy to another based on changes in events or circumstances, such as a change in the observability of an input. Any such transfer will be recognized at the end of the reporting period.

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

Table of Contents

affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. The Company s management has established a full valuation allowance against its deferred tax assets based on the determination that it is not more likely than not that the Company will recognize the benefits of those assets.

The Company applies the guidance codified in ASC 740, *Income taxes* (ASC 740) related to accounting for uncertainty in income taxes. ASC 740 specifies the accounting for uncertainty in income taxes recognized in a company s financial statements by prescribing a minimum probability threshold a tax position is required to meet before being recognized in the financial statements.

The Company records income tax benefits related to research and development tax credits, which will be claimed from H. M. Revenue & Customs, the United Kingdom s taxation and customs authority, with respect to qualifying research and development costs incurred in the same accounting period.

Stock-based Compensation

The Company grants stock options, restricted stock units and restricted stock to officers, employees and directors under the Amended and Restated Equity Incentive Plan (2006 Plan), which was approved on March 16, 2006, as amended on May 21, 2007, and subsequently amended and restated on April 14, 2008. The Company has granted various types of awards under the 2006 Plan, which is described more fully in *Note 7 - Stock-Based Compensation Arrangements*. The Company accounts for these awards under ASC 718, *Compensation Stock Compensation* (ASC 718).

ASC 718 requires measurement of compensation cost for all stock-based awards at fair value on the date of grant and recognition of compensation over the requisite service period for awards expected to vest. The fair value of restricted stock and restricted stock units is determined based on the number of awards granted and the quoted price of the Company s common stock on the date of grant. The determination of grant-date fair value for stock option awards is estimated using the Black-Scholes model, which includes variables such as the expected volatility of the Company s share price, the anticipated exercise behavior of its employees, interest rates, and dividend yields. These variables are projected based on the Company s historical data, experience, and other factors. Changes in any of these variables could result in material adjustments to the expense recognized for share-based payments. Such value is recognized as expense over the requisite service period, net of estimated forfeitures, using the straight-line attribution method. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from current estimates, such amounts are recorded as a cumulative adjustment in the period estimates are revised. The Company considers many factors when estimating expected forfeitures, including type of awards granted employee class, and historical experience. Actual results and future estimates may differ substantially from current estimates.

Segments

The Company has determined its reportable segments in accordance with ASC 280, *Segment Reporting* (ASC 280) and related disclosures about products, services, geographic areas and major customers. After considering its business activities and geographic reach, the Company has concluded that it operates in just one operating segment being the discovery, development and commercialization of novel, mechanism-targeted drugs to treat cancer and other serious disorders, with development operations in two geographic areas, namely the United States and the United Kingdom.

13

Table of Contents

Net Loss per Common Share

The Company calculates net loss per common share in accordance with ASC Topic 260, *Earnings Per Share* (ASC 260). Basic and diluted net loss per common share was determined by dividing net loss applicable to common stockholders by the weighted average number of common shares outstanding during the period. All share and per share information presented gives effect to the reverse stock split, which occurred on August 24, 2012. The Company s potentially dilutive shares, which include outstanding common stock options, restricted stock, restricted stock units, convertible preferred stock, and common stock warrants, have not been included in the computation of diluted net loss per share for all periods as the result would be anti-dilutive.

	September 30, 2011	**September 30, 2012**
Stock options	447,025	480,415
Unvested restricted stock and restricted stock units	9,671	40,121
Convertible preferred stock	73,747	73,747
Contingently issuable common stock and common stock warrants associated with Economic Rights		435,187
Common stock warrants	834,800	1,973,431
Total shares excluded from calculation	1,365,243	3,002,901

Comprehensive Income (Loss)

In accordance with ASC 220, *Comprehensive Income* (ASC 220) all components of comprehensive income (loss), including net income (loss), are reported in the financial statements in the period in which they are recognized. ASC 220 defines comprehensive income (loss) 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, are reported, net of any related tax effect, to arrive at comprehensive income (loss). No taxes were recognized in relation to items of other comprehensive income.

Table of Contents

3. DISCONTINUED OPERATIONS

On August 10, 2012, the Company entered into an agreement with Sinclair to terminate, effective September 30, 2012, the distribution agreements relating to the promotion and sale of Xclair®, Numoisyn® Lozenges and Numoisyn® Liquid.

Product revenue, cost of goods sold and selling, general and administrative costs related to the promotion and sales of the of Xclair®, Numoisyn® Liquid and Numoisyn® Lozenges have been reclassified from operating results from continuing operations to income (loss) from discontinued operations in the consolidated statement of operations for all periods presented as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,		Period from August 13, 1996 (inception) to September 30, 2012
	2011 (Unaudited)	2012 (Unaudited)	2011 (Unaudited)	2012 (Unaudited)	(Unaudited)
Product revenue	$ 164	$ 302	$ 524	$ 583	$ 3,604
Cost of goods sold	(95)	(110)	(273)	(293)	(2,045)
Selling, general and administrative	(237)	(121)	(755)	(578)	(9,266)
Goodwill and intangible impairment					(5,187)
Interest expense					(110)
Gain on termination of distribution agreements		1,192		1,192	1,192
Income (loss) from discontinued operations, net of tax of $0 for all periods presented	(168)	1,263	(504)	904	(11,812)

The approximately $0.9 million present value of the estimated $1.0 million of minimum royalty payments the Company will receive over the next three years ending September 30, 2015 arising from the termination and settlement agreement and the recognition of approximately $0.3 million associated with a $0.3 million product returns provision liability for which an offsetting asset has been recorded based on our rights under the termination and settlement agreement result in a $1.2 million gain on termination of the distribution agreements for the three and nine months ended September 30, 2012.

The assets and liabilities associated with product promotion and sale have been classified within assets and liabilities of discontinued operations in the accompanying consolidated balance sheets:

	December 31, 2011 (Unaudited)	September 30, 2012 (Unaudited)
Current assets of discontinued operations:		
Inventory	$ 182	$
Short term portion of minimum royalty arrangement receivable, net		423
Returns indemnification receivable		336
Accounts receivable	131	122
Total current assets of discontinued operations	313	881

Long-term assets of discontinued operations:	
Long-term portion of minimum royalty arrangement receivable, net	433

Table of Contents

	December 31, 2011 (Unaudited)	September 30, 2012 (Unaudited)
Total assets of discontinued operations	313	1,314
Current liabilities of discontinued operations:		
Accounts payable	$ 46	$
Returns provision	202	336
Accrued liabilities and other current liabilities	279	102
Total current liabilities of discontinued operations	$ 527	$ 438

4. FAIR VALUE MEASUREMENTS

As defined in ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), 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, ASC 820 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.

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.

The fair value of the Company s financial assets and liabilities that are measured on a recurring basis were determined using the following inputs as of December 31, 2011:

	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
ASSETS				
Cash equivalents	19,894			19,894
Total assets	19,894			19,894
LIABILITIES				

Other liabilities measured at fair value:		
Warrants liability	51	51
Scottish Enterprise agreement	20	20
Other liabilities measured at fair value	71	71
Total liabilities	71	71

Table of Contents

The fair value of the Company s financial assets and liabilities that are measured on a recurring basis were determined using the following inputs as of September 30, 2012:

	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
ASSETS				
Cash equivalents		14,592		
Total assets		14,592		
LIABILITIES				
Economic rights			1,070	1,070
Other liabilities measured at fair value:				
Warrants liability				
Scottish Enterprise agreement			20	20
Other liabilities measured at fair value			20	20
Total liabilities			1,090	1,090

The following table reconciles the beginning and ending balances of Level 3 inputs for the nine months ended September 30, 2012:

	Level 3 $000
Balance as of December 31, 2011	71
Sale of Economic Rights	1,097
Change in valuation of Economic Rights	(27)
Change in valuation of warrants liability	(51)
Balance as of September 30, 2012	1,090

Economic Rights

On March 22, 2012, the Company entered into a financing agreement with certain existing institutional stockholders. Under the terms of the agreement, investors received contractual rights to receive cash equal to 10% of any future litigation settlement related to the specified intellectual property, subject to a cap. In certain defined situations, the Company may have to issue either additional common shares or warrants (Collectively, the Economic Rights).

