NANOBAC PHARMACEUTICALS INC
Form 10QSB
August 14, 2006

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

FORM 10-QSB
QUARTERLY REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarter Period Ended
June 30, 2006

Nanobac Pharmaceuticals, Incorporated
(Exact name of registrant as specified in its charter)

Florida	**0-24696**	**59-3248917**
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(I.R.S. Employer Identification Number)

4730 North Habana Avenue, Suite 205, Tampa, Florida 33614
(Address of Principal Executive Office) (Zip Code)

(813) 264-2241
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for a 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 is an accelerated filer (as defined in Rule 12b-2 of the Act):

Yes o No x

The number of shares issued and outstanding of the Registrant's Common Stock, no par value, as of August 11, 2006 was 193,506,760.

NANOBAC PHARMACEUTICALS, INCORPORATED AND SUBSIDIARIES

PART I - FINANCIAL INFORMATION

Item 1: Financial Statements

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NANOBAC PHARMACEUTICALS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) June 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS		
Cash	$ 186,835	$ 8,975
Account receivable	4,925	3,283
Inventory	110,898	117,280
Prepaid expenses	35,396	43,725
Total current assets	338,054	173,263
FURNITURE AND EQUIPMENT, less accumulated depreciation of $92,956 at June 30, 2006 and $131,163 at December 31, 2005	67,546	106,952
OTHER ASSETS		
Security deposits	23,714	20,695
Intangible assets, less accumulated amortization of $1,060,581at June 30, 2006 and $1,539,621 at December 31, 2005	4,182,461	5,053,421
Goodwill	3,615,393	3,615,393
Total other assets	7,821,568	8,689,509
TOTAL ASSETS	$ 8,227,168	$ 8,969,724
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 375,648	$ 313,932
Accrued compensation	335,276	462,658
Accrued expenses	389,658	376,874
Short-term notes payable	-	50,843
Other liabilities	12,068	29,425
Related party loans	4,021,686	2,434,733
Total current liabilities	5,134,336	3,668,465
LONG-TERM LIABILITIES		
Stock settlement obligation	2,836,538	2,836,538
Total liabilities	7,970,874	6,505,003
COMMITMENTS AND CONTINGENCIES	-	-
STOCKHOLDERS' EQUITY		
Preferred stock, no par value, 1,000,000 shares authorized, no shares issued and outstanding	-	-

Common stock, no par value, 250,000,000 shares authorized, 2006: 193,506,760 shares issued and outstanding 2005: 189,006,760 shares issued and outstanding		16,428,550		16,307,050
Additional paid-in capital		3,503,681		3,503,681
Accumulated deficit		(19,703,682)		(17,380,535)
Accumulated other comprehensive income		27,745		34,525
Total stockholders' equity		256,294		2,464,721
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	8,227,168	$	8,969,724

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

NANOBAC PHARMACEUTICALS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months ended June 30, 2006	Three Months ended June 30, 2005 (Restated)	Six Months ended June 30, 2006	Six Months ended June 30, 2005 (Restated)
REVENUE (Note 3)	$ 37,565	$ 167,988	$ 198,851	$ 319,853
COST OF REVENUE	22,623	58,461	67,818	102,299
GROSS PROFIT	14,942	109,527	131,033	217,554
OPERATING EXPENSES				
Selling, general and administrative	275,289	234,152	701,159	509,938
Research and development	431,016	283,547	785,338	694,841
Impairment loss on intangible asset	-	-	585,000	-
Depreciation and amortization	117,811	189,474	306,028	377,726
Total Operating Expenses	824,116	707,173	2,377,525	1,582,505
OPERATING LOSS	(809,174)	(597,646)	(2,246,492)	(1,364,951)
OTHER INCOME (EXPENSES)				
Interest expense	(46,269)	(17,321)	(84,508)	(22,514)
Loss on stock settlement obligation	-	-	-	(717,908)
Other, net	19,983	(28,802)	7,853	(44,317)
LOSS BEFORE INCOME TAXES	(835,460)	(643,769)	(2,323,147)	(2,149,690)
PROVISION FOR INCOME TAXES	-	-	-	-
NET LOSS	$ (835,460)	$ (643,769)	$ (2,323,147)	$ (2,149,690)
LOSS PER COMMON SHARE				
Basic and Diluted	$ (0.00)	$ (0.00)	$ (0.01)	$ (0.01)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING				
Basic and Diluted	193,506,760	189,006,759	192,369,397	188,700,715

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

NANOBAC PHARMACEUTICALS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE SIX MONTHS ENDED JUNE 30, 2006
(Unaudited)

