INTRABIOTICS PHARMACEUTICALS INC /DE
Form 10-Q
November 07, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 10-Q

þ **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2006

Or

o **Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission File Number 0-29993

INTRABIOTICS PHARMACEUTICALS, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE	94-3200380
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1009 Oak Hill Rd., Suite 201
Lafayette, CA 94549
(Address of principal executive offices)
(925) 906-5331
(Registrant s telephone number including area code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by checkmark whether registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (check one)

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes þ No o

There were 9,338,333 shares of the Registrant s common stock, par value $0.001, outstanding as of September 30, 2006.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

INTRABIOTICS PHARMACEUTICALS, INC.
CONDENSED BALANCE SHEETS
(Dollars In thousands, except per share data)

	September 30, 2006 (Unaudited)	December 31, 2005 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 12,156	$ 2,772
Short-term investments	36,884	46,058
Prepaid expenses and other current assets	465	341
Total assets	$ 49,505	$ 49,171
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 19	$ 58
Accrued clinical liabilities	7	99
Other accrued liabilities	189	194
Total current liabilities	215	351
Stockholders equity:		
Convertible preferred stock, $0.001 par value: 5,000,000 shares authorized; 300 shares outstanding and $3,000 aggregate liquidation preference at September 30, 2006 and December 31, 2005, respectively	1,634	1,634
Common stock, $0.001 par value: 70,000,000 shares authorized at September 30, 2006 and December 31, 2005; 9,338,333 and 9,287,685 shares outstanding at September 30, 2006 and December 31, 2005, respectively	9	9
Additional paid-in capital	283,354	282,828
Deferred stock compensation		(45)
Accumulated other comprehensive loss	(5)	(36)
Accumulated deficit	(235,702)	(235,570)
Total stockholders equity	49,290	48,820
Total liabilities and stockholders equity	$ 49,505	$ 49,171

See accompanying notes to unaudited condensed financial statements

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INTRABIOTICS PHARMACEUTICALS, INC.
CONDENSED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Operating expenses:				
Research and development	$	$ 7	$ 7	$ 255
General and administrative	463	560	1,677	2,605
Restructuring charge		(27)		648
Total operating expenses	463	540	1,684	3,508
Operating loss	(463)	(540)	(1,684)	(3,508)
Other income	4	1	2	1
Interest income	635	395	1,731	1,043
Net Income (loss)	176	(144)	49	(2,464)
Non-cash dividends on Series A preferred stock	(60)	(60)	(180)	(180)
Net income (loss) applicable to common stockholders	$ 116	$ (204)	$ (131)	$ (2,644)
Basic net income (loss) per share applicable to common stockholders	$ 0.01	$ (0.02)	$ (0.01)	$ (0.29)
Diluted net income (loss) per share applicable to common stockholders	$ 0.01	$ (0.02)	$ (0.01)	$ (0.29)
Shares used to compute basic net income (loss) per share applicable to common stockholders	9,334	9,180	9,316	9,087
Shares used to compute diluted net income (loss) per share applicable to common stockholders	11,560	9,180	9,316	9,087

See accompanying notes to unaudited condensed financial statements

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INTRABIOTICS PHARMACEUTICALS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2006	**2005**
Operating activities		
Net income (loss)	$ 49	$ (2,464)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Stock compensation for directors	393	(43)
Amortization of deferred stock compensation		39
Stock compensation for consultant services	2	141
Depreciation and amortization		9
Loss on disposal of property and equipment		27
Change in assets and liabilities:		
Prepaid expenses and other current assets	(124)	(104)
Accounts payable	(39)	(100)
Accrued clinical liabilities	(92)	(62)
Accrued employee liabilities		(38)
Accrued restructuring charges		(5)
Other accrued liabilities	(5)	(115)
Net cash provided by (used in) operating activities	184	(2,715)
Investing activities		
Proceeds from sale of property and equipment		10
Purchase of short term investments	(156,069)	(116,672)
Proceeds from sale or maturity of short-term investments	165,269	117,613
Net cash provided by investing activities	9,200	951
Financing activity		
Proceeds from issuance of common stock, net of issuance costs		497
Net cash provided by financing activities		497
Net increase (decrease) in cash and cash equivalents	9,384	(1,267)
Cash and cash equivalents at beginning of the period	2,772	1,755
Cash and cash equivalents at end of the period	$ 12,156	$ 488
Supplemental disclosure of non-cash information:		
Issuance of common stock dividend on Series A preferred stock	$ (180)	$ (180)

Issuance of common stock upon conversion of Series A preferred stock	$	$ (137)

See accompanying notes to unaudited condensed financial statements

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INTRABIOTICS PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed financial statements are unaudited and have been prepared by IntraBiotics Pharmaceuticals, Inc. (the Company) in accordance with the rules and regulations of the Securities and Exchange Commission for interim financial information, and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X.