The Economic Rights are accounted for as a derivative financial instrument under ASC 815, *Derivative financial instruments* (ASC 815), and are measured at fair value. Changes in fair value are recognized in earnings. The fair value of the Economic Rights has been estimated using a decision-tree analysis method. This is an income-based method that incorporates the expected benefits, costs and probabilities of contingent outcomes under varying scenarios. Each scenario within the decision-tree is discounted to the present value using the company s credit adjusted risk-free rate and ascribed a weighted probability to determine the fair value.

Table of Contents

The Company has concluded the fair value of this liability was approximately $1.1 million as of September 30, 2012, respectively. The fair value of the Economic Rights increased approximately $63,000 million and decreased $27,000 for the three months and nine months ended September 30, 2012, respectively. Decreases and increases in the valuation of Economic Rights are recognized in the consolidated statement of operations as gains and losses, respectively.

The most significant inputs in estimating the fair value of this liability are:

(i) The Company s credit adjusted risk-free rate, which has been derived from the observable returns on debt for more developed pharmaceuticals companies, adjusted for the Company s risk profile.

(ii) The amount of the return to the investors, which will vary depending on:

a. The outcome of the litigation, including consideration of whether the litigation may be resolved in a jury trial or settled out of court;

b. The amount of the settlement or award, which the Company has estimated predominantly based on observable royalty rates arising from the settlement of other cases of intellectual property litigation; and

c. The form of the settlement or award.

(iii) The projected timing of the cash flows to the investors, which could vary between several months to several years depending upon whether the litigation is settled, when the court may decide the case, whether any appeal is made on any court decision and the form of any settlement or award.

(iv) The number of contingent warrants that could be issued, which is based on a formula.

The decision-tree analysis model used to calculate the fair value of the derivative requires the probability of alternative scenarios to be determined at a series of decision points. Each scenario may contain more than one decision point resulting in further scenarios. Therefore, the probability estimates made by management at each decision point are a significant input to the valuation model.

All of these inputs are unobservable inputs, which have an interrelated effect on the fair value of the derivative. It is not possible to evaluate the impact on the fair value of each factor in combination. However, generally the fair value of the derivative liability will increase, (i) the higher the value of the expected settlement or award, (ii) the lower the discount rate employed and (iii) the more likely it is that a settlement or award will be made. The fair value of the derivative liability will decrease if the timing of settlement is delayed, the expected settlement decreases, or anticipated litigation costs increase. The impact on the fair value of the derivative liability related to the probability of whether the litigation is settled prior to the court hearing or whether a settlement award is made by the court and the form of the settlement will depend on the other

factors above and cannot be estimated in isolation.

The decision-tree analysis model has been performed by valuation specialists, based on inputs provided by the Company and other sources. At each reporting period, the inputs to the model will be evaluated to determine whether any adjustments are appropriate, and to reflect changes in the time value of the expected cash flows.

Table of Contents

The Company used the following assumptions to calculate the value of the Economic Rights:

	March 22, 2012	September 30, 2012
Probability of unsuccessful/successful outcomes	25% - 75%	25% - 75%
Amount of award or settlement (1)	$10.0 million - $20.0 million	$10.0 million - $20.0 million
Discount rate	16%	16%
Timing of cash flows	0.75 2.27 years	0.25 1.77 years
Royalty rate	6%	6%
Litigation expenses	$1.0 million $3.0 million	$1.0 million $3.0 million

(1) Assumptions take into consideration the cap on the amount that the Company would have to pay investors in the event of an award or settlement.

Other Liabilities Measured at Fair Value

Warrants Liability

The Company issued warrants to purchase shares of common stock under the registered direct financing completed in February 2007. These warrants are being accounted for as a liability in accordance with ASC 815. 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 4.68%, expected volatility 85%, expected dividend yield 0%, and a remaining contractual life of 7 years. As of September 30, 2012, the fair value of the warrants is nil based on the high exercise price of the warrants relative to the Company s stock price at September 30, 2012 and the term of 1.38 years. The fair value of the warrant is remeasured each reporting period, with a gain or loss recognized in the consolidated statement of operations. Such gains or losses will continue to be reported until the warrants are exercised or expired. The Company used the Black-Scholes option-pricing model to value the warrants.

The Company recognized the change in the value of warrants as a gain on the consolidated statement of operations of $0.4 million and approximately $1,000 for the three months ended September 30, 2011 and 2012, respectively. The Company recognized a gain of $0.6 million and approximately $51,000 for the nine months ended September 30, 2011 and 2012, respectively.

Scottish Enterprise Agreement

On June 22, 2009, the Company amended the Agreement with Scottish Enterprise (SE) (the Amendment), in order to allow the Company to implement a reduction of the Company s research operations located in Scotland in exchange for the parties agreement to modify the payment terms of the Agreement in the principal amount of £5 million (approximately $8.0 million at December 31, 2009), which SE had previously entered into with the Company. The Agreement provided for repayment of up to £5 million in the event the Company significantly reduced its Scottish research operations. Pursuant to the terms of the Amendment, in association with Cyclacel s material reduction in staff at its Scottish

research facility, the parties agreed to a modified payment of £1 million (approximately $1.7 million at June 22, 2009) payable in two equal tranches. On July 1, 2009, the first installment of £0.5 million (approximately $0.8 million) was paid and the remaining amount of £0.5 million (approximately $0.8 million) was paid on January 6, 2010. In addition, should a further reduction below current minimum staff levels be effectuated before July 2014 without SE s prior consent, the Company may be obligated to pay up to £4 million to SE, which will be calculated as a maximum of £4 million (approximately $6.2 million at December 31, 2011 and $6.5 million at September 30, 2012) less the market value of the shares held by SE at the time staffing levels in Scotland fall below the prescribed minimum levels. If the Company were to have reduced staffing levels below the prescribed levels, the amount potentially payable to SE would have been approximately

Table of Contents

£3.8 million (approximately $5.9 million) and approximately £3.8 million (approximately $6.2 million) at December 31, 2011 and September 30, 2012, respectively.

This arrangement is accounted for as a liability under ASC Topic 480, *Distinguishing Liabilities from Equity* (ASC 480), and is measured at fair value. Changes in fair value are recognized in earnings. Due to the nature of the associated contingency and the likelihood of occurrence, the Company has concluded the fair value of this liability was approximately $20,000 at December 31, 2011 and September 30, 2012, respectively. The most significant inputs in estimating the fair value of this liability are the probabilities that staffing levels fall below the prescribed minimum and that the Company is unable or unwilling to replace such employees within the prescribed time period. At both December 31, 2011 and September 30, 2012, the Company used a scenario analysis model to arrive at the fair value of the Scottish Enterprise Agreement and assumed a 30% probability of falling below a minimum staffing level and a 1% probability that the occurrence of such an event would not be cured within the prescribed time period. At each reporting period, the inputs used to determine the fair value of the liability will be evaluated to determine whether adjustments are appropriate. Changes in the value of this liability are recorded in the consolidated statement of operations.

5. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following:

	December 31, 2011	September 30, 2012
	($000s)	
Research and development tax credit receivable	541	732
Prepayments	317	318
Other current assets	211	185
Total prepaid expenses and other current assets	1,069	1,235

6. ACCRUED LIABILITIES AND OTHER CURRENT LIABILITIES

Accrued and other current liabilities consisted of the following:

	December 31, 2011	September 30, 2012
	($000s)	
Accrued research and development.	3,621	3,335
Other current liabilities	562	792
	4,183	4,127

During the nine months ended September 30, 2012, the Company recorded out of period reversals of pre-clinical expense accruals of $0.4 million as a decrease to accrued liabilities and other current liabilities on the consolidated balance sheets and as a decrease to research and development expenses on the consolidated statements of operations.