	Common Shares	Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Loss	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2005	**189,006,760**	**$ 16,307,050**	**$ 3,503,681**	**($17,380,535)**		**$ 34,525**	**$ 2,464,721**
Stock issued for services	4,500,000	121,500	-	-	-	-	121,500
Comprehensive loss:							
Net loss	-	-	-	(2,323,147)	($2,323,147)		(2,323,147)
Foreign currency translation adjustment	-	-	-	-	(6,780)	(6,780)	(6,780)
Comprehensive loss					($2,329,927)		
Balance, June 30, 2006	**193,506,760**	**$ 16,428,550**	**$ 3,503,681**	**$ (19,703,682)**		**$ 27,745**	**$ 256,294**

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

NANOBAC PHARMACEUTICALS INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months ended June 30, 2006	Six Months ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		(Restated)
Net loss	$ (2,323,147)	$ (2,149,690)
Adjustments to reconcile net loss to cash flows from operating activities:		
Depreciation and amortization	306,028	377,726
Impairment loss on intangible asset	585,000	-
Loss on disposition of fixed assets	18,330	-
Derivative loss	-	717,908
Charges for common stock issued for services	-	10,500
Interest expense accrued for stockholder loan	84,280	20,663
Net (increase) decrease in assets:		
Accounts receivable	(1,642)	(2,658)
Inventory	6,382	(2,784)
Other assets	8,329	35,894
Net increase (decrease) in liabilities:		
Accounts payable	61,716	(222,181)
Accrued compensation	(5,882)	(62,639)
Accrued expenses	12,784	(117,439)
Deferred revenue	(17,357)	(5,790)
Total adjustments	1,057,968	749,200
Net cash flows from operating activities	(1,265,179)	(1,400,490)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of furniture and equipment	(3,942)	(37,766)
Proceeds from sale of furniture and equipment	6,547	-
Payment of security deposits	(2,731)	-
Net cash flows from investing activities	(126)	(37,766)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of common stock pursuant to subscription agreements	-	200,000
Stock issuance costs	-	(30,373)
Proceeds from stockholder loans, net	1,502,673	1,254,392
Proceeds from notes payable	2,601	30,907
Payment of notes payable	(53,675)	(41,683)
Net cash flows from financing activities	1,451,599	1,413,243
Effect of exchange rate changes	(8,434)	30,428

Net change in cash		177,860		5,415
Cash balance, beginning of year		8,975		17,908
Cash balance, end of year	$	186,835	$	23,323
Supplemental disclosures of cash flow information:				
Cash paid for interest	$	228	$	1,851
Supplemental schedule of non-cash investing and financing activities:				
Common stock issued in exchange for current liabilities	$	121,500	$	-

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

NANOBAC PHARMACEUTICALS, INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SIX MONTHS ENDED JUNE 30, 2006
(UNAUDITED)

1. Nature of operations and summary of significant accounting polices

Nature of business

Nanobac Pharmaceuticals, Incorporated and subsidiaries, ("Nanobac", the "Company", or "NNBP") trades under the symbol "NNBP."

NNBP's primary business is research and development of therapeutic and diagnostic technologies related to nanobacterium sanguineum ("Nanobacteria"). Nanobacteria are believed to be small, calcifying nano-particles that can be found in human blood, kidney stones and arterial wall plaques.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Nanobac Sciences LLC, Nanobac OY and Nanobac Research Institute LLC. All material intercompany transactions and balances have been eliminated in consolidation.

Basis of presentation

In the opinion of management, the accompanying financial statements include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with generally accepted accounting principles. The results of operations for the six months ended June 30, 2006 are not necessarily indicative of the results for a full year.

The financial statements for the period ended June 30, 2006 and notes thereto should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2005 for the Company as filed in the annual report on Form 10-KSB, which information is included herein by reference.

Liquidity and management plans

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred recurring losses and has a working capital deficiency at June 30, 2006. The Company is dependent on continued financing from outside investors including additional shareholder loans. All of these matters raise substantial doubt about the ability of the Company to continue as a going concern. Management believes that the Company will need to raise additional capital in order to launch new clinical trials, fund research and development for new treatment areas, and general working capital requirements. Capital may be raised through further sales of equity securities, which may result in dilution of the position of current shareholders. At this time, there is no firm commitment to invest in NNBP.

There can be no assurances that NNBP will be successful in obtaining debt or equity financing in order to achieve its financial objectives and continue as a going concern. The financial statements do not include any adjustments to the carrying amount of assets and the amounts and classifications of liabilities that might result from an adverse outcome of this uncertainty.

