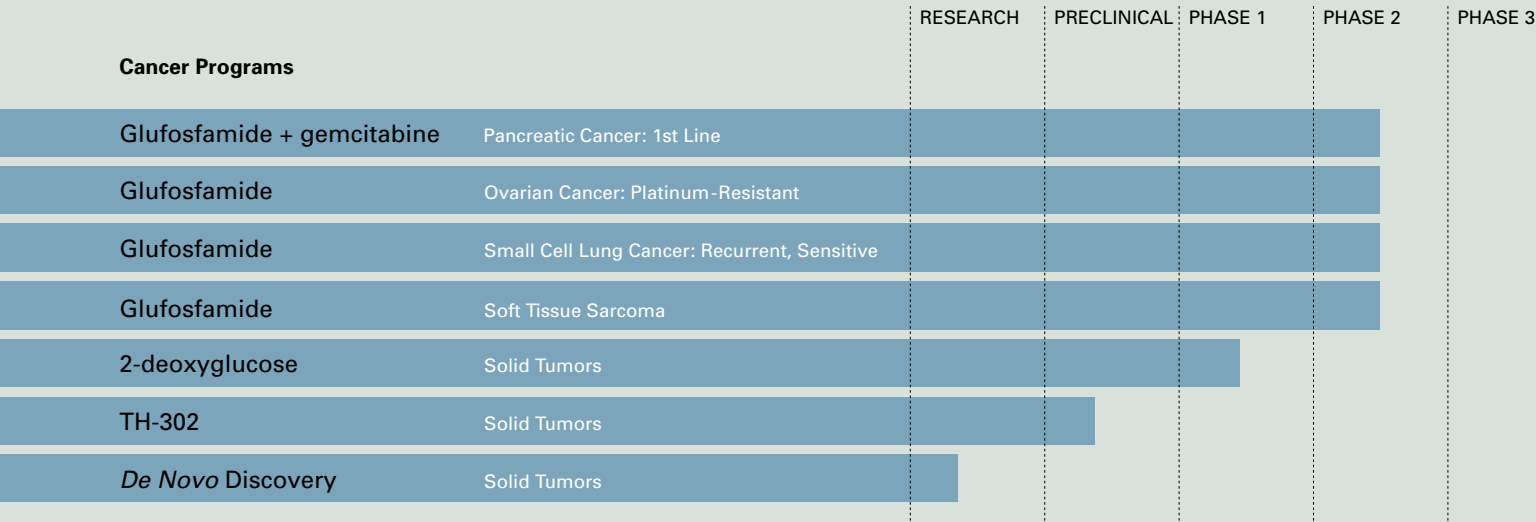




FOCUS ON CANCER

THRESHOLD PHARMACEUTICALS is a biotechnology company focused on the discovery and development of therapeutics based on Metabolic Targeting, a powerful scientific approach that offers broad potential to treat most solid tumors. By selectively targeting tumor cells, we are building a pipeline of drugs that hold promise to be more effective and less toxic to healthy tissues than conventional drugs. Nasdaq: THLD.

THRESHOLD PHARMACEUTICALS
PRODUCT CANDIDATE PIPELINE



TO OUR SHAREHOLDERS,

The past year was a challenging one for Threshold. Our two lead programs, TH-070 for Benign Prostatic Hyperplasia (BPH) and glufosfamide for second-line pancreatic cancer, both suffered disappointing Phase 3 clinical trial results, leading to a discontinuation of the TH-070 clinical program and a corporate realignment.

While our management team has undergone turnover, we have been able to promote extremely talented individuals from within the company to fill those leadership positions. We have demonstrated our ability to initiate, execute and complete large international Phase 3 clinical trials in a timely fashion. Our efficient development process allowed us to reach rapid decisions, enabling us to preserve cash and focus our resources on other strategic opportunities.

On the effort to discover and develop novel therapeutics to improve patients' lives, clinical trial failure is a substantial risk. Many companies face disappointments—the successful ones are those that are able to persevere in the face of setbacks and redirect efforts into new opportunities.

Discontinued Benign Prostatic Hyperplasia Program

In May 2006, as a result of abnormalities observed in liver enzyme levels in six subjects in ongoing TH-070 BPH clinical trials, the U.S. Food and Drug Administration placed the U.S. TH-070 program on partial clinical hold. To protect all of our patients, we voluntarily discontinued dosing in an additional Phase 3 BPH clinical trial that was ongoing outside of the United States. We continued to monitor the effect of prior dosing on the patients enrolled in both trials.