Certain information and footnote disclosures normally included in the Company s annual audited financial statements (as required by accounting principles generally accepted in the United States) have been condensed or omitted. The interim condensed financial statements, in the opinion of management, reflect all adjustments (consisting entirely of normal recurring adjustments) necessary for a fair presentation of the Company s financial position as of September 30, 2006, the results of its operations for the three months and nine months ended September 30, 2006 and 2005 and cash flows for the nine months ended September 30, 2006 and 2005.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the entire fiscal year. These interim condensed financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2005, which are contained in the Company s Annual Report on Form 10-K, and filed with the Securities and Exchange Commission on February 21, 2006. The condensed balance sheet as of December 31, 2005 is derived from such audited financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including amounts accrued for stock-based compensation.

The Company s estimate of accrued costs is based on historical experience, information received from third parties and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could therefore differ materially from those estimates under different assumptions or conditions.

Note 2. Stock-Based Compensation

The Company s 2004 Stock Incentive Plan (the 2004 Plan) was adopted in May 2004, and replaced the 2000 Equity Incentive Plan (the 2000 Plan), which in turn had replaced the 1995 Incentive Stock Plan (the 1995 Plan), collectively the Predecessor Plans. The termination of the Predecessor Plans had no effect on the options that were granted thereunder. The terms of awards granted under the Predecessor Plans were substantially similar to those granted under the 2004 Plan. The 2004 Plan allows for the granting of options to purchase stock, stock bonuses and rights to acquire restricted stock of up to 2,050,000 shares of common stock to employees, consultants, and directors. The number of shares of Common Stock available for issuance under the Plan shall automatically increase on the first trading day of January each calendar year during the term of the Plan, beginning with calendar year 2005. In accordance with the preceding formula, the shares available for issuance under the 2004 Plan were increased by 529,510 on January 1, 2005 and 543,302 on January 1, 2006. All options granted under the 2004 Plan must have exercise prices equal to the fair market value of the common stock on the option grant date, and are to have a term not greater than 10 years from the grant date. Options granted under the 2004 plan vest ratably over periods ranging from 3 months to six years. Options granted under Predecessor Plans vest ratably over periods ranging from 18 months to six years.

The 2002 Non-Officer Equity Incentive Plan (the 2002 Plan) was adopted in August 2002 and allows the granting of stock awards, stock bonuses and rights to acquire restricted common stock of up to 208,333 shares of common stock, to employees of the Company who are not officers, to executive officers not previously employed by the Company as an inducement to entering into an employment contract with the Company, and to consultants of the Company. All options are to have a term not greater than 10 years from the grant date.

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To cover the exercise of vested options the Company issues new shares from its authorized but unissued share pool. As of September 30, 2006 there were 2,575,310 and 56,250 shares of common stock available for issuance under the 2004 Plan and the 2002 Plan, respectively.

No cash proceeds from the sales of common stock under employee option plans were received for the nine months ended September 30, 2006, versus $497,000 during the first nine months of 2005. No income tax benefits were realized from the sales of common stock during the nine months ended September 30, 2006. In accordance with SFAS 123 (R), the Company presents excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

Adoption of SFAS No. 123 (R)

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) 123(R) - Share-Based Payment , a revision of SFAS 123, Accounting for Stock-Based Compensation which superseded Accounting Principles Board (APB) Opinion No.25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS 123(R) establishes standards for the accounting for transactions where an entity exchanges its equity instruments for goods or services. The principal focus of SFAS 123(R) is the accounting for transactions in which an entity obtains employee services in share-based payment transactions, and where the measurement of the cost of employee (or member of the Board of Directors) services received in exchange for an award of equity instruments is based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee (or director) is required to provide service in exchange for the award the requisite service period and unless observable market prices for the same or similar instruments are available, will be estimated using option-pricing models adjusted for the unique characteristics of the instruments. If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification.

Stock Compensation Expense

Under SFAS 123(R), we determined the appropriate fair value model to be used for valuing share-based payments and the amortization method for compensation cost. The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. The Company s Consolidated Financial Statements as of and for the three months and nine months ended September 30, 2006 reflects the impact of SFAS 123(R). During the three months and nine months ended September 30, 2006, the Company recognized $136,000 and $393,000, respectively, in compensation expense related to options granted to employees and directors, which was $120,000 and $345,000 higher than if it had continued to account for share-based compensation under Statement 123. There were no tax benefits from share-based compensation since the Company has substantial tax loss carry forwards and sustained a loss to stockholders for the nine months ended September 30, 2006. In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). The impact on both basic and diluted earnings per share for the three months and nine months ended September 30, 2006 was $0.01 and $0.04, respectively.

Prior to 2006, the Company accounted for stock-based compensation in accordance with APB 25 using the intrinsic value method, which did not require that compensation cost be recognized for the Company s stock awards provided the exercise price was established at 100% of the common stock fair market value at the date of grant. Prior to fiscal 2006 the Company provided pro forma disclosure amounts in accordance with SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, as if the fair value method defined by SFAS 123 had been applied to its stock-based compensation. If the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation for the three and nine months ended September 30, 2005, it would have recorded an expense of $264.000 and $1.6 million, respectively. The difference between the two years (actual 2006 and pro-forma 2005) is primarily due to the decreased volatility of the stock and option exercises and cancellations resulting from the discontinuance of Iseganan and subsequent termination of all employees. The impact on both basic and diluted earnings per share for the three months and nine months ended September 30, 2005 was $0.03 and $0.18, respectively.