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NANOBAC PHARMACEUTICALS, INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SIX MONTHS ENDED JUNE 30, 2006
(UNAUDITED)

1. Nature of operations and summary of significant accounting polices (continued)

Impairment of long-lived assets and intangible assets

In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), and Statement of Financial Accounting Standards, No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), the Company reviews its non-amortizable long-lived assets, including intangible assets and goodwill for impairment annually, or sooner whenever events or changes in circumstances indicate the carrying amounts of such assets may not be recoverable. Other depreciable or amortizable assets are reviewed when indications of impairment exist. Upon such an occurrence, recoverability of these assets is determined as follows. For long-lived assets that are held for use, the Company compares the forecasted undiscounted net cash flows to the carrying amount. If it is determined that the long-lived asset will be unable to recover its carrying amount, then it is written down to fair value. For long-lived assets held for sale, assets are written down to fair value. Fair value is determined based on discounted cash flows of appraised values from management's estimates, depending upon the nature or the assets. Impairment within goodwill is tested using a two step method. The first step is to compare the fair value of the reporting unit to its book value, including goodwill. If the fair value of the unit is less than its book value, the Company then determines the implied fair value of goodwill by deducting the fair value of the reporting unit's net assets from the fair value of the reporting unit. If the book value of goodwill is greater than its implied fair value, the Company writes down goodwill to its implied fair value. There were no impairment adjustments recorded in 2005. As described in Note 3, during the six months ended June 30, 2006, the Company's Product Rights intangible asset was deemed fully impaired based on the Company terminating the marketing and sales of dietary supplements and therefore the asset is not expected to be recoverable from the use or eventual disposition of the asset.

Recent accounting pronouncements

The Financial Accounting Standards Board ("FASB") has recently announced a new interpretation, FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), which will be effective for fiscal years beginning after December 15, 2006, FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has not determined the impact of the adoption of FIN 48 on its consolidated financial statements.

NANOBAC PHARMACEUTICALS, INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SIX MONTHS ENDED JUNE 30, 2006
(UNAUDITED)

2. Related party transactions

An entity controlled by the Chief Executive Officer (who is also the largest stockholder of NNBP), has loaned NNBP approximately $4.0 million as of June 30, 2006. These loans bear interest at the rate of 5% per annum and are due on demand. Interest expense for the above loans for the three and six months ended June 30, 2006 was approximately $38,000 and $84,000, respectively.

3. Discontinuance of product line

During March 2006, the Company's management established a plan for Nanobac to discontinue the sale of dietary supplements and the Company's focus to be exclusively on the science that will ultimately lead to drug discovery and the development of diagnostic products. Effective March 30, 2006, the Company assigned these product rights to an entity owned by the primary stockholder for no compensation. As a result of the above decision, a charge to earnings of $585,000 for the impairment of the product rights intangible asset has been recognized in operating expenses in the accompanying condensed consolidated statement of operations for the six months ended June 30, 2006.

4. Abandonment of lease

During March 2006, the Company ceased occupying leased office space in Tampa, Florida. As a result of the early abandonment of this office lease, a charge to earnings of approximately $125,000 for the write-off leasehold improvements and the acceleration of lease payments associated with the abandoned lease has been recognized in operating expenses and other expenses in the accompanying condensed consolidated statement of operations for the six months ended June 30, 2006.

5. Subsequent events

Effective July 1, 2006, the Company and an employee amended the employee's employment agreement to (a) delete a $175,000 signing bonus that was due to the employee on January 31, 2006 and (b) to grant the employee 3,500,000 fully vested stock options with an exercise price of $0.05 per common share. As of June 30, 2006, $175,000 is included in accrued expenses. The Company's Board of Directors has not yet approved a Stock Option Plan for the above stock option grant.

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

Business

Nanobac Pharmaceuticals, Inc. and its subsidiaries (which may be referred to as “Nanobac”, “the Company”, “NNBP”, “we”, “us” or “our”) is a life science company dedicated to the discovery and developments of products and services to improve people's health through the detection and treatment of Calcifying Nano-Particles (“CNPs”), otherwise known as "nanobacteria". The Company's pioneering research is establishing the pathogenic role of nanobacteria in soft tissue calcification, particularly in coronary artery heart disease, prostatitis and vascular disease.

Nanobac manufactures and markets In Vitro Diagnostic (IVD) kits and reagents for the detection of Calcifying Nano-Particles. IVD products include the NANOCAPTURE and NANO-SERO ELISA assays and the Nano-Vision line of antibodies and reagents. Nanobac's BioAnalytical Services works with biopharmaceutical partners to develop and apply methods for avoiding, detecting, and inactivating or eliminating CNPs from raw materials. Nanobac's drug discovery and development efforts are focused on developing new and existing compounds that effectively inhibit, destroy or neutralize CNPs.

Calcification is a significant feature in most diseases that are leading causes of death, including heart disease. Calcification is shown in numerous studies to block circulation, cause inflammation and cell disruption, and is a sign of various cancers. We have decided to have a sharpened focus on drug therapy based on findings by Nanobac scientists that certain drugs, when combined, are effective at halting the calcification process. Some of these drug combinations have not been tested in animals or humans. However, the Company has an advantage in that each of these drugs on its own has an FDA-approved record of being safe; therefore regulatory hurdles are significantly lower in every national jurisdiction.