7. STOCK BASED COMPENSATION

All share and per share information presented gives effect to the reverse stock split, which occurred on August 24, 2012.

Stock based compensation has been in the consolidated statement of operations for the three and six months ended September 30, 2011 and 2012 as shown in the following table:

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2012	2011	2012
	($000s)			
Research and development	39	16	130	49
General and administrative	171	59	515	202
Income (loss) from discontinued operations, net of tax	11	1	32	36
Stock-based compensation costs before income taxes	221	76	677	287

Table of Contents

At the Company s annual shareholder meeting on May 23, 2012, the stockholders approved and amended the number of shares reserved under the 2006 Plan to 10,000,000 shares of the Company s common stock, up from 5,200,000 shares. Stock option awards granted under the 2006 Plan have a maximum life of 10 years and generally vest over a four-year period from the date of grant.

A summary of activity for the options under the Company s 2006 Plan for the nine months ended September 30, 2012 is as follows:

	Options		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value ($000s)
Options outstanding at December 31, 2011	502,253	$	26.11	6.44	140
Granted	33,571	$	3.29		
Exercised	(15,438)	$	3.06		
Expired					
Cancelled / forfeited	(39,970)	$	20.03		
Options outstanding at September 30, 2012	480,415	$	25.76	5.84	212
Unvested at September 30, 2012	77,607	$	9.00	8.67	36
Vested and exercisable at September 30, 2012	402,808	$	28.99	5.30	176

ASC 718 requires compensation expense associated with share-based awards to be recognized over the requisite service period, which for the Company is the period between the grant date and the date the award vests or becomes exercisable. Most of the awards granted by the Company (and still outstanding), vest ratably over four years, with 1/4 of the award vesting one year from the date of grant and 1/48 of the award vesting each month thereafter. However, certain awards made to executive officers vest over three to five years, depending on the terms of their employment with the Company. In addition, recent awards made to rank-in-file employees vest ratably over three to four years, with 1/36 to 1/48 of the award vesting each month.

Table of Contents

The Company estimates the grant date fair value of stock option awards using 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, 2011 and 2012:

	For the nine months ended September 30,	
	2011	**2012**
Expected term	5 6 yrs.	6 yrs.
Risk free interest rate	1.47 2.29%	0.95%
Expected volatility	93 99%	98%
Expected dividend yield over expected term		
Resulting weighted average grant fair value	$8.05	$2.52

There were 28,500 and 33,571 options granted during the nine months ended September 30, 2011 and 2012, respectively. For grants made during the nine months ended September 30, 2011 and 2012, the expected term assumption was estimated using past history of early exercise behavior and estimated expectations of future exercise behavior. Starting with the December 2010 annual grants to the Company s employees, the Company began to rely exclusively on its historical volatility as an input to the option pricing model as the Company s management believes that this rate will be representative of future volatility over the expected term of the options. Prior to December 2010, because the Company had been publicly traded for a limited period, the expected volatility assumption was based on the historical volatility of peer companies over the expected term of the option awards.

ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. This analysis is evaluated quarterly and the forfeiture rate adjusted as necessary. Ultimately, the actual expense recognized over the requisite service period is based on only those shares that vest.

Estimates of pre-vesting option forfeitures are based on the Company s experience. For outstanding options, the Company uses a forfeiture rate of 0 30% depending on when and to whom the options are granted. The Company adjusts its estimate of forfeitures over the requisite service period based on the extent to which actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures are recognized through a cumulative adjustment in the period of change and may impact the amount of compensation expense to be recognized in future periods.

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, Cyclacel uses the weighted average of the two Federal Reserve securities closest to the expected term of the employee option.

During the nine months ended September 30, 2011, 948 stock options were exercised resulting in approximately $3,000 of cash proceeds to the Company. During the nine months ended September 30, 2012, there were 15,438 stock options exercised totaling approximately $48,000 in proceeds. As the Company presently has tax loss carry forwards from prior periods and expects to incur tax losses during the year ended December 31, 2012, the Company is not able to benefit from the deduction for exercised stock options in the current reporting period.

Restricted Stock

In November 2008, the Company issued 7,143 shares of restricted common stock to an employee subject to certain forfeiture provisions. Specifically, one quarter of the award vests one year from the date of grant and 1/48 of the award effectively vests each month thereafter. This restricted stock grant was

Table of Contents

accounted for at fair value at the date of grant and an expense is recognized during the vesting term. Summarized information for the restricted stock grant for the nine months ended September 30, 2012 is as follows:

	Restricted Stock		Weighted Average Grant Date Value Per Share
Non-vested at December 31, 2011	1,632	$	3.08
Vested	(1,341)	$	3.08
Non-vested at September 30, 2012	291	$	3.08

Restricted Stock Units

In November 2008 and December 2011, respectively, the Company issued 13,100 and 34,000 restricted stock units to senior executives. Each unit entitles the holder to receive a share of the Company s common stock.

During the first quarter of 2012, the Company issued approximately 12,281 restricted stock units to employees as part of its annual grant.

The 2008 grants vest over four years and the 2011 and 2012 grants vest over three years. A restricted stock unit grant is accounted for at fair value at the date of grant which is equivalent to the market price of a share of the Company s common stock, and an expense is recognized over the vesting term. Summarized information for restricted stock grants for the nine months ended September 30, 2012 is as follows:

	Restricted Stock Units		Weighted Average Grant Date Value Per Share
Non-vested at December 31, 2011	36,463	$	5.60
Granted	12,281	$	3.85
Forfeited	(6,904)	$	4.99
Vested	(2,010)	$	3.08
Non-vested at September 30, 2012	39,830	$	5.32

8. COMMITMENTS AND CONTINGENCIES

Licensing Agreements

The Company has entered into licensing agreements with academic and research organizations. Under the terms of these agreements, the Company has received licenses to technology and patent applications. The Company is required to pay royalties on future sales of product employing the technology or falling under claims of patent applications.

Pursuant to the Daiichi Sankyo license under which the Company licenses certain patent rights for sapacitabine, its lead drug candidate, the Company is under an obligation to use reasonable endeavors to develop a product and obtain regulatory approval to sell a product and has agreed to pay Daiichi Sankyo an up-front fee, reimbursement for Daiichi Sankyo s enumerated expenses, milestone payments and royalties on a country-by-country basis. The up-front fee and certain past reimbursements have been paid and, as a result of the SEAMLESS trial entering Phase 3 during the first quarter of 2011, a milestone payment of $1.6 million was paid in April 2011. A further $10.0 million in aggregate milestone payments could be payable subject to achievement of all the specific contractual milestones and the Company s decision to continue with these projects. Royalties are payable in each country for the term of patent protection in the country or for ten years following the first commercial sale of licensed products in the country, whichever is later.

Table of Contents

Royalties are payable on net sales. Net sales are defined as the gross amount invoiced by the Company or its affiliates or licensees, less discounts, credits, taxes, shipping and bad debt losses. The agreement extends from its commencement date to the date on which no further amounts are owed under it. If the Company wishes to appoint a third party to develop or commercialize a sapacitabine-based product in Japan, within certain limitations, Daiichi Sankyo must be notified and given a right of first refusal to develop and/or commercialize in Japan. In general, the license may be terminated by the Company for technical, scientific, efficacy, safety, or commercial reasons on six months notice, or upon twelve months notice after a launch of a sapacitabine-based product. The license also may be terminated by either party for material default. Effective July 11, 2011, the license agreement was amended to irrevocably waive a termination right Daiichi Sankyo possessed under a provision of the agreement that required the Company to obtain regulatory approval to sell sapacitabine in at least one country by September 2011, and releases the Company from all claims and liability of any kind arising under such provision. The amendment further provides that the royalty rate due from the Company to Daiichi Sankyo on future net sales of sapacitabine be increased between 1.25% and 1.50% depending on the level of net sales of sapacitabine realized.