Two months later, we announced that the Phase 2 and Phase 3 trials of TH-070 did not meet their primary endpoints of symptomatic improvement as measured by International Prostate Symptom Score (IPSS). The Phase 2 trial did not generate a statistically significant dose response relationship, and the Phase 3 trial did

not achieve a statistically significant difference in IPSS between TH-070 and placebo. Based on the safety and efficacy results of these trials, we discontinued development of TH-070 for BPH. We underwent a corporate realignment and reduced staff by approximately one-third. These actions enabled us to preserve cash and focus on multiple cancer indications with three clinical and preclinical product candidates: glufosfamide, 2-deoxyglucose and TH-302.

Focus on Cancer

We are now focused on developing novel targeted therapies for cancers that affect many patients and their families worldwide. Glufosfamide is being investigated in clinical trials for various solid tumors. We have ongoing Phase 2 clinical trials in pancreatic, ovarian and small cell lung cancer, and plan to start a Phase 2 clinical trial in soft tissue sarcoma as well. Glufosfamide combines the active part of an approved alkylator, a member of a widely used class of chemotherapy drugs, with a glucose molecule. Because of its glucose component and a tumor cell's increased need for glucose, glufosfamide may be preferentially transported into tumors compared to most normal tissues.

Glufosfamide was shown to promote increased survival in a small subset of pancreatic cancer patients, based on data from a Phase 2 clinical trial in 31 chemotherapy-naïve patients. These data led to two Threshold clinical trials: a Phase 3 trial for the potential treatment of patients with metastatic pancreatic cancer who had relapsed after gemcitabine chemotherapy, and a Phase 2 trial of glufosfamide in combination with gemcitabine for the treatment of advanced pancreatic cancer in the first-line setting.

In February 2007, we announced that the Phase 3 trial of glufosfamide did not show a statistically significant improvement in overall survival compared to best supportive care (BSC) in patients with metastatic pancreatic cancer who had relapsed after gemcitabine chemotherapy. In this multi-national, randomized, open-label Phase 3 trial, 303 patients with metastatic pancreatic cancer

were randomized to receive glufosfamide every three weeks plus BSC (n=148) or BSC alone (n=155). The primary efficacy comparison of overall survival was based on 261 deaths, and the observed 18% improvement in survival on the glufosfamide treatment arm did not reach statistical significance (p=0.19). The hazard ratio of glufosfamide to BSC was 0.85 (95% confidence interval of 0.66 to 1.08). The median survival of patients who were treated with glufosfamide was 105 days versus 84 days for the patients who received BSC. No unexpected safety signals were observed.

The Phase 2 trial of glufosfamide in combination with gemcitabine for the first-line treatment of pancreatic cancer is ongoing. In December 2006, we announced top-line results from this Phase 2 clinical trial of 28 evaluable patients with pancreatic cancer previously untreated with chemotherapy. Overall, 5 patients achieved a confirmed partial response, and one other patient achieved an unconfirmed partial response. In addition, 10 patients (36%) experienced stable disease.

We believe that there is scientific and clinical rationale to expand clinical trial investigation of glufosfamide into other types of solid tumors. In early 2007, we started two Phase 2 clinical trials of glufosfamide. The first is in women with platinum-resistant ovarian cancer. Forty-five women with ovarian cancer who have previously relapsed after up to four prior chemotherapy regimens, and who have demonstrated resistance to their last platinum-containing regimen will be enrolled in the trial. The American Cancer Society (ACS) estimates that 22,430 women will be diagnosed with ovarian cancer in the United States in 2007, and approximately 15,280 women will die from the disease.

The second Phase 2 trial is in patients with recurrent, sensitive small cell lung cancer. Fifty patients with extensive recurrent sensitive small cell lung cancer, who have progressed at least sixty days after completing chemotherapy, will be enrolled in the trial. The ACS estimates that 213,380 people will be diagnosed with lung cancer in the United States in 2007, and approximately 160,390 people will die from the disease. About 15 to 20 percent of all lung cancers are the small cell type.