Our plan is to focus on the following priorities over the next 12-18 months:

- **Therapy -** We are entering into agreements to test our proprietary drug combinations to treat stone-forming diseases, with a preliminary focus on prostatitis, which affects millions of men and currently is largely untreatable. We will also conduct tests with other stone forming diseases such as gallstones and kidney stones.

- **Infection -** The gold standard for proving that something is infectious is Koch's postulates. We intend to validate earlier findings on Koch's postulates with calcifying nanoparticles in laboratory animals, including testing whether the infection can be prevented or treated with a proprietary drug combination.

- **Characterization -** We have preliminary photographic and biochemical evidence that calcifying nanoparticles self-replicate in non-precipitating conditions, suggesting further that they have the ability to be infectious. We have designed an experiment with NASA to demonstrate this via time-lapse photography, using new microscopic technology developed in 2005.

- **Thrombosis -** Thrombosis is the cause of death in most hemodialysis patients. We intend to validate findings that calcifying nanoparticles discovered in human blood provoke thrombosis and might be preventable.

- **Diagnostics** - We believe that our proprietary Elisa antibody test uniquely recognizes calcifying nanoparticles known as nanobacteria, and plan to further validate the functionality of this diagnostic test.

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Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

We will continue optimizing our proprietary diagnostics, with a clear focus on developing effective therapies in cooperation with well-established partners including NASA, Mayo Clinic, Cleveland Clinic, and numerous other institutions. Once these experiments are completed, we will have a compelling and well-rounded scientific basis for the Company to move forward.

Current Developments- Dr. Benedict S. Maniscalco, M.D. joined Nanobac as Director of Clinical Research, Medical Director and member of the Board of Directors on March 29, 2006. Dr. Maniscalco replaces Jan Egberts who resigned effective March 29, 2006.

During March 2006, we decided to terminate the marketing and selling of dietary supplements in order for the Company to focus exclusively on the science related to CNPs, which we plan to lead to drug discovery and the development of diagnostic products for the detection and treatment of CNP related diseases. Furniture and equipment related to the dietary supplements' business were sold at book value to an entity controlled by our Chief Executive Officer and largest shareholder.

Patents - We have filed applications for a number of patents, have been granted patents, and await prosecution of pending application in the US and International Stages.

Patent		General Subject Matter	Expiration Date
US 5,135,851	U.S.	-Method for the culture and detection of nanobacteria also known as calcifying nanoparticles (issued in 1992)	May 8, 2010
US 6,706,290 PCT/EP1999/004555	U.S. & International Application (PCT)	-Methods for the eradication of Nanobacteria from articles and animals using various novel combinations of systems, chemicals, compounds, drugs, prodrugs, supplements, etc. (issued in 2004)	Jul 6, 2018
	U.S. & PCT Applications Filed	-Methods and Compositions (combinations) for treating diseases characterized by pathological calcification (Filed in 2004)	
	U.S. & PCT Applications Filed	-Methods and combinations of compositions including Bisphosphonates, chelators, and citrates (Filed in 2004)	
	U.S.	-Methods for the treatment of disease associated with calcification and/or plaque formation (Filed in 2004)	
	U.S. & PCT Application Filed	-Detection of antibodies against compositions of conformationally changed proteins comprising calcium binding protein hydroxy apatite complexes and novel in vitro test methods (Filed in 2005)	

	U.S. & PCT Applications filed	-Methods and compositions to detect calcifying nanoparticles including the identification and quantification of proteins thereon and correlation to diseases thereof (Filed in 2005)	

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Patents (continued) - There can be no assurance that our patents or pending applications will afford legal protection against competitors or provide significant proprietary protection or competitive advantage. In addition, our patents or pending applications could be held invalid or unenforceable by a court, or infringed or circumvented by others, or others could obtain patents that we would need to license or circumvent. Competitors or potential competitors may have filed patent applications or received patents, and may obtain additional patents and proprietary rights relating to proteins, small molecules, compounds, or processes competitive with ours. Additionally, for certain of our product candidates, competitors, or potential competitors may claim that their existing or pending patents prevent us from commercializing such product candidates in certain territories. Further, when our patents expire, other companies could develop new competitive products to our products.

Trade secret protection for our unpatented confidential and proprietary information is important to us. To protect our trade secrets, we generally require our staff members, material consultants, scientific advisors, and parties to collaboration and licensing agreements to execute confidentiality agreements upon the commencement of employment, the consulting relationship, or the collaboration or licensing arrangement with us. However, others could either develop independently the same or similar information or obtain access to our information.

Results of Operations

The following table presents the percentage of period-over-period dollar change for the line items in our Condensed Consolidated Statements of Operations for the three and six month periods ended June 30, 2006 and 2005. These comparisons of financial results are not necessarily indicative of future results.