At September 30, 2006, the total compensation cost related to unvested stock-based awards granted to employees under the stock option plans but not yet recognized was approximately $361,000, after estimated forfeitures. The cost will be recognized on a straight-line basis over an estimated weighted average period of approximately .7 years for stock options and will be adjusted if necessary for forfeitures and cancellations.

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Determining Fair Value

Valuation and amortization method The Company estimates the fair value using a Black-Scholes option pricing formula and a single option award approach. This fair value is then amortized ratably over the requisite service periods of the awards, which is generally the vesting period.

Expected Term The expected term of options is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding; which results from certain groups of employees exhibiting different behavior.

Expected Volatility The Company s expected volatility for the quarter ended September 30, 2006 is based on Company s historical volatility.

Risk-Free Interest Rate The risk-free interest rate used in the Black-Scholes option valuation method is based on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the option.

Expected Dividend The dividend yield reflects that the Company has not paid any dividends and has no intention to pay dividends in the foreseeable future.

Estimated Forfeiture The Company does not anticipate forfeiture due to the limited number of people (3) that have stock options outstanding.

In the three months ended September 30, 2006 and 2005, respectively, the fair value of each option grant was estimated on the date of grant using the Black-Scholes option valuation model using a dividend yield of 0% and the following weighted average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Risk-free interest rate	n/a	n/a	4.60%	3.79%
Volatility	n/a	n/a	0.20	0.89
Dividend yield	n/a	n/a	0.00%	0.00%
Expected life of option	n/a	n/a	6.2	6.1

No stock options were granted to employees during the three months ended September 30, 2006 and 2005. There were no post-vesting restrictions.

Stock Options and Awards Activities

The following is a summary of the Company s stock option activity under the stock option plans as of September 30, 2006 and related information:

		Outstanding Options		
		Weighted Average		Aggregate
	Number of Shares	Exercise Price	Remaining Contract Life	Intrinsic Value (000's)
Balance at December 31, 2005	570,667	$ 8.92	7.08	
Granted	37,500	$ 3.50		
Exercised	0	$		
Forfeitures and cancellations	(119,000)	$ 10.13		
Balance at September 30, 2006	489,167	$ 8.13	6.21	$ 231,892
Vested and expected to Vest at September 30, 2006	489,167	$ 8.13	6.21	$ 231,892

Exercisable at September 30, 2006	357,911	$ 7.69	5.7	$ 199,553
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The weighted-average grant date fair value of options granted for both the three months and nine month periods ended September 30, 2006 and 2005 was $3.50 and $3.98, respectively. The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company s closing stock price of $3.79 at September 30, 2006, which would have been received by option holders had all option holders exercised their options that were in-the-money as of that date. The total number of in-the-money options exercisable as of September 30, 2006 was approximately 249,167 shares. The aggregate intrinsic value of options exercised during the three and nine months ended September 30, 2006 was zero, since there were no options exercised.

The exercise prices for options outstanding and exercisable as of September 30, 2006 and their weighted average remaining contractual lives were as follows:

	Options Outstanding			Options Exercisable	
	Options Outstanding			Options exercisable	
Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$ 2.40	8,333	0.06	2.40	8,333	$ 2.40
$ 2.76	203,334	4.26	2.76	182,495	$ 2.76
$ 3.50	37,500	9.37	3.50		$ 3.50
$ 4.08	20,000	8.26	4.08	20,000	$ 4.08
$13.06	100,000	7.60	13.06	58,333	$ 13.06
$13.93	40,000	7.70	13.93	30,000	$ 13.93
$16.49	80,000	7.34	16.49	58,750	$ 16.49
Totals	489,167	6.21	8.13	357,911	$ 7.69

Pro-forma Disclosures

The following table illustrates the effect on net income and net income per share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation during the three-month and nine month periods ended September 30, 2005 (in thousands, except per share amounts):

	(In thousands, except per share amounts)	
	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net loss applicable to common stockholders, as reported	$ (204)	$ (2,644)
Add: Stock-based employee compensation expense (recovery) included in reported net loss applicable to common stockholders	16	(4)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(280)	(1,643)
Net loss applicable to common stockholders, pro forma	$ (468)	$ (4,291)

Net loss per share applicable to common stockholders:					
Basic and diluted	as reported	$	(0.02)	$	(0.29)
Basic and diluted	pro forma	$	(0.05)	$	(0.47)

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For the purposes of this pro forma disclosure, the value of the options was estimated using a Black-Scholes option valuation model and recognized over the respective vesting periods of the awards.