We plan to commence a third Phase 2 glufosfamide trial in 2007 in patients with previously treated, advanced soft tissue sarcoma. Twenty-two patients with soft tissue sarcoma who have progressed after completing one or two chemotherapy regimens for advanced disease will be enrolled in the trial. The ACS estimates that 9,220 people will be diagnosed with soft tissue sarcoma in the United States in 2007, and approximately 3,560 people will die from the disease.

We continue to evaluate our earlier-stage product candidate, 2-deoxyglucose (2DG), in a Phase 1 clinical trial as a monotherapy and in combination with docetaxel in patients with various solid tumors.

Advanced Proprietary Research Efforts

This past year we made significant advances in research. TH-302 is a hypoxically activated prodrug that consists of two distinct parts, a toxic portion and an attached trigger molecule. To prevent general toxicity, the trigger molecule masks the toxin until the pro-drug is activated by the low oxygen concentration in the tumor. Once activated, the toxin kills cells in its vicinity. We have designed prodrugs that are triggered only at the very low oxygen levels found in the hypoxic regions of tumors. Our preclinical experiments indicate that we can achieve a greater than 100-fold difference in cytotoxicity between normoxic cells (cells with normal oxygen levels) and hypoxic cells. We have identified lead compounds with promising *in vitro* and *in vivo* data and plan to file an Investigational New Drug (IND) application for TH-302 this year.

2007 Milestones

We look forward to achieving the following milestones in 2007:

- reporting results from a Phase 2 clinical trial of glufosfamide for first-line treatment of advanced pancreatic cancer;
- reporting top-line results from a Phase 1 clinical trial of 2-DG for treatment of solid tumors;
- initiating a Phase 2 clinical trial of glufosfamide in patients with previously treated advanced soft tissue sarcoma;
- filing an IND application for TH-302 for solid tumors; and
- completing enrollment in the ovarian cancer, small-cell lung cancer and soft tissue sarcoma Phase 2 trials.

We remain focused on addressing the needs of our patients, shareholders and employees. We face our new challenges and opportunities with optimism and confidence and look forward to reporting our progress during 2007.



Harold E. "Barry" Selick, Ph.D.

Chief Executive Officer

March 2007



THRESHOLD PHARMACEUTICALS, INC.

Notice of Annual Meeting of Stockholders

To Be Held May 16, 2007

The Annual Meeting of Stockholders of Threshold Pharmaceuticals, Inc., or the Company, will be held on May 16, 2007, at 12:00 p.m., local time, at the Company's principal executive offices located at 1300 Seaport Boulevard, Redwood City, California 94063, for the following purposes, as more fully described in the accompanying proxy statement:

1. To elect three Class III directors to hold office until the 2010 Annual Meeting of Stockholders and until their successors are elected and qualified.
2. To ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007.
3. To transact such other business as may properly come before the meeting or any adjournments or postponements thereof.

Only stockholders of record at the close of business on March 22, 2007 will be entitled to notice of, and to vote at, such meeting or any adjournments or postponements thereof.

BY ORDER OF THE BOARD OF DIRECTORS

A handwritten signature in black ink, appearing to read "Harold E. Selick".

Dr. Harold E. Selick
Chief Executive Officer

Redwood City, California
April 16, 2007

YOUR VOTE IS IMPORTANT!

WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE COMPLETE, SIGN, DATE AND MAIL PROMPTLY THE ACCOMPANYING PROXY CARD IN THE ENCLOSED RETURN ENVELOPE, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES. THIS WILL ENSURE THE PRESENCE OF A QUORUM AT THE MEETING. ALTERNATIVELY, YOU MAY VOTE YOUR SHARES ON THE INTERNET OR BY TELEPHONE BY FOLLOWING THE INSTRUCTIONS ON YOUR PROXY CARD. IF YOU ATTEND THE MEETING, YOU MAY VOTE IN PERSON IF YOU WISH TO DO SO EVEN IF YOU HAVE PREVIOUSLY SENT IN YOUR PROXY CARD OR VOTED.

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THRESHOLD PHARMACEUTICALS, INC.