	Three months ended June 30,			Six months ended June 30,		
	2006	2005	% Change	2006	2005	% Change
Revenue	$ 37,565	$ 167,988	-78%	$ 198,851	$ 319,853	-38%
Cost of revenue	22,623	58,461	-61%	67,818	102,299	-34%
Gross Profit	14,942	109,527	-86%	131,033	217,554	-40%
Gross Profit percentage	40%	65%		66%	68%	
Selling, general and admin	275,289	234,152	18%	701,159	509,938	37%
Research and development	431,016	283,547	52%	785,338	694,841	13%
Impairment Loss on Intangible asset	-	-	-%	585,000	-	-%
Depreciation and amortization	117,811	189,474	-38%	306,028	377,726	-19%
Operating loss	(809,174)	(597,646)	35%	(2,246,492)	(1,364,951)	65%
Other income (Expense)	(26,286)	(46,123)	-43%	(76,655)	(784,739)	-90%

Net loss	($835,460)	($643,769)	30%	($2,323,147)	($2,149,690)	-8%

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Revenue

Revenue for the three and six months ended June 30, 2006 and 2005 is summarized as follows:

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Dietary Supplements	$ 2,202	$ 137,185	$ 122,495	$ 262,313
Observation Rights	6,000	0	12,000	0
Diagnostic Products	29,363	30,803	64,356	57,540
	$ 37,565	$ 167,988	$ 198,851	$ 319,853

During March 2006, we discontinued the sale of our dietary supplements. Accordingly, we had only an insignificant amount of revenue from the sale of remaining product inventory for the three months ended June 30, 2006. We expect no significant revenue from dietary supplements in future periods.

Revenue from observation rights is being recognized over the agreement’s 12-month term using the straight-line method.

Cost of Revenue

Cost of revenue consists of direct materials, testing services and shipping.

Gross Profit

As a percentage of revenue, our gross profit was between 65% to 70% of revenue when we were selling dietary supplements. Our diagnostic product line has historically generated a gross profit margin of 40% to 50%.

Selling, General and Administrative

Approximately two-thirds of selling, general and administrative (“SG&A”) expenses are comprised of payroll and professional fees. The majority of professional fees are related to patents and public company expenses for audit, legal and investor relations. Other significant SG&A expenses include facility rental and insurance.

SG&A increased to approximately $275,000 for the three months ended June 30, 2006 from approximately $234,000 for the three months ended June 30, 2005. This increase of $41,000 was attributable to $100,000 increase in professional fees connected with patents, consultants and accountants offset by a $70,000 decrease in payroll related costs and $17,000 decrease in other SG&A expenses. The higher professional fees and lower payroll reflect our shift to a research based company.

SG&A increased to $701,000 for the six months ended June 30, 2006 compared to $510,000 for the six months ended June 30, 2005. This increase is attributable to the abandoned lease described below offset by other net decreases in SG&A.

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Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Selling, General and Administrative (continued)

During March 2006, the Company ceased occupying leased office space in Tampa, Florida. As a result of the early abandonment of this office lease, a charge to earnings of approximately $106,000 for the acceleration of lease payments associated with the abandoned lease has been recognized in the accompanying financial statements for the six months ended June 30, 2006.

Research and Development

For the six months ended June 30, 2006 and 2005 research and development (“R&D) expenses consisted of the following types of expenses:

	Six Months ended June 30	
	2006	2005
U.S. Payroll and medical directors	54%	61%
Finland payroll and laboratory	32%	29%
Research studies	9%	7%
Other	5%	3%
	100%	100%

For the three months ended June 30, 2006, R&D expenses increased to approximately $431,000 or by 70% compared to approximately $284,000 for the three months ended June 30, 2005. The increase was the result of greater payroll expenses and medical director costs as we have shifted our primary emphasis to R&D.

For the six months ended June 30, 2006, R&D expenses increased to approximately $785,000 or by 32% compared to approximately $694,000 for the six months ended June 30, 2005. The increase was the result of greater payroll expenses and medical director costs as we have shifted our primary emphasis to R&D. In addition, we incurred an additional $27,000 for research studies with outside laboratories.

With our renewed focus on R&D, we anticipate increasing R&D expenses during the next several months.

Impairment loss on intangible assets

During March 2006, we established a plan to discontinue the sale of dietary supplements. As a result of the above decision, the product rights’ intangible asset was deemed fully impaired and an impairment loss of $585,000 has been recognized during the six months ended June 30, 2006.

Depreciation and amortization

Over 95% of depreciation and amortization are related to the amortization of intangible assets (primarily patents) acquired in the June 2003 acquisition of LABS and the November 2003 acquisition of OY. Amortization expense decreased for the three and six months ended June 30, 2006 compared to the three and six months ended June 30, 2005 as the amortization of product rights was eliminated due to the impairment of this intangible asset described above.