Note 3. Comprehensive Income (Loss)

The components of comprehensive loss in each period presented are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(In thousands)		(In thousands)	
Net income (loss)	$ 176	$ (144)	$ 49	$ (2,464)
Unrealized gain (loss) on available-for-sale securities	6	9	31	7
Comprehensive income (loss)	$ 182	$ (135)	$ 80	$ (2,457)

Note 4. Net Income (Loss) Per Share

Basic and diluted net income (loss) per share applicable to common stockholders is presented in accordance with Financial Accounting Standards Board Statement No. 128, *Earnings Per Share,* and is calculated using the weighted-average number of shares of common stock outstanding during the period. Net profit or loss per share applicable to common stockholders includes the impact of potentially dilutive securities (stock options, warrants and convertible preferred stock). As the Company s potentially dilutive securities were anti-dilutive for all loss periods presented, they are not included in the calculations of diluted net loss per share applicable to common stockholders for those loss periods. Potentially dilutive shares used to compute 2006 third quarter basic and diluted net income per share were calculated using the net exercise method. The total number of shares underlying the stock options, warrants and convertible preferred stock excluded from the calculations of net income (loss) per share applicable to common stockholders was 285,565 and 2,917,484 for the three months ended September 30, 2006 and 2005, respectively and 2,716,966 and 3,293,626 for the nine months ended September 30, 2006 and 2005, respectively.

Note 5. Stockholders Equity

In February 2005, a holder of 25 shares of Preferred Stock converted the shares into 131,529 shares of common stock. At the same time, the same investor exercised warrants to purchase 65,764 shares of common stock, using the net exercise method, resulting in the issuance of 30,704 shares of common stock. There were no cash proceeds to the Company resulting from these transactions.

On October 14, 2005, the Company s Common Stock was delisted from The NASDAQ National Market. The delisting decision was made by the NASDAQ Listings Qualifications Panel, following an appeal by the Company of a prior determination by the staff of the NASDAQ Stock Market (the Staff) that the Company was a public shell, raising public interest concerns pursuant to Marketplace Rule 4300.

As previously disclosed, the Company issued warrants to purchase shares of its common stock in connection with its Series A convertible preferred stock offering on May 1, 2003 which provide that if the Company s common stock is delisted from NASDAQ, the purchase price for the stock upon exercise of the warrants will be reduced by 50% without any concomitant increase in the number of shares of common stock for which the warrants are then exercisable. This provision was triggered by the delisting. As of September 30, 2005 the Company had 789,171 such warrants outstanding with an exercise price of $2.066 per share. As a result of the October 14, 2005 delisting, the exercise price dropped from $2.066 to $1.033 per share, and the Company recorded a non-cash charge to other expense resulting from the change in exercise price and an offsetting increase to paid-in-capital in December of 2005 in the amount of $789,000 to reflect the fair market value.

The Company s quotation for its common stock appears in the Pink Sheets under the trading symbol IBPI or IBPI.PK .

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In February 2006, the Company issued 16,580 shares of common stock in connection with dividends payable to holders of preferred stock on December 31, 2005. In May 2006, the Company issued 17,179 shares of common stock in connection with dividends payable to holders of preferred stock on March 31, 2006. In July of 2006, the Company issued 16,889 shares of common stock in connection with dividends payable to holders of preferred stock on June 30, 2006.

Note 6. Commitments

At September 30, 2006, the Company had no operating lease commitments.

Note 7. Legal Proceedings

Beginning on July 2, 2004, three purported class action shareholder complaints were filed in the United States District Court for the Northern of California against IntraBiotics and several of its officers. The actions were consolidated and a consolidated amended complaint has been filed, purportedly brought on behalf of purchasers of IntraBiotics common stock between September 5, 2003 and June 22, 2004. The amended complaint generally alleges that IntraBiotics and several of its officers and directors made false or misleading statements concerning the clinical trial of Iseganan. The plaintiffs seek unspecified monetary damages. On February 28, 2005, the Company and the individual defendants filed a motion to dismiss the amended complaint. On January 23, 2006, the court issued its decision on the motion, granting the motion to dismiss the claim under the Securities Exchange Act of 1934, with leave to amend, and denying the motion to dismiss the claims under the Securities Act of 1933. Plaintiffs filed an amended complaint on February 22, 2006. IntraBiotics and the other defendants moved to dismiss all claims alleged in the amended complaint on March 14, 2006. In orders issued on August 1 and August 30, 2006, the court dismissed all claims against the defendants. The court entered judgment in favor of defendants on October 3, 2006. Plaintiffs had 30 days in which to file a notice of appeal. As plaintiffs did not appeal the judgment before the end of that time limit, the case has now ended in favor of IntraBiotics and the individual defendants.

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

The following discussion and analysis of our financial condition and results of operations should be read together with our financial statements and related notes included in our quarterly report on this Form 10-Q and in our annual report on Form 10-K for the year ended December 31, 2005. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. The actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth in Part1, Item 1A Risk Factors of our Form 10-K for the year ended December 31, 2005. All forward-looking statements included in this document are based on information available to us on the date of this document and we assume no obligation to update any forward-looking statements contained in this Form 10-Q.