Legal proceedings

On April 27, 2010, the Company was served with a complaint filed by Celgene Corporation in the United States District Court for the District of Delaware seeking a declaratory judgment that four of the Company s own patents (claiming the use of romidepsin injection in T-cell lymphomas) are invalid and not infringed by Celgene s products, but directly involve the use and administration of Celgene s ISTODAX® (romidepsin for injection) product. On June 17, 2010, the Company filed its answer and counterclaims to the declaratory judgment complaint. The Company has filed counterclaims charging Celgene with infringement of each of its four patents for Celgene s sale of ISTODAX® to CTCL, and, more recently, peripheral T-cell lymphoma (PTCL) and seeking damages for Celgene s infringement as well as injunctive relief.A Scheduling Order was entered February 2, 2012, at which time the court set significant dates, the remaining of which are the following: March 14, 2013 (claim construction hearing); August 14, 2013 (summary judgment briefing); and June 2, 2014 (7 day jury trial start date). Discovery is currently ongoing.

9. STOCKHOLDERS EQUITY

All share and per share information presented gives effect to the reverse stock split, which occurred on August 24, 2012.

Preferred stock

As of September 30, 2012, there were 1,213,142 shares of Preferred Stock issued and outstanding at an issue price of $10.00 per share. Dividends on the Preferred Stock are cumulative from the date of original issuance 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.

The Preferred Stock is convertible at the option of the holder at any time into the Company s shares of common stock at a conversion rate of approximately 0.06079 shares of common stock for each share of Preferred Stock based on a price of $164.50. The Company has reserved 73,747 shares of common stock for issuance upon conversion of the remaining shares of Preferred Stock outstanding at September 30, 2012.

During 2010, 833,671 shares of Preferred Stock were converted into 236,514 shares of the Company s common stock. Since inception through September 30, 2012, holders have voluntarily converted 1,776,858 shares of Preferred Stock into common stock. The converted shares of Preferred Stock have been retired and canceled and shall upon cancellation be restored to the status of authorized but unissued shares of preferred stock, subject to reissuance by the Board of Directors as shares of Preferred Stock of one or more series.

The Company may automatically convert the Preferred Stock into common stock if the closing price of the Company s common stock has exceeded $246.75, which is 150% of the conversion price of the

Table of Contents

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 Certificate of Designations governing the Preferred Stock provides that if the Company fails to pay dividends on its Preferred Stock for six quarterly periods, holders of Preferred Stock are entitled to nominate and elect two directors to the Company s Board of Directors. This right accrued to the holders of Preferred Stock as of August 2, 2010 and two directors were nominated and elected at the annual meeting held on May 24, 2011.

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

From November 6, 2007, the Company may, at its option, redeem the Preferred Stock in whole or in part, out of funds legally available at the redemption prices per share stated below, plus an amount equal to accrued and unpaid dividends up to the date of redemption:

Year from November 1, 2011 to October 31, 2012	$	10.18
Year from November 1, 2012 to October 31, 2013	$	10.12
Year from November 1, 2013 to October 31, 2014	$	10.06
November 1, 2014 and thereafter	$	10.00

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.

On March 6, 2012, June 22, 2012, and September 12, 2012, the Company s Board of Directors decided not to declare a quarterly cash dividend on the Company s 6% Convertible Exchangeable Preferred Stock (Preferred Stock) with respect to the first, second, and third quarters of 2012, respectively, that would have otherwise been payable on May 1, 2012, August 1, 2012 and November 1, 2012, respectively.

Common Stock

March 2012 Sale of Common Stock and Economic Rights

On March 22, 2012, the Company entered into a purchase agreement with certain existing institutional stockholders, raising approximately $2.9 million of proceeds, net of certain fees and expenses. The proceeds from the financing will be used to fund ongoing litigation-related expenses on certain intellectual property and for general corporate purposes.

Under the terms of the purchase agreement, the investors purchased 669,726 shares of the Company s common stock at a price of $4.53, which is equal to the 10-day average closing price of the Company s common stock for the period ending on March 21, 2012. In addition to the common stock, investors received contractual rights to receive cash equal to 10% of any future litigation settlement related to the specified intellectual property, subject to a cap. In certain defined situations, the Company may have to issue either additional shares or warrants. The shares issued at closing are subject to a lock-up period of one year from the date of issuance. See *Note 4 - Fair Value Measurements* for further details.

Table of Contents

Common Stock Warrants

The following table summarizes information about warrants outstanding at September 30, 2012:

Issued in Connection With	Expiration Date	Common Shares Issuable		Weighted Average Exercise Price
April 2006 stock issuance	2013	367,347	$	49.00
February 2007 stock issuance	2014	151,773	$	59.08
December 2007 CEFF	2013	14,286	$	9.80
July 2009 Series II stock issuance	2014	98,894	$	7.00
January 2010 stock issuance	2015	101,786	$	22.82
January 2010 stock issuance	2015	100,714	$	19.95
October 2010 stock issuance	2015	594,514	$	13.44
July 2011 stock issuance	2015	544,118	$	9.52
Total		1,973,432	$	22.96

There were no exercises of warrants during the three and nine months ended September 30, 2011 and 2012.

Table of Contents

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 that the forward-looking statements be covered by the safe harbor for forward-looking statements in 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, entitled Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2011, as updated and supplemented by Part II, Item 1A, entitled Risk Factors, of our Quarterly Reports 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 development and commercialization of small-molecule drugs that target the various phases of the cell cycle for the treatment of cancer and other serious diseases, particularly those of high unmet medical need.

Our core area of expertise is in cell cycle biology and we focus primarily on the 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 have generated 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/VEGFR 2 inhibitors and Plk 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 interact with unique target profiles and mechanisms. For example we believe that our sapacitabine is the only orally-available nucleoside analogue presently being tested in a Phase 3 trial in AML and in Phase 2 for acute myeloid leukemia (AML), myelodysplastic syndromes (MDS) and non-small cell lung cancer (NSCLC) and seliciclib is the most advanced orally-available CDK inhibitor currently in Phase 2 trials. Our resources are primarily directed towards advancing our lead drug candidate sapacitabine through in-house development activities although we are also progressing our earlier stage novel drug series through working with external collaborators but with limited investment by us.

27

Table of Contents

We have worldwide rights to commercialize sapacitabine and seliciclib and our business strategy is to enter into selective partnership arrangements with these programs. Taken together, our pipeline covers all four phases of the cell cycle, which we believe will improve the chances of successfully developing and commercializing novel drugs that work on their own or in combination with approved conventional chemotherapies or with other targeted drugs to treat human cancers.

Sapacitabine is being evaluated in the SEAMLESS Phase 3 trial being conducted under a Special Protocol Assessment agreement with the US Food and Drug Administration (FDA) for the front-line treatment of AML in the elderly and in Phase 2 studies for MDS, lung cancer and chronic lymphocytic leukaemia. Additionally, sapacitabine has been shown to have increased activity in cancer cells with BRCA- or Homologous Recombinant repair-deficient backgrounds, including ovarian cancer cell lines. In June, we reported new data at the American Society of Clinical Oncology Annual Meeting from an on-going multicenter Phase 2 randomized trial of oral sapacitabine capsules, in older patients with MDS after treatment failure of front-line hypomethylating agents, such as azacitidine (Vidaza®) and/or decitabine (Dacogen®). Median overall survival to date for all patients is 252 days or approximately 8.4 months. We will initiate regulatory discussions regarding an appropriate registration plan in this setting after a dosing schedule is selected.

We have ongoing clinical programs in development awaiting further data. Once data becomes available and is reviewed, we will determine the feasibility of pursuing further development and/or partnering these assets, including sapacitabine in combination with seliciclib and seliciclib in NSCLC and nasopharyngeal cancer, or NPC. In addition, we marketed directly in the United States Xclair® Cream for radiation dermatitis and Numoisyn® Liquid and Numoisyn® Lozenges for xerostomia. However, the distribution agreements for the promotion and sale of these products terminated effective September 30, 2012.

From our inception in 1996 through September 30, 2012, 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, 2012, our accumulated deficit during the development stage was $265.5 million. We expect to continue incurring substantial losses for the next several years as we continue to develop our clinical and pre-clinical drug candidates. Our operating expenses are comprised of research and development expenses and general and administrative expenses.