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Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Operating Loss

Our operating loss increased to approximately $809,000 for the three months ended June 30, 2006 compared to approximately $598,000 for the three months ended June 30, 2005. Approximately $95,000 of this increased loss was the result of the decrease in revenues from dietary supplements. In addition, R&D costs increased $177,000 due to our increased focus on research initiatives. These increases were partially offset by a decrease in amortization expense of $61,000.

Our operating loss increased to approximately $2.2 million for the six months ended June 30, 2006 compared to approximately $1.4 million for the six months ended June 30, 2005. The majority of the increase is attributable to the $106,000 charge for the abandonment of our Tampa lease and the $585,000 impairment loss for our product right's intangible asset due to our termination of marketing and selling of dietary supplements. We also experienced an increase in R&D expense for this period.

Other income (expense)

Other income (expense) for the three and six months ended June 30, 2006 and 2005 is summarized as follows:

	Three months ended June 30,		**Six months ended June 30,**	
	2006	2005	2006	2005
Interest expense:				
Stockholder loan	($46,257)	($16,768)	($84,280)	($20,663)
Other	(12)	(553)	($228)	(1,851)
Derivative loss	-	-	-	(717,908)
Loss on disposition of assets	-	-	(18,330)	-
Foreign exchange gain (loss)	17,236	(25,415)	24,238	(36,132)
Other, net	2,747	(3,387)	1,945	(8,185)
Total	($26,286)	($46,123)	($76,655)	($784,739)

The shares issued in connection with the 2005 and 2004 Subscription Agreement transactions are financial instruments with characteristics of both liabilities and equity and as such have been presented in the accompanying condensed consolidated balance sheets as a liability. Changes in the liability are recorded as charges to the condensed consolidated statement of operations as a loss on the stock settlement obligation for the six months ended June 30, 2005.

Loss on disposition of assets is attributable to leasehold improvements in connection with the abandonment of our lease.

Foreign currency gain results from exchange rate changes between the U.S. dollar and the Euro on intercompany advances between our U.S. subsidiary and our Finland subsidiary.

Net Loss

We are experiencing significant losses as we conduct research and development related to nanobacteria. We believe it will take significant time before we will earn meaningful revenue to offset our expenses and there is no assurance that we will be able to accomplish this goal. As a result of the losses, we are dependent on affiliates of our CEO and other investors to provide sufficient cash sources to fund our operations.

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Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)
Liquidity and Capital Resources

Since the United States Bankruptcy Court confirmed a plan of reorganization that allowed the Company to emerge from Chapter 11 during calendar 2002, the Company has financed its activities primarily through loans made by entities affiliated with our current Chief Executive Officer (referred to herein as "the Affiliated Entities"). These loans were made as funding was needed and were extremely advantageous to the Company in that the amounts were funded as the Company needed financial infusions and allowed the Company to avoid the costs and distractions of attempting to raise these amounts from unrelated parties. It is unrealistic to believe that unrelated parties would have offered terms as generous as those obtained from the Affiliated Entities, and it is also unlikely that any financing could have been obtained under any terms without the financing of the Affiliated Entities. From time to time the Affiliated Entities have agreed to allow a portion of the loan balances to be converted into shares of the Company's common stock. There is no obligation on the part of the Affiliated Entities to make additional loans to the Company. The Affiliated Entities are also under no obligation to convert any portion of the loan balances owed to it into additional shares of the Company's stock.

Since August of 2004, the Company has received $1.4 million (net of $125,000 of expenses) from three unaffiliated investors and one affiliate for shares of the Company's stock and an equal amount of warrants to acquire additional shares of the Company's stock. The exact number of shares to be issued is dependent upon the average closing bid price of the Company's stock on the five trading days immediately prior to the date on which a registration statement for these shares is declared effective. The purchase price of the shares is equal to the lesser of (1) $.12 or (2) 52% of the average closing price described above. An additional $1.5 million is to be received from these investors within five days of registering the common shares and warrants. A registration statement has not yet been declared effective for these shares and we do not know if and when a registration statement will be declared effective for these shares. Also there are no assurances that the SEC will declare a registration statement effective.

As of June 30, 2006, we had total assets of approximately $8.2 million of which only $338,000 were current assets. At June 30, 2006, we had total current liabilities of approximately $5.1 million and a working capital deficit of $4.8 million. $4.0 million of the $4.8 million working capital deficit is attributable to the related party loans from Affiliated Entities described above.

Net cash used in operations for the six months ended June 30, 2006 was approximately $1.3 million. The negative cash flow from operations reflects the $2.3 million net loss for the period offset by non-cash charges of $891,000 for depreciation, amortization and impairment loss plus $106,000 non-cash loss for the abandonment of a lease (included in accrued expenses).