Overview

From inception in 1994, through May 2005, we devoted substantially all of our efforts to research and development of anti-microbial drugs, and generated no product revenues. From the fourth quarter of 2002 until September 2004 we focused our attention on developing Iseganan for the prevention of ventilator-associated pneumonia (VAP). In September 2004, the Company discontinued its clinical trial of Iseganan for the prevention of VAP following a recommendation of the independent data monitoring committee. Subsequently, the Company terminated the Iseganan development program, reduced employees, and evaluated (and continues to evaluate) strategic alternatives, including mergers, acquisitions, in-licensing opportunities, and liquidation of the Company.

On May 5, 2005, after considering a variety of strategic alternatives, none of which was determined by management and the Board of Directors to be in the best interests of the Company and its shareholders, the Board of Directors decided to suspend the Company s active evaluation process and reduce operating expenses to a minimum appropriate level. In accordance with these plans, the Company terminated all of its remaining regular employees on June 15, 2005. The Company engaged Hickey & Hill, Inc. of Lafayette, California, a firm specializing in managing companies in transition, to assume the responsibilities of day-to-day administration of the Company, and appointed Denis Hickey of Hickey & Hill, Inc. as its Chief Executive Officer and Chief Financial Officer. In addition, the Company is continuing to pursue strategic alternatives in the biotechnology industry with the support of consultants and the active participation of its Board.

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The registrant plans to conduct its affairs in the most financially efficient manner practical for a public company. During the period that Hickey & Hill, Inc. will handle the administration of the Company s affairs, the Board of Directors and selected consultants will evaluate any strategic alternatives that come to the Company s attention. The Company, in any case, will continue operations at least until all alternative options currently under consideration are fully evaluated.

On September 30, 2006, the Company had a total of $49 million in cash, cash equivalents, and short-term investments, and recorded liabilities of $0.2 million. Based on current projections, the Company expects cash flows between $0.2 million positive and $0.3 million negative during 2006. Actual cash may be lower as a result of costs associated with any strategic alternative or liquidation of the Company. There can be no assurance that such a range will be achieved, as actual expenditures and interest income may differ significantly from projected levels.

We have granted stock options to consultants, which resulted in stock compensation expense of $0 during the three and nine months ended September 30, 2006, respectively, and $16,000 and $140,000 during the three and nine months ended September 30, 2005, respectively.

We intend that the following discussion of our results of operations and financial condition will provide information to assist in the understanding of our financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our financial statements.

Critical Accounting Policies and Estimates

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. Management believes the following critical accounting policies reflect its more significant estimates and assumptions used in the preparation of the financial statements. We review the accounting policies used in our financial statements on a regular basis.

Our discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses, and related disclosures. On an ongoing basis, we evaluate these estimates, including those related to clinical trial accruals, income taxes, restructuring costs and stock-based compensation. Estimates are based on historical experience, information received from third parties and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could therefore differ materially from those estimates under different assumptions or conditions.

Stock-Based Compensation

As permitted by Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation* , as amended by Statement of Financial Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure,* the Company elected to follow APB 25 and related interpretations in accounting for stock-based employee compensation through December 31, 2005. Under APB 25, if the exercise price of an employee or director stock option is set equal or in excess of the fair market value of the underlying stock on the date of grant, no compensation expense is recognized. In February 2003, certain employee and director stock options for which the exercise prices had originally been set at less than the fair market value of the underlying stock on the grant date, were cancelled and re-granted in a one-for-one exchange. The Company had recorded deferred compensation for the difference between the original exercise price and the fair market value of the underlying stock on the grant date as a component of stockholders equity, and the total was being amortized on a straight-line basis over the vesting period of the original awards, ranging from four to six years. The related re-granted options all vest over a four-year period, and the remaining unamortized deferred compensation as of the re-grant date is now being amortized over the new four-year vesting schedule, commencing at the date of re-grant. The amount of deferred stock compensation expense to be recorded in future periods could decrease if options, for which accrued but unvested

compensation has been recognized, are forfeited prior to vesting. No adjustments for material changes in estimates have been recognized in any period presented.

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) 123(R) - Share-Based Payment , a revision of SFAS 123, Accounting for Stock-Based Compensation which

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superseded Accounting Principles Board (APB) Opinion No.25, Accounting for Stock Issued to Employees, and its related implementation guidance on August 1, 2005. SFAS 123(R) establishes standards for the accounting for transactions where an entity exchanges its equity instruments for goods or services. The principal focus of SFAS 123(R) is the accounting for transactions in which an entity obtains employee services in share-based payment transactions, and where the measurement of the cost of employee (or member of the Board of Directors) received in exchange for an award of equity instruments is based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee (or director) is required to provide service in exchange for the award the requisite service period - and unless observable market prices for the same or similar instruments are available, will be estimated using option-pricing models adjusted for the unique characteristics of the instruments. If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification.