To date, we have not generated significant product revenue but have financed our operations and internal growth through private placements, registered direct financings, licensing revenue, collaborations, interest on investments, government grants and research and development tax credits. We have recognized revenues from continuing operations from inception through September 30, 2012, totaling $6.8 million, which consists of $3.1 million of fees under collaborative agreements and $3.7 million of grant revenue from various United Kingdom and European government grant awards. We have also recognized $19.2 million in research and development tax credits from inception through September 30, 2012, which are reported as income tax benefits on the consolidated statements of operations, from the United Kingdom s tax authority, H.M. Revenue & Customs since inception. In addition, we have recognized revenue from discontinued operations from inception through September 30, 2012 of approximately $3.6 million from sales of commercial products.

Recent Developments

Reverse Stock Split

On August 24, 2012, we effected a 1-for-7 reverse stock split of shares of common stock in order to increase the per share trading price of our shares of common stock to satisfy the $1.00 minimum bid requirement for continued listing on the NASDAQ Global Market. We received notification from NASDAQ that as of September 11, 2012, we evidenced a closing bid of our common stock price in excess of the $1.00 minimum requirement for at least 10 consecutive trading days. Accordingly, we have regained compliance with Listing Rule 5450(a)(1). All share and per share information presented gives effect to the reverse stock split, which occurred on August 24, 2012.

Table of Contents

Termination and Settlement Agreement

On August 10, 2012, we entered into an agreement with Sinclair Pharmaceuticals Limited (Sinclair) to terminate, effective September 30, 2012, the distribution agreements relating to the promotion and sale of Xclair®, Numoisyn® Lozenges and Numoisyn® Liquid. The agreement includes a minimum royalty arrangement based on future net revenues, under which Sinclair will pay us a minimum of approximately $1.0 million in quarterly installments over the next three years ending on September 30, 2015. The operating results associated with the promotion and sale of Xclair®, Numoisyn® Liquid and Numoisyn® Lozenges are classified within Income (loss) from discontinued operations, net of tax in the consolidated statements of operations for all periods presented, and the associated assets and liabilities are classified within current and long-term assets of discontinued operations and current liabilities of discontinued operations, as appropriate, in the consolidated balance sheets for all applicable periods presented.

Preferred Stock Dividend

On September 12, 2012, our Board of Directors decided not to declare a quarterly cash dividend on our 6% Convertible Exchangeable Preferred Stock (Preferred Stock) with respect to the third quarter of 2012 that would have otherwise been payable on November 1, 2012.

Subsequent Developments

Grant Award

In November 2012, we were awarded a grant of approximately $1.9 million from the UK Government s Biomedical Catalyst to complete an Investigational New Drug (IND) directed preclinical development of CYC065, a novel orally available, second generation, CDK inhibitor.

Results of Operations

Three Months Ended September 30, 2011 and 2012

Results of Continuing Operations

Revenues

The following table summarizes the components of our revenues for the three months ended September 30, 2011 and 2012:

	Three months ended September 30,			
	2011	2012	Difference	Difference
		($000s)		%
Grant revenue		38	38	
Total revenue		38	38	

We recognized approximately $38,000 in grant revenue for the three months ended September 30, 2012 in connection with an award from the European Union to study ovarian cancer therapies. We had no grant revenue for the three months ended September 30, 2011.

We may also recognize, from time to time, revenue from collaboration and research and development. We had no collaboration and research and development revenue for each of the three months periods ended September 30, 2011 and 2012.

The future

We expect to recognize approximately $0.1 million in grant revenue over the next twelve to eighteen months from the European Union and approximately $1.9 million in grant revenue over the next two years from the UK Government s Biomedical Catalyst.

Table of Contents

Research and development expenses

We expense all research and development expenses as they are incurred. Research and development expenses primarily include:

- clinical trial and regulatory-related costs;
- payroll and personnel-related expenses, including consultants and contract research;
- preclinical studies and laboratory supplies and materials;
- technology license costs; and
- rent and facility expenses for our laboratories.

The following table provides information with respect to our research and development expenditure for the three months ended September 30, 2011 and 2012:

	Three months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Sapacitabine	1,848	1,424	(424)	(23)
Other research and development costs	218	108	(110)	(50)
Total research and development expenses	2,066	1,532	(534)	(26)

Total research and development expenses represented 53% and 43% of our operating expenses for the three months ended September 30, 2011 and 2012, respectively.

Research and development expenditures decreased by $0.5 million from $2.1 million for the three month period ended September 30, 2011 to $1.5 million for the three month period ended September 30, 2012. The decrease was primarily due to a $0.2 million decrease in clinical supply costs, $0.1 million decrease in clinical trial costs and $0.1 million decrease in employment costs.

The future

We expect to continue to concentrate our resources on the development of sapacitabine. We anticipate that overall research and development expenditures, excluding contractual milestone payments for the year ended December 31, 2012 to be similar compared to the year ended December 31, 2011 as we increase enrollment on the randomized portion of the SEAMLESS pivotal Phase 3 trial.

Table of Contents

General and administrative expenses

General and administrative expenses include costs for sales and marketing and administrative personnel, legal and other professional expenses and general corporate expenses. The following table summarizes the general and administrative expenses for the three months ended September 30, 2011 and 2012:

	Three months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Total general and administrative expenses	1,814	2,028	214	12

Total general and administration expenses represented 47% and 57% of our operating expenses for the three months ended September 30, 2011 and 2012, respectively.

Our general and administrative expenditure increased by approximately $0.2 million to $2.0 million for the three months ended September 30, 2012, from $1.8 million for the three months ended September 30, 2011. The increase in expenses was primarily attributable to a net increase in professional and consultancy costs of $0.6 million, offset by a $0.1 million reduction in stock compensation charges, $0.1 million reduction in employment costs, and $0.2 million in other general and administrative costs.

The future

We expect our general and administrative expenditures for the year ended December 31, 2012 to be higher than our expenditures for the year ended December 31, 2011 as a result of an expected increase in professional and consultancy costs.

Other income (expense)

The following table summarizes other income (expense) for the three months ended September 30, 2011 and 2012:

	Three months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Change in valuation of Economic Rights		(63)	(63)	
Change in valuation of other liabilities measured at fair value	440	1	(439)	(100)
Foreign exchange gains (losses)	28	6	(22)	(79)
Interest income	9	5	(4)	(44)

Other income		1	1	
Total other income (expense)	477	(50)	(527)	(110)

Total other income and expense, net, decreased by $0.5 million, from income of approximately $0.5 million for the three months ended September 30, 2011, to expense of $0.1 million for the three months ended September 30, 2012. The decrease was primarily due to the change of valuation of other liabilities measured at fair value of $0.4 million and change in valuation of Economic Rights of $0.1 million.

The change in valuation of Economic Rights relates to the change in the fair value of contractual rights issued as part of a financing agreement entered into in March 2012. These collective rights are classified as liabilities and are marked to market each reporting period. For the three months ended September 30, 2012, we recognized expense of approximately $0.1 million due to the change in the value of Economic Rights.

The change in valuation of other liabilities measured at fair value relates to the issue of warrants to purchase shares of our common stock under the registered direct financing completed in February 2007 and our liability under an agreement with the Scottish Enterprise, (SE) that would potentially require us to make a payment to SE should staffing levels in Scotland fall below prescribed minimum levels. The warrants and agreement are classified as liabilities. The value of the warrants is being marked to market

Table of Contents

each reporting period as a gain or loss. Such gains or losses will continue to be reported for the warrants until they are exercised or expired. Gains or losses on the SE Agreement will be reported until the agreement expires in July 2014. For the three months ended September 30, 2011 and 2012, the change in the valuation of other liabilities measured at fair value was a decrease of $0.4 million and approximately $1,000, respectively.

Foreign exchange gains (losses) decreased by $22,000 to a gain of $6,000 for the three months ended September 30, 2012, compared to a gain of approximately $28,000 for the three months ended September 30, 2011. Foreign exchange gains (losses) are reported in the consolidated statement of operations as a separate line item within other income (expense).