1300 Seaport Boulevard
Redwood City, California 94063
(650) 474-8200

PROXY STATEMENT

2007 ANNUAL MEETING OF STOCKHOLDERS

Threshold Pharmaceuticals, Inc., a Delaware corporation, or the Company, is furnishing this proxy statement and the enclosed proxy in connection with the solicitation of proxies by the Board of Directors of the Company, or the Board, for use at the Annual Meeting of Stockholders, or the Annual Meeting, to be held on May 16, 2007, at 12:00 p.m., local time, at the Company's principal executive offices located at 1300 Seaport Boulevard, Redwood City, California 94063 and at any adjournments or postponements thereof. These materials are being mailed to stockholders on or about April 16, 2007.

Only holders of the Company's common stock as of the close of business on March 22, 2007, or the Record Date, are entitled to vote at the Annual Meeting. Stockholders who hold shares of the Company in "street name" may vote at the Annual Meeting only if they hold a valid proxy from their broker. As of the Record Date, there were 37,407,750 shares of common stock, par value \$0.001 per share, outstanding and entitled to vote at the Annual Meeting. There are no statutory or contractual rights of appraisal or similar remedies available to stockholders in connection with any matter to be acted on at the Annual Meeting.

A majority of the outstanding shares of common stock entitled to vote at the Annual Meeting must be present in person or by proxy in order for there to be a quorum at the meeting. Stockholders of record who are present at the meeting in person or by proxy and who abstain from voting, including brokers holding customers' shares of record who cause abstentions to be recorded at the meeting, will be included in the number of stockholders present at the meeting for purposes of determining whether a quorum is present.

Each stockholder of record is entitled to one vote at the Annual Meeting for each share of common stock held by such stockholder on the Record Date. Stockholders do not have cumulative voting rights. Stockholders may vote their shares by using the proxy card enclosed with this proxy statement. Alternatively, stockholders may vote their shares on the Internet or by telephone by following the instructions on the proxy card. All proxy cards received by the Company which are properly signed and have not been revoked will be voted in accordance with the instructions contained in the proxy cards. If a signed proxy card is received which does not specify a vote or an abstention, the shares represented by that proxy card will be voted for the nominees to the Board listed on the proxy card and in this proxy statement and for the ratification of the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007. The Company is not aware, as of the date hereof, of any matters to be voted upon at the Annual Meeting other than those stated in this proxy statement and the accompanying Notice of Annual Meeting of Stockholders. If any other matters are properly brought before the Annual Meeting, the enclosed proxy card gives discretionary authority to the persons named as proxies to vote the shares represented by the proxy card in their discretion.

Under Delaware law and the Company's Amended and Restated Certificate of Incorporation and Bylaws, if a quorum exists at the meeting, (i) the affirmative vote of a plurality of the votes cast at the meeting is required for the election of directors and (ii) the affirmative vote of the holders of a majority of the shares represented in person or by proxy and entitled to vote at the Annual Meeting will be required to approve the proposal to ratify

the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007. A properly executed proxy marked "Withhold Authority" with respect to the election of one or more directors will not be voted with respect to the director or directors indicated, although it will be counted for purposes of determining whether there is a quorum. A properly executed proxy marked "Abstain" with respect to any other matter will not be voted, although it will be counted for purposes of determining whether there is a quorum. Accordingly, an abstention will have the effect of a negative vote.

For shares held in "street name" through a broker or other nominee, the broker or nominee may not be permitted to exercise voting discretion with respect to some of the matters to be acted upon. Thus, if stockholders do not give their broker or nominee specific instructions, their shares may not be voted on those matters and will not be counted in determining the number of shares necessary for approval. Shares represented by such "broker non-votes" will, however, be counted in determining whether there is a quorum.

There are four different ways to vote your shares:

- *By Internet:* You may submit a proxy or voting instructions over the Internet by following the instructions at www.proxyvoting.com/thld.
- *By Telephone:* You may submit a proxy or voting instructions by calling 1 (866) 540-5760 and following the instructions.
- *By Mail:* If you received your proxy materials via the U.S. mail, you may complete, sign and return the accompanying proxy and voting instruction card in the postage-paid envelope provided.
- *In Person:* If you are a stockholder as of the Record Date, you may vote in person at the meeting. Submitting a proxy will not prevent a stockholder from attending the Annual Meeting and voting in person.