Under SFAS 123(R), we determined the appropriate fair value model to be used for valuing share-based payments and the amortization method for compensation cost. The Company adopted SFAS 123(R) using the Black-Scholes modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. The Company s Consolidated Financial Statements as of and for the three and nine months ended September 30, 2006 reflects the impact of SFAS 123(R). During the three and nine months ended September 30, 2006, the Company recognized $136,000 and $393,000, respectively in compensation expense related to options granted employees and directors. In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). If the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation for the three and nine months ended September 30, 2005, it would have recorded an expense of $264,000 and $1.6 million, respectively. The difference between the two years is primarily due to the decreased volatility of the stock and option exercises and cancellations resulting from the discontinuance or Iseganan and subsequent termination of all employees.

Options or stock awards issued to non-employees are recorded at their fair value as determined in accordance with SFAS 123 and the FASB s Emerging Issues Task Force issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* , and are recognized over the related service period. The fair values are estimated using the Black-Scholes option pricing model, and are periodically re-measured as the underlying options vest. The option pricing model is dependent on a number of inputs, which may change over time. Other option pricing models may produce fair values that are substantially different from the Black-Scholes model. No adjustments for material changes in estimates have been recognized in any period presented.

Results of Operations

Three and Nine months ended September 30, 2006 and 2005

Research and Development

Research and development expenses primarily include research and development payroll expense, drug substance expense, allocated facilities costs and non-cash stock compensation charges. Research and development expenses were $0 and $7,000 respectively during the three and nine months ended September 30, 2006 as compared to $7,000 and $255,000, respectively, for the three and nine months ended September 30, 2005. The decrease is due to the termination of our Iseganan development project in September 2004. Except for the adjustment of certain payables, current research and development costs have ceased as a result of our decision to discontinue the Iseganan program and reduce operating expenses to a minimum appropriate level.

General and Administrative

General and administrative costs currently include outside contractors, legal and accounting fees, insurance, non-cash stock compensation charges, and other general administrative expenses and expenses associated with the evaluation of our strategic options. General and administrative expenses were $463,000 and $1.7 million, respectively, during the three and nine months ended September 30, 2006 and $560,000 and $2.6 million, respectively during the three and nine months ended September 30, 2005. The decrease between the three month and nine month periods is

primarily the result of our decision to reduce operating expenses to a minimum appropriate level. Stock compensation expense was $136,000 and $393,000 during the three months and nine months ended September 30, 2006, respectively, versus $76,000 and $129,000 during the three and nine months ended September 30, 2005, respectively.

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The increase in stock compensation expense was the result of adopting with SFAS 123 (R) in 2006. Under SFAS 123(R) option-pricing models are required to use the fair value of each option grant on the date of the grant. A significant number of shares in the calculation were granted when the Company s stock was at relatively high values, before the Company discontinued Iseganan and terminated all of its regular employees. As a result, the calculated average value for each option share, using the Black-Scholes option-pricing model, is $3.75, versus a market value per share for the Company s stock at September 30, 2006 of $3.79.

In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for periods prior to 2006 have not been restated to reflect, and do not include, the impact of SFAS 123(R). If the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation for the three and nine months ended September 30, 2005, it would have recorded expenses of $264,000 and $1.6 million, respectively. The difference between the two years is primarily due to the decreased volatility of the stock and option exercises and cancellations resulting from the discontinuance or Iseganan and subsequent termination of all employees.

Restructuring Charges

There were no restructurings during the nine months ended September 30, 2006. Restructuring charges were a credit of $27,000 and a loss of $648,000 during the three and nine months ended September 30, 2005 related to the termination of all remaining employees in September 2005.

Interest Income

Interest income was $635,000 and $1.7 million, respectively, during the three and nine months ended September 30, 2006, versus $395,000 and $1 million during the three and nine months ended September 30, 2005, respectively. Interest income increased primarily because of substantially higher average interest earning investment balances and higher average interest rates during the 2006 periods.

Net Income (Loss) Applicable to Common Stockholders

Net income (loss) applicable to common stockholders was $116,000 and ($131,000), respectively, during the three and nine months ended September 30, 2006 and a loss of $204,000 and $2.6 million, respectively, during the three and nine months ended September 30, 2005. The difference in 2006 versus 2005 is primarily attributable to the substantial reduction of research and development and general and administrative expenses as described above and higher interest income, offset by increased employee stock compensation. Net income (loss) applicable to common stockholders also includes the impact of Series A preferred stock dividends of $60,000 and $180,000 in the three and nine month periods ended September 30, 2006, respectively. Preferred stock dividends represents the 8% annual dividends payable quarterly in common stock to the holders of our Series A preferred stock.

Liquidity and Capital Resources

As of September 30, 2006, we had total cash, cash equivalents, and short-term investments of $49 million versus $48.8 million as of December 31, 2005. The increase was the result of a timing difference in collecting interest receivable on short term investments, which receivable increased from $70,000 in December of 2005 to $361,500 in September of 2006. Short-term investments were $36.9 million as of September 30, 2006 as compared to $46.1 million as of December 31, 2005. We had no debt outstanding as of September 30, 2006. We invest excess funds in short-term money market funds and securities pursuant to our investment policy guidelines.