The future

The valuation of the Economic Rights, warrants liability, and SE Agreement will continue to be re-measured at the end of each reporting period. The change in valuation of the Economic Rights is dependent on a number factors, including our stock price, and certain management assumptions, including, the probability of success of the underlying litigation, amount of award or settlement, discount rate, royalty rate, and timing of cash flows, and may fluctuate significantly, which may have a significant impact on our statement of operations. The valuation of the warrants is dependent upon many factors, including our stock price, interest, and remaining term of the instrument and may fluctuate significantly, which may have a significant impact on our statement of operations. The valuation of the SE Agreement is dependent on a number of factors, including our stock price and the probability of the occurrence of certain events that would give rise to a payment. We do not expect the valuation of fair value of the SE Agreement to fluctuate significantly.

As the nature of funding advanced through intercompany loans is that of a long-term investment in nature, future unrealized foreign exchange gains and losses on such funding will be recognized in other comprehensive income until repayment of the intercompany loan becomes foreseeable.

Income tax benefit

Credit is taken for research and development tax credits, which are claimed from the United Kingdom s revenue and customs authority, or HMRC, in respect of qualifying research and development costs incurred.

The following table summarizes research and development tax credits for the three months ended September 30, 2011 and 2012:

	Three months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Total income tax benefit	126	419	293	233

Research and development tax credits recoverable increased $0.3 million to $0.4 million for the three months ended September 30, 2012 from $0.1 million for the three months ended September 30, 2011. The level of tax credits recoverable is linked directly to qualifying research and development expenditure incurred in any one year. In 2011 the tax credit was also restricted to the payroll taxes paid by us to HMRC in that year. However, in July 2012, legislation was passed to eliminate this restriction for the year ended December 31, 2012. As a result, an adjustment of approximately $0.3 million was recorded for the three months ended September 30, 2012.

The future

We expect to continue to be eligible to receive United Kingdom research and development tax credits for the foreseeable future and will elect to do so. In July 2012, legislation was passed, effective for the year ended December 31, 2012, that eliminates the restriction of the amount recoverable to the payroll taxes paid in a period. Historically, our qualifying research and development expenditure has exceeded payroll taxes

Table of Contents

and, as we expect this to continue, the amount of tax credits we will be able to recover will increase for the year ended December 31, 2012.

Results of Discontinued Operations

Income (loss) from discontinued operations, net of tax

	Three months ended September 30,			
	2011	2012 ($000s)	Difference	Difference %
Discontinued operations	(168)	71	239	(142)
Gain on termination of distribution agreements		1,192	1,192	
Income (loss) from discontinued operations, net of tax of $0 for all periods presented	(168)	1,263	1,431	852

We entered into a termination and settlement agreement to terminate, effective September 30, 2012, our license to distribute the ALIGN products, after which we will no longer generate product revenue. Income (loss) from discontinued operations, net of tax increased $1.4 million from a loss of $0.2 million for the three months ended September 30, 2011, to a gain of $1.3 million for the three months ended September 30, 2012. The increase is the result of a $1.2 million gain on termination of the distribution agreements, which represents the $0.9 million present value of the $1.0 million we will receive over the next three years as part of a minimum royalty arrangement included in our termination agreement with Sinclair and the recognition of $0.3 million associated with a $0.3 million product returns provision liability for which an offsetting asset has been recorded based on our rights under the termination and settlement agreement.

The future

We have ceased operations associated with the ALIGN products effective September 30, 2012 and do not expect significant activity beyond the year ended December 31, 2012. We may earn additional income from discontinued operations over the next three years if certain sales targets are met by a successor distributor according to the termination agreement with Sinclair.

Nine Months Ended September 30, 2011 and 2012

Results of Continuing Operations

Revenues

The following table summarizes the components of our revenues for the nine months ended September 30, 2011 and 2012:

	Nine months ended September 30,			
	2011	2012 ($000s)	Difference	Difference %
Grant revenue		64	64	
Total revenue		64	64	

We recognized approximately $64,000 in grant revenue for the nine months ended September 30, 2012 in connection with an award from the European Union to study ovarian cancer therapies. We had no grant revenue for the nine months ended September 30, 2011.

We may also recognize, from time to time, revenue from collaboration and research and development and from grant awards. We had no collaboration and research and development revenue or grant revenue for each of the nine months periods ended September 30, 2011 and 2012.

The future

We expect to recognize approximately $0.1 million in grant revenue over the next twelve to eighteen from the European and approximately $1.9 million in grant revenue over the next two years from the UK Government s Biomedical Catalyst.

Table of Contents

Research and development expenses

We expense all research and development expenses as they are incurred. Research and development expenses primarily include:

- clinical trial and regulatory-related costs;
- payroll and personnel-related expenses, including consultants and contract research;
- preclinical studies and laboratory supplies and materials;
- technology license costs; and
- rent and facility expenses for our laboratories.

The following table provides information with respect to our research and development expenditure for the nine months ended September 30, 2011 and 2012:

	Nine months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Sapacitabine	6,579	4,488	(2,091)	(32)
Other research and development costs	426	108	(318)	(75)
Total research and development expenses	7,005	4,596	(2,409)	(34)

Total research and development expenses represented 58% and 44% of our operating expenses for the nine months ended September 30, 2011 and 2012, respectively.

Research and development expenditures decreased by $2.4 million to $4.6 million for the nine month period ended September 30, 2012 from $7.0 million for the nine month period ended September 30, 2011. The decrease was primarily due to $1.6 million of contractual expenses recognized during the nine months ended September 30, 2011, resulting from an achievement of a milestone triggered by the opening of enrollment in the lead-in portion our SEAMLESS trial, pursuant to the Daiichi-Sankyo license under which we license certain patent rights for sapacitabine, a $0.4 million decrease in outsourced research costs as a result of an out of period reversal of accrued pre-clinical costs, a $0.4

million decrease in sapacitabine clinical supply costs, a $0.1 million decrease in stock compensation charges, and a $0.2 million decrease in employment costs and partially offset by a $0.4 million increase in clinical trial costs.

The future

We expect to continue to concentrate our resources on the development of sapacitabine. We anticipate that overall research and development expenditures, excluding contractual milestone payments, for the year ended December 31, 2012 to be similar compared to the year ended December 31, 2011, as we continue enrollment on the randomized portion of the SEAMLESS pivotal Phase 3 trial.

General and administrative expenses

General and administrative expenses include costs for sales and marketing and administrative personnel, legal and other professional expenses and general corporate expenses. The following table summarizes the general and administrative expenses for the nine months ended September 30, 2011 and 2012:

	Nine months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Total general and administrative expenses	5,136	5,917	781	15%

Total general and administration expenses represented 42% and 56% of our operating expenses for the nine months ended September 30, 2011 and 2012, respectively.

Table of Contents

Our general and administrative expenditure increased by approximately $0.8 million to $5.9 million for the nine months ended September 30, 2012, from $5.1 million for the nine months ended September 30, 2011. The increase in expenses was primarily attributable to a net increase in professional and consultancy costs of $1.1 million and offset by a decrease in stock compensation costs of $0.3 million.

The future

We expect our general and administrative expenditures for the year ended December 31, 2012 to be higher than our expenditures for the year ended December 31, 2011 as a result of an expected increase in professional and consultancy costs.

Other income (expense)

The following table summarizes other income (expense) for the nine months ended September 30, 2011 and 2012:

	Nine months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Change in valuation of Economic Rights		27	27	
Change in valuation of other liabilities measured at fair value	643	51	(592)	(92)
Foreign exchange gains (losses)	(59)	237	296	502
Interest income	33	17	(16)	(48)
Other income		77	77	
Total other income (expense)	617	409	(208)	(34)

Total other income and expense, net, decreased by approximately $0.2 million, from income of approximately $0.6 million for the nine months ended September 30, 2011, to income of $0.4 million for the nine months ended September 30, 2012. The increase was primarily because of the $0.6 million decrease in change in valuation of other liabilities measured at fair value, partially offset by a $0.3 million increase in foreign exchange gains (losses), mostly due to the increase in exchange rate of the British Pound Sterling relative to the U.S. Dollar., and an approximately $62,000 gain on sale of equipment.