Net cash used by investing activities for the three months ended June 30, 2006 included $4,000 for the purchase of fixed assets, $3,000 for a security deposit offset by $6,000 of proceeds from the sale of property and equipment to affiliated entities at book value.

Net cash provided by financing activities for the six months ended June 30, 2006 was $1.5 million, which is primarily attributable to increased stockholder loans.

As noted above, cash from stockholder loans and capital contributions financed our negative cash flow from operations. We are dependent on raising additional funding necessary to implement our business plan. Should we not be successful in raising cash from our CEO and other investors, we are unlikely to continue as a going concern.

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

Critical accounting policies

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

Forward Looking Statements

Our disclosure and analysis in this Form 10-QSB contains some forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995 ("the Act"), that set forth anticipated results based on our plans and assumptions. From time to time, we also provide forward-looking statements in other materials we release to the public as well as oral forward-looking statements. Such statements give our current expectations or forecasts of future events; they do not relate strictly to historical and current facts. We have tried wherever possible to identify such statements by using words such as "anticipate", "estimate", "expect", "project", "intend", "plan", "believe", "will" and similar expressions in connection with any discussion of future operating or financial performance.

In light of the important factors that can materially affect results, including those set forth above and elsewhere in this report, the inclusion of forward-looking information herein should not be regarded as a representation by us or any other person that our objectives or plans will be achieved. We may encounter competitive, technological, financial and business challenges making it more difficult than expected to continue to market our products and services; competitive conditions within our industry may change adversely; we may be unable to retain existing key management and research personnel; our forecasts may not accurately anticipate market demand; and there may be other material adverse changes in our operations or business. Certain important factors affecting the forward looking statements made herein include, but are not limited to (i) accurately forecasting capital expenditures; (ii) obtaining new sources of external financing; (iii) serving as the nexus for nanobacteria research and (iv) conducting successful clinical trials supporting Dr. Kajander's theories that the human body does not recognize nanobacteria as harmful, and accordingly, nanobacteria could be the cause of pathological disease causing calcification found in multiple diseases. Assumptions relating to budgeting, marketing, product development and other management decisions are subjective in many respects and thus susceptible to interpretations and periodic revisions based on actual experience and business developments, the impact of which may cause the Company to alter its capital expenditure or other budgets, which may in turn affect the Company's financial position and results of operations.

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

Quantitative and Qualitative Disclosures About Market Risk

While most of our operations are conducted in the United States, we also operate a laboratory in Kuopio, Finland. We face two risks related to foreign currency exchange: translation risk and transaction risk. Amounts invested in our Finland operations are translated into US Dollars at the exchange rates in effect at the balance sheet date. Since the functional currency of our Finland subsidiary is the local currency, foreign currency translation of the balance sheet is reflected as a component of stockholders' equity and does not impact operating results.

Our Finland subsidiary collects revenue and pays expenses in Euros, mitigating transaction risk. Revenues and expenses in Euros translate into varying amounts of US Dollars depending upon whether the US Dollar weakens or strengthens against the Euro. Therefore, changes in exchange rates may negatively affect the Company's consolidated revenues and expenses (as expressed in US Dollars) from foreign operations.

Currency transaction gains or losses are incurred on our US Subsidiary's intercompany advance to our Finland Subsidiary. We recognize a gain on the intercompany advance as the US Dollar weakens against the Euro and we recognize a loss when the US Dollar strengthens against the Euro.

The Company has not entered into a material amount of foreign currency forward exchange contracts or other derivative financial instruments to hedge the effects of adverse fluctuations in foreign currency exchange rates.

Item 3: Controls and Procedures

Disclosure controls and procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report, and, based on this evaluation, our Chief Executive Officer has concluded that these controls and procedures are effective.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Item 3: Controls and Procedures (continued)

Section 404 of the Sarbanes-Oxley Act of 2002

Section 404 of the Sarbanes-Oxley Act of 2002 requires our report on Form 10-KSB for 2007 to include a report of management on internal control over financial reporting. Internal control over financial reporting, as defined under these rules, is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

In our report, we will be required, among other things, to assess the effectiveness of our internal control over financial reporting. The report must also disclose any material weaknesses in internal control over financial reporting identified by management, and if there are any material weaknesses, we must conclude that our internal control over financial reporting was not effective. A material weakness, under the applicable rules, is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

In conducting our ongoing assessment of its internal control over financial reporting to prepare for compliance with the requirements under Section 404 of the Sarbanes-Oxley Act, we have identified a lack of segregation of duties to be a potential material weakness in internal controls. Lack of segregation of duties is inherent to our company due to the small number of employees. Our assessment is still in process to determine if this situation is actually a material weakness or if there are any other material weaknesses.

Changes in internal controls

There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II - OTHER INFORMATION

Item 1: Legal Proceedings

Except as described below, we know of no material, active or pending legal proceedings against us, nor are we involved as a plaintiff in any material proceedings or pending litigation. There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial stockholders are an adverse party or has a material interest adverse to us.