Net cash provided by operating activities for the nine months ended September 30, 2006 was $184,000 versus $2.7 million used during the nine months ended September 30, 2005. The cash provided in 2006 was due primarily to the increase in interest income. The cash used in 2005 consisted primarily of the net loss adjusted for non-cash stock compensation expense and changes in prepaid expenses and accrued clinical liabilities.

Net cash provided by investing activities was $9.2 million during the nine months ended September 30, 2006, as compared to net cash provided by investing activities of $1.0 million during the nine months ended September 30, 2005. The cash provided in both periods primarily represents purchases of short-term investments offset by proceeds from the sale or maturity of short-term investments. The cash provided in 2006 increased cash and cash equivalents, whereas the cash provided in 2005 financed operations.

No cash was provided by financing activities during the nine months ended September 30, 2006, versus $497,000 during the first

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nine months of 2005 related to the exercise of stock options.

We expect to continue to incur operating losses and will not receive any product revenues in the foreseeable future. Our efforts are focused on reducing operating expenses to a minimum appropriate level, conducting our affairs in the most financially efficient manner practical for a public company, and pursuing strategic alternatives in the biotech industry. Based on current projections, the Company expects cash, cash equivalents and short-term investments as of December 31, 2006 to be in the range of $48.5 to $49 million. Actual cash may be lower as a result of costs associated with any strategic alternative or liquidation of the Company. We currently anticipate our cash, cash equivalents and short-term investments to be sufficient to fund the foregoing efforts for at least the next 12 months. This forecast is a forward-looking statement that involves risks and uncertainties, and actual results could vary.

Contractual Obligations

As of September 30, 2006, the Company had no operating lease obligations, no long-term debt obligations, no capital lease obligations or purchase obligations (each as defined under Item 303(a)(5) of Regulation S-K).

The holders of our Series A preferred stock are entitled to receive cumulative dividends at the rate of 8% per annum of the original purchase price of $10,000 per share of Series A preferred stock. Based on the number of shares of preferred stock outstanding as of September 30, 2006 this equates to $240,000 per year. The dividends are payable quarterly in shares of common stock, and the number of shares payable are determined based on the average closing sale price of the common stock on the NASDAQ National Market or other market on which our common stock is traded for each of the five trading days immediately preceding the applicable dividend payment date. We do not currently anticipate paying any cash dividends in the foreseeable future.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements (as that term is defined in Item 303 of Regulation S-K) that are reasonably likely to have a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Indemnifications

In the ordinary course of business, we enter into contractual arrangements under which we may agree to indemnify the third party to such arrangement from any losses incurred relating to the services they perform on behalf of IntraBiotics or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to past performance. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial. In addition, we have entered into indemnity agreements with each of our directors and executive officers and Hickey & Hill. Such indemnity agreements contain provisions, which are in some respects broader than the specific indemnification provisions contained in Delaware law. We also maintain an insurance policy for our directors and executive officers insuring against certain liabilities arising in their capacities as such.

ITEM 3. Quantitative and Qualitative Disclosure About Market Risk

The primary objective of our investment activities is to preserve our capital until it is required to fund operations while at the same time maximizing the income we receive from our investments without significantly increasing risk. As of September 30, 2006, we own financial instruments that are sensitive to market risk as part of our investment portfolio. To minimize this risk and to avoid classification as an investment company under the Investment Company Act of 1940, we have limited our investments to cash and securities of the Government of the United States of America and its federal agencies. The average duration of our investment portfolio as of September 30, 2006 was less than six months. Due to the short-term nature of these investments, a 50 basis point movement in market interest rates would not have a material impact on the fair value of our portfolio as of September 30, 2006. We have no investments denominated in foreign currencies and therefore our investments are not subject to foreign currency exchange risk.

ITEM 4. Controls and Procedures

As of the end of the period covered by this quarterly report, an evaluation was performed under the supervision and with the

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participation of the Company s management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Section 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

There have been no significant changes in the Company s internal controls over financial reporting that occurred during the Company s third fiscal quarter that has materially affected or is reasonably likely to materially affect the Company s internal control over financial reporting.

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Our disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

Scope of the Controls Evaluation

During the evaluation of our controls and procedures, we looked to identify data errors, control problems or acts of fraud and confirm that appropriate corrective action (including process improvements) was being undertaken. This evaluation is performed on a quarterly basis so that the conclusions of management, including the Chief Executive Officer and the Chief Financial Officer, concerning the effectiveness of the disclosure controls and procedures can be disclosed to our Board of Directors and to our independent auditors, and reported in our Quarterly Reports on Form 10-Q and in our Annual Report on Form 10-K.

Future requirements

The regulations implementing Section 404 of the Sarbanes-Oxley Act of 2002 require management s assessment of the effectiveness of the Company s internal controls over financial reporting beginning with our Annual Report on Form 10-K for the fiscal year ending December 31, 2007. The Company s independent auditors will be required to confirm in writing whether management s assessment of the effectiveness of the internal controls over financial reporting is fairly stated in all material respects, and separately report on whether they believe management maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008.