The change in valuation of Economic Rights related to the sale of Economic Rights in connection with the purchase agreement completed in March 2012. These collective rights are classified as liabilities and are marked to market each reporting period. For the nine months ended September 30, 2012, we recognized a gain of approximately $27,000 due to the change in the value of Economic Rights from the transaction date of March 22, 2012 to September 30, 2012.

The change in valuation of other liabilities measured at fair value relates to the issue of warrants to purchase shares of our common stock under the registered direct financing completed in February 2007 and our liability under an agreement with the Scottish Enterprise, or SE, that would potentially require us to make a payment to SE should staffing levels in Scotland fall below prescribed minimum levels. The warrants and

agreement are classified as liabilities. The value of the warrants is being marked to market each reporting period as a gain or loss. Such gains or losses will continue to be reported for the warrants until they are exercised or expired. Gains or losses on the SE Agreement will be reported until the agreement expires in July 2014. For the nine months ended September 30, 2011 and 2012, the change in the valuation of other liabilities measured at fair value was a gain of $0.6 million and a gain of approximately $51,000, respectively.

Foreign exchange gains (losses) increased by $0.3 million to a gain of $0.2 million for the nine months ended September 30, 2012 compared to a loss of approximately $0.1 million for the nine months ended September 30, 2011. Foreign exchange gains (losses) are reported in the consolidated statement of operations as a separate line item within other income (expense).

Table of Contents

We recognized $62,000 in other income from the sale of laboratory equipment during the nine months ended September 30, 2012. We did not recognize any such income during the nine months ended September 30, 2011.

The future

The valuation of the Economic Rights, warrants liability, and SE Agreement will continue to be re-measured at the end of each reporting period. The change in valuation of the Economic Rights is dependent on a number factors, including our stock price, and other management assumptions, including, the probability of success of the underlying litigation, amount of award or settlement, discount rate, royalty rate, and timing of cash flows, and may fluctuate significantly, which may have a significant impact on our statement of operations. The valuation of the warrant is dependent upon many factors, including our stock price, interest, and remaining term of the instrument and may fluctuate significantly, which may have a significant impact on our statement of operations. The valuation of the SE Agreement is dependent on a number of factors, including our stock price and the probability of the occurrence of certain events that would give rise to a payment. We do not expect the valuation of fair value of the SE Agreement to fluctuate significantly.

As the nature of funding advanced through intercompany loans is that of a long-term investment in nature, future unrealized foreign exchange gains and losses on such funding will be recognized in other comprehensive income until repayment of the intercompany loan becomes foreseeable.

Income tax benefit

Credit is taken for research and development tax credits, which are claimed from the United Kingdom s revenue and customs authority, or HMRC, in respect of qualifying research and development costs incurred.

The following table summarizes research and development tax credits for the nine months ended September 30, 2011 and 2012:

	Nine months ended September 30,			
	2011	**2012**	**Difference**	**Difference**
		($000s)		**%**
Total income tax benefit	443	714	271	61

Research and development tax credits recoverable increased by approximately $0.3 million to $0.7 million for the nine months ended September 30, 2012 relative to the nine-month period ended September 30, 2011. The level of tax credits recoverable is linked directly to qualifying research and development expenditure incurred in any one year. In 2011 it was also restricted to the payroll taxes paid by us to HMRC in that year. However, in July 2012, legislation was passed to eliminate this restriction for the year ended December 31, 2012. As a result, an adjustment of approximately $0.3 million was recorded for the nine months ended September 30, 2012.

The future

We expect to continue to be eligible to receive United Kingdom research and development tax credits for the foreseeable future and will elect to do so. In July 2012, legislation was passed, effective for the year ended December 31, 2012, that eliminates the restriction of the amount recoverable to the payroll taxes paid in a period. Historically, our qualifying research and development expenditure has exceeded payroll taxes and, as we expect this to continue, the amount of tax credits we will be able to recover will increase for the year ended December 31, 2012.

Table of Contents

Results of Discontinued Operations

Income (loss) from discontinued operations, net of tax

	Nine months ended September 30,			
	2011	2012 ($000s)	Difference	Difference %
Discontinued operations	(504)	(288)	216	43
Gain on termination of distribution agreement		1,192	1,192	
Income (loss) from discontinued operations, net of tax of $0 for all periods presented	(504)	904	1,408	279

We entered into a termination and settlement agreement to terminate, effective September 30, 2012, our license to distribute the ALIGN products, after which we will no longer generate product revenue. Income (loss) from discontinued operations increased $1.4 million from a loss of $0.5 million for the nine months ended September 30, 2011, to a income of $0.9 million for the nine months ended September 30, 2012. The increase is the result of a $1.2 million gain on termination of the distribution agreements, which represents the $0.9 million present value of the $1.0 million we will receive over the next three years as part of a minimum royalty arrangement included in our termination agreement with Sinclair and the recognition of $0.3 million associated with a $0.3 million product returns provision liability for which an offsetting asset has been recorded based on our rights under the termination and settlement agreement.

The future

We have ceased operations associated with the ALIGN products effective September 30, 2012 and do not expect significant activity beyond the year ended December 31, 2012. We may earn additional income from discontinued operations over the next three years if certain sales targets are met by a successor distributor according to the termination agreement with Sinclair.

Liquidity and Capital Resources

The following is a summary of our key liquidity measures at December 31, 2011 and September 30, 2012:

	December 31, 2011	September 30, 2012 ($000s)	$ Difference	% Difference
Cash and cash equivalents	24,449	17,837	(6,612)	(27)
Working capital:				
Current assets	25,831	19,953	(5,878)	(23)
Current liabilities	(6,498)	(7,297)	(799)	12
Working capital	19,333	(12,656)	(6,677)	(35)

At September 30, 2012, we had cash and cash equivalents of $17.8 million compared to $24.4 million at December 31, 2011. The decrease in balance was primarily due to normal cash outflows required to operate our business, offset by $2.9 million in proceeds, net of certain expenses, received from a sale of common stock and Economic Rights completed in March 2012. Since our inception, we have not generated any significant revenue and have relied primarily on the proceeds from sales of equity and preferred securities to finance our operations and internal growth. Additional funding has come through income on our investments, licensing revenue, government grants and research and development tax credits. We have incurred significant losses since our inception. As of September 30, 2012, we had an accumulated deficit during the development stage of $265.5 million.

We currently anticipate that our cash and cash equivalents are sufficient to meet our anticipated short-term working capital needs and to fund our on-going sapacitabine clinical trials for at least the next twelve

Table of Contents

months. However, we cannot be certain that we will be able to raise sufficient funds to complete the development and commercialize any of our product candidates currently in clinical development, should they succeed.

Cash provided by (used in) operating, investing and financing activities

Cash provided by (used in) operating, investing and financing activities for the nine months ended September 30, 2011 and 2012, is summarized as follows:

	Nine months ended September 30,	
	2011	2012
	($000s)	
Net cash used in operating activities	(10,718)	(9,584)
Net cash (used in) provided by investing activities	(6)	50
Net cash provided by financing activities	8,897	2,934

Cash flows generated from discontinued operations have been combined with the cash flows from continuing operations within each of the Operating, Investing and Financing activities sections.

Operating activities

Net cash used in operating activities decreased from $10.7 million for the nine months ended September 30, 2011 to $9.6 million for the nine months ended September 30, 2012. The $1.1 million decrease is primarily due to the $1.6 million of contractual expenses paid during the nine months ended September 30, 2011, resulting from an achievement of a milestone triggered by the opening of enrollment in the lead-in portion our SEAMLESS trial, pursuant to the Daiichi-Sankyo license under which we license certain patent rights for sapacitabine, a $0.7 million increase in payments for professional fees and a $0.2 million decrease in employment costs. Net cash used in operating activities from discontinued operations was $0.6 million and $0.2 million for the nine months ended September 30, 2011 and 2012, respectively.