On August 10, 2004, we were served with a civil action as filed in the Superior Court of Fulton County State of Georgia by Foltz Martin LLC and Openbook Learning Club, Inc. (“Foltz”). This suit alleges that the Company is liable for approximately $67,000 of liabilities plus approximately $11,000 interest for services performed by the plaintiffs for HealthCentrics, Inc. in 2003 and 2004. The Company owned 100% of HealthCentrics from December 2003 through March 2004 when HealthCentrics was sold by the Company to an affiliate. A judgment has been entered in Superior Court of Fulton County, State of Georgia , in favor of Foltz in this matter. We do not believe that the Company is liable for the obligations of HealthCentrics.

On January 19, 2006, we were served with a civil action as filed in the Superior Court of Fulton County State of Georgia by EliteCorp Atlanta, LLC (“EliteCorp”). This suit alleges that the Company is liable for approximately $318,000 of liabilities plus approximately $110,000 interest for services performed by the plaintiffs for HealthCentrics, Inc. in 2003 and 2004. We responded to this action on February 17, 2006 and denied virtually all the

allegations of EliteCorp. We do not believe that the Company is liable for the obligations of HealthCentrics.

Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

From August 2004 through February 2005, we executed Subscription Agreements with three unaffiliated investors and one affiliated investor. These investors paid us 50% of the subscription price at execution and the remaining 50% is due within five days from the date that a registration statement is declared effective for the common shares that are being issued. In exchange for the cash consideration, we are to issue these investors shares of our common stock equal to the amount paid divided by the lesser of (a) $0.12 or (b) fifty-two percent of the average closing bid price for our common stock for the five days immediately prior to the date on which a registration statement is declared effective ("The Fixed Price"). In addition, upon which a registration statement is declared effective, each of these investors will receive an equivalent number of warrants with expiration dates of five years from the date of issuance. One half of these warrants will be priced at 110% of the Fixed Price and the remainder will be priced at 150% of the Fixed Price. The minimum number of shares and warrants that will be issued under these Subscription Agreements (assuming a Fixed Price of $0.12 per share) is as follows:

	Number of Shares		Per Share		Proceeds
Common Stock:					
Unaffiliated Investors	16,250,000	$	0.12	$	1,950,000
Affiliates	8,333,333	$	0.12	$	1,000,000
	24,583,333			$	2,950,000

	Number of Warrants		Exercise Price
Warrants:			
Unaffiliated Investors	8,125,000	$	0.13
Unaffiliated Investors	8,125,000	$	0.18
Affiliates	4,166,667	$	0.13
Affiliates	4,166,666	$	0.18
	24,583,333		

As of June 30, 2006, proceeds of $1,475,000 have been received and 12,297,667 unregistered shares had been issued under the above Subscription Agreements. The actual number of shares and warrants that ultimately will be issued under these Subscription Agreements may be substantially higher due to the variability of the Fixed Price. Based on our recent traded price of $0.04 to $0.09 per share, three to six times as many shares and warrants would be issued as described above. Further, if the Fixed Price is less than $0.09 per share, we do not have sufficient authorized shares to issue the common stock and warrants required under the above subscription agreements. Our stockholders need to approve any increase in our authorized shares.

Each of these investors received their shares in reliance upon Section 4(2) of the Securities Act of 1933, because each of the holders was knowledgeable, sophisticated and had access to comprehensive information about us. At all relevant times we were a reporting company under the Securities Exchange Act of 1934 and there was readily available adequate current public information with respect to the Company.

A success fee was awarded to a broker for one of the above unaffiliated investor transactions in the form of 5-year warrants equal to 20% of the value of the transaction. These warrants have exercise prices equal to $0.16 to $0.22 per share for transactions completed to date. Future warrants issued under this agreement will have an exercise price equal to NNBP's stock price on the date of closing. We estimate that 2 million warrants will be issued to this broker.

Item 3: Defaults upon Senior Securities

None.

Item 4: Submission of Matters to a Vote of Security Holders

None.

Item 5: Other Information

None

Item 6: Exhibits and Reports on Form 8-K

(a) The following exhibits are filed as part of this report:

Exhibit 31.1 - Certification to Section 302 of the Sarbanes-Oxley Act of 2002 - Chief Executive Officer

Exhibit 31.2 - Certification to Section 302 of the Sarbanes-Oxley Act of 2002 - Chief Financial Officer

Exhibit 32.1 - Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Chief Executive Officer

Exhibit 32.2 - Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Chief Financial Officer

(b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 11, 2006

NANOBAC PHARMACEUTICALS, INCORPORATED

By: /s/ John D Stanton

John D Stanton
Chief Executive Officer

Nanobac Pharmaceuticals, Incorporated

EXHIBIT INDEX