This process will be resource and time consuming, and will require significant attention of management. If a material weakness is discovered, corrective action may be time consuming, costly and further divert the attention of management. The disclosure of a material weakness, even if quickly remedied, could reduce the market s confidence in the Company s financial statements and harm the Company s stock price, especially if a restatement of financial statements for past periods is required.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Beginning on July 2, 2004, three purported class action shareholder complaints were filed in the United States District Court for the Northern of California against IntraBiotics and several of its officers. The actions were consolidated and a consolidated amended complaint has been filed, purportedly brought on behalf of purchasers of IntraBiotics common stock between September 5, 2003 and June 22, 2004. The amended complaint generally alleges that IntraBiotics and several of its officers and directors made false or misleading statements concerning the clinical trial of Iseganan. The plaintiffs seek unspecified monetary damages. On February 28, 2005, the Company and the individual defendants filed a motion to dismiss the amended complaint. On January 23, 2006, the court issued its decision on the motion, granting the motion to dismiss the claim under the Securities Exchange Act of 1934, with leave to amend, and denying the motion to dismiss the claims under the Securities Act of 1933. Plaintiffs filed an amended complaint on February 22, 2006. IntraBiotics and the other defendants moved to dismiss all claims alleged in the amended complaint on March 14, 2006. In orders issued on August 1 and August 30, 2006, the court dismissed all claims against the defendants. The court entered judgment in favor of defendants on October 3, 2006. Plaintiffs had 30 days in which to file a notice of appeal. As plaintiffs did not appeal the judgment before the end of that time limit, the case has now ended in favor of IntraBiotics and the individual defendants.

Item 1A. Risk Factors

We face significant risks and the risks described in Part 1, Item 1A Risk Factors of our Form 10-K for the fiscal year ended December 31, 2005 may not be the only risks we face. Additional risks that we do not know of, or that we currently believe are immaterial, may also adversely affect the Company. If any of the events or circumstances described in our Form 10-K actually occurs, our business, financial condition, or results of operations could be materially adversely affected. The following risk factors have been updated from the December 31, 2005 10K Part 1, Item 1A Risk Factors :

Directors, principal stockholders and affiliated entities beneficially own or control at least 51% of our capital stock outstanding and may be able to exert control over our activities, and the results of our operations and financial condition may suffer.

As of September 30, 2006, our directors, principal stockholders and affiliated entities beneficially own or control securities representing, in the aggregate, at least 51% of our outstanding common stock. These stockholders, if they determine to vote in the same manner, may be able to control the outcome of any matter requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions or terms of any liquidation. In addition certain directors, principal stockholders and affiliated entities beneficially own or control Series A preferred stock or warrants which are convertible into 2,489,117 additional shares of common stock.

We may continue to incur net operating losses.

Our accumulated deficit as of September 30, 2006 was $236 million, and we may continue to incur operating losses through the end of 2006. We reduced operating expenses to a minimum appropriate level while conducting our affairs in the most financially efficient manner practical for a public company and litigating our securities litigation aggressively.

Our stock price has been, and will be volatile, and the value of your investment may continue to decline.

During 2005 and for the first nine months of 2006, our closing stock prices ranged from a low of $3.25, to a high of $4.07. Announcements regarding strategic alternatives, including an in-licensing transaction or merger or sale of the Company, or the securities litigation described in Part II, Item 1, in addition to the other risk factors described in this section, may have a significant impact on the market price of our common stock.

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

None

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Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

On November 6, 2006, the Company further amended its Services Agreement, dated June 20, 2005, as amended on June 27, 2006 (the Agreement), with Hickey & Hill, in order to add a provision which was inadvertently omitted by the parties from the amendment on June 27, 2006. Pursuant to the terms of the amendment, the Company agreed to pay additional compensation at a rate of $200 per hour for services in excess of 86 hours in a month in which Hickey & Hill devotes more than 20 hours to the Company related to any discovery requests, dissolution process, merger or acquisition or in-licensing agreements. The amendment is retroactive to the date of the term of the Agreement. A copy of the amendment is furnished herewith as Exhibit 10.1 and is incorporated herein by reference.

Item 6. Exhibits

The exhibits listed on the Exhibit Index (following the signature section of this Quarterly Report) are included, or incorporated by reference, in this Quarterly Report.

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SIGNATURES

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

IntraBiotics Pharmaceuticals, Inc.

November 7, 2006

/s/ Denis Hickey
Denis Hickey
Chief Executive Officer and Chief Financial Officer

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EXHIBIT INDEX

10.1	Third Amendment to Services Agreement, dated as of November 1, 2006, by and between IntraBiotics Pharmaceuticals, Inc. and Hickey & Hill, Inc.*
31.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rules 13a-14(a) or 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.*
32.1	Certifications of Chief Executive Officer and Chief Financial Officer as required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).*

Filed herewith.