Investing activities

Net cash (used in) provided by investing activities increased from approximately $6,000 used in investing activities for the nine months ended September 30, 2011 to approximately $50,000 provided by investing activities for the nine months ended September 30, 2012, primarily as a result of the sale of laboratory equipment.

Financing activities

Net cash provided by financing activities for the nine months ended September 30, 2011 was $8.9 million, mostly from $9.3 million in financing proceeds, net of certain expenses, and offset by the payment of a $0.4 million dividend to the holders of our Preferred Stock. Net cash provided by financing activities was $2.9 million for the nine months ended September 30, 2012 as a result of approximately $2.9 million proceeds, net of certain expenses, from the sale of stock and Economic Rights.

Operating Capital and Capital Expenditure Requirements

We expect to continue to incur substantial operating losses in the future. We cannot guarantee that we will generate any significant product revenues until a product candidate has been approved by the FDA or similar regulatory agencies in other countries and successfully commercialized. We have generated a limited amount of cash flows from ALIGN product sales but these sales ceased on September 30, 2012. However, we will receive $1.0 million in quarterly installments over the next three years as part of a minimum royalty arrangement included in our termination agreement with Sinclair and cash flows from these payments will be included in cash flows provided by (used in) investing activities in our condensed consolidated statements of cash flows.

We currently anticipate that our cash and cash equivalents will be sufficient to fund our operations for at least the next 12 months. We cannot be certain that any of our programs will be successful or that we will be able to raise sufficient funds to complete the development and commercialize any of our product candidates currently in development, should they succeed. Additionally, we plan to continue to evaluate in-

Table of Contents

licensing and acquisition opportunities to gain access to new drugs or drug targets that would fit with our strategy. Any such transaction would likely increase our funding needs in the future.

Our future funding requirements will depend on many factors, including but not limited to:

- the rate of progress and cost of our clinical trials, preclinical studies and other discovery and research and development activities;
- the costs associated with establishing manufacturing and commercialization capabilities;
- the costs of acquiring or investing in businesses, product candidates and technologies;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights;
- the costs and timing of seeking and obtaining FDA and other regulatory approvals;
- the effect of competing technological and market developments; and
- the economic and other terms and timing of any collaboration, licensing or other arrangements into which we may enter.

Until we can generate a sufficient amount of product revenue to finance our cash requirements, which we may never do, we expect to finance future cash needs primarily through public or private equity offerings, debt financings or strategic collaborations. Although we are not reliant on institutional credit finance and therefore not subject to debt covenant compliance requirements or potential withdrawal of credit by banks, the current economic climate has also impacted the availability of funds and activity in equity markets. We do not know whether additional funding will be available on acceptable terms, or at all. If we are not able to secure additional funding when needed, we may have to delay, reduce the scope of or eliminate one or more of our clinical trials or research and development programs or make changes to our operating plan. In addition, we may have to partner one or more of our product candidate programs at an earlier stage of development, which would lower the economic value of those programs to us.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and related disclosure of contingent assets and liabilities. We review our estimates on an ongoing basis. We base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. We believe the judgments and estimates required by the following accounting policies to be critical in the preparation of our consolidated financial statements.

Stock-based Compensation

We grant stock options, restricted stock units and restricted stock to officers, employees, directors and consultants under the Company s Amended and Restated Equity Incentive Plan, which was amended and restated as of April 14, 2008. We measure compensation cost for all stock-based awards at fair value on date of grant and recognize compensation over the requisite service period for awards expected to vest. The fair value of restricted stock and restricted stock units is determined based on the number of shares granted and the quoted price of our common stock on the date of grant. The determination of grant-date fair value for stock option awards is estimated using an option-pricing model, which includes variables such as the expected volatility of our share price, the anticipated exercise behavior of our employees, interest rates, and dividend yields. These variables are projected based on our historical data, experience, and other factors. Changes in any of these variables could result in material adjustments to the expense recognized for share-based payments.

Table of Contents

The fair value is recognized as an expense over the requisite service period, net of estimated forfeitures, using the straight-line attribution method. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts are recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience.

Economic Rights

The Economic Rights are accounted for as a derivative financial instrument and measured at fair value. Changes in fair value are recognized in earnings. The fair value of the Economic Rights has been estimated using a decision-tree analysis method. This is an income-based method that incorporates the expected benefits, costs and probabilities of contingent outcomes under varying scenarios. Each scenario within the decision-tree is discounted to the present value using the company s credit adjusted risk-free rate and ascribed a weighted probability to determine the fair value. Changes in any of these assumptions could result in material adjustments to the expense recognized for changes in the valuation of the Economic Rights.

The Company has concluded the fair value of this liability was approximately $1.1 million as of September 30, 2012. We recognized a loss of approximately $63,000 million and a gain of approximately $27,000 on our consolidated statement of operations for the three and nine month periods ended September 30, 2012, respectively, as a result of changes in value of the Economic Rights during those periods.

Other Liabilities Measured at Fair Value

Warrants Liability

The accounting guidance on derivatives and hedging requires freestanding contracts that are settled in our own stock, including common stock warrants to be designated as equity instruments, assets or liabilities. Under the provisions of this guidance, a contract designated as an asset or a liability must be carried at fair value until exercised or expired, with any changes in fair value recorded in the results of operations. A contract designated as an equity instrument must be included within equity, and no subsequent fair value adjustments are required. We review the classification of the contracts at each balance sheet date. Since we are unable to control all the events or actions necessary to settle the warrants in registered shares the warrants have been recorded as a current liability at fair value. The fair value of the outstanding warrants is evaluated at each reporting period with any resulting change in the fair value being reflected in the consolidated statements of operations. We recorded income of approximately $0.4 million and $1,000 to reflect the change in fair value for the three months ended September 30, 2011 and 2012, respectively, and income of approximately $0.6 million and $51,000 for the nine months ended September 30, 2011 and 2012, respectively. Fair value is estimated using an option-pricing model, which includes variables such as the expected volatility of our share price, interest rates, and dividend yields. These variables are projected based on our historical data, experience, and other factors. Changes in any of these variables could result in material adjustments to the expense recognized for changes in the valuation of the warrants liability. The fair value of the warrants liability as of September 30, 2012 is nil due to the high exercise price of the warrants relative to the Company s stock price at September 30, 2012 and the expected term of 1.38 years.

Scottish Enterprise Agreement

The accounting guidance on distinguishing liabilities and equity requires freestanding financial instruments that meet certain criteria to be accounted for as liabilities and carried at fair value until exercised or expired, with any changes in fair value recorded in the results of operations. We entered into an agreement with SE in 2009 that would require us to pay SE £4 million (approximately $6.5 million at September 30, 2012) less the market value of the shares held by SE if staffing levels in Scotland fall below minimum levels stipulated in the Agreement. Due to the nature of the associated contingency and the likelihood of occurrence, we concluded the fair value of this liability was approximately $20,000 at September 30, 2012. The most significant inputs in estimating the fair value of this liability are the

Table of Contents

probabilities that staffing levels fall below the prescribed minimum levels and that we are unable or unwilling to replace such employees within the prescribed time period. As of September 30, 2012, we concluded the probability of the combination of these events occurring is minimal. We record changes in fair value in the consolidated statement of operations. There were no changes to the fair value for the three and nine month periods ended September 30, 2012 and 2011.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer and principal financial and accounting officer, we conducted an evaluation of the effectiveness, as of September 30, 2012, of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based upon such evaluation, our chief executive officer and principal financial and accounting officer have concluded that, as of September 30, 2012, our disclosure controls and procedures were effective to provide reasonable assurance that the information we are required to disclose in our filings with the Securities and Exchange Commission, or SEC, under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) accumulated and communicated to our management, including our chief executive officer and principal financial and accounting officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitation on the Effectiveness of Internal Controls

The effectiveness of any system of internal control over financial reporting, including ours, is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, an