A stockholder of record may revoke a proxy at any time before it is voted at the Annual Meeting by (a) delivering a proxy revocation or another duly executed proxy bearing a later date to the Secretary of the Company at 1300 Seaport Boulevard, Redwood City, California 94063 or (b) attending the Annual Meeting and voting in person. Attendance at the Annual Meeting will not revoke a proxy unless the stockholder actually votes in person at the meeting. A stockholder who hold shares of the Company in "street name" must contact their broker directly to revoke a proxy.

The proxy card accompanying this proxy statement is solicited by the Board. The Company will pay all of the costs of soliciting proxies. In addition to solicitation by mail, officers, directors and employees of the Company may solicit proxies personally, or by telephone, without receiving additional compensation. The Company, if requested, will also pay brokers, banks and other fiduciaries who hold shares of Common Stock for beneficial owners for their reasonable out-of-pocket expenses of forwarding these materials to stockholders.

BOARD OF DIRECTORS

The name, age and year in which the term expires of each member of the Board is set forth below:

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Term Expires on the Annual Meeting held in the Year</u>
Bruce C. Cozadd ⁽²⁾	43	Director	2007
David R. Hoffmann ⁽¹⁾⁽³⁾	62	Director	2007
George G.C. Parker, <i>Ph.D.</i> ⁽²⁾	68	Director	2007
Michael F. Powell, <i>Ph.D.</i> ⁽¹⁾⁽³⁾	52	Director	2008
Harold E. Selick, <i>Ph.D.</i>	52	Chief Executive Officer and Director	2008
William A. Halter ⁽³⁾	46	Director	2009
Wilfred E. Jaeger, <i>M.D.</i> ⁽¹⁾⁽²⁾	51	Director	2009

- (1) Member of the audit committee
- (2) Member of the compensation committee
- (3) Member of the nominating and governance committee

The Company's Amended and Restated Certificate of Incorporation divides the Board into three classes, with staggered three-year terms. The Class III directors, whose terms expire at the Annual Meeting, are Mr. Bruce C. Cozadd, Mr. David R. Hoffmann and Dr. George G.C. Parker. The Class I directors, whose terms expire at the 2008 Annual Meeting, are Dr. Michael F. Powell and Dr. Harold E. Selick. The Class II directors, whose terms expire at the 2009 Annual Meeting, are Mr. William A. Halter and Dr. Wilfred E. Jaeger. Only one class of directors is elected at each annual meeting. The directors in the other classes continue to serve for the remainder of such class' three-year term. Dr. Parker, who is a Class III director previously elected by the Company's stockholders, and each of Mr. Cozadd and Mr. Hoffmann, who are Class III directors previously appointed by the Board, are nominees for re-election at the Annual Meeting. The nominating and governance committee recommended to the Board that Mr. Cozadd, Mr. Hoffmann and Dr. Parker be nominated for election to this class, each for a three-year term ending on the date of the 2010 Annual Meeting or until a successor is duly elected or appointed. Each nominee has consented to serve an additional three-year term.

NOMINEES AND CONTINUING DIRECTORS

The following individuals have been nominated for election to the Board at the Annual Meeting:

Bruce C. Cozadd has served as a member of the Board since December 2005. He has been the Executive Chairman of Jazz Pharmaceuticals, Inc. since its inception in 2003. Prior to co-founding Jazz Pharmaceuticals, Mr. Cozadd served in various executive management positions with ALZA Corporation from 1991 until its acquisition by Johnson & Johnson in 2001. At the time of the merger, Mr. Cozadd was serving as Executive Vice President and Chief Operating Officer of ALZA, with responsibility for research and development, manufacturing, and sales and marketing. Prior to joining ALZA, he was in the Corporate Finance Health Care group at Smith Barney, Harris Upham & Co. Inc. He serves on the board of directors of Cerus Corp., The Nueva School and Stanford Hospital and Clinics, and is also a member of the Stanford Molecular Imaging Advisory Board. He received his B.S. from Yale University and his M.B.A. from Stanford University.

David R. Hoffmann has served as a member of the Board since April 2007. Mr. Hoffmann is retired from ALZA Corporation (now a Johnson & Johnson company) where he held the positions of Vice President and Treasurer from 1992 to until his retirement in October 2002, Vice President of Finance from 1982 to 1992 and Director of Accounting/Finance from 1976 to 1982. Mr. Hoffmann is currently Chief Executive Officer of Hoffmann Associates, a multi-group company specializing in cruise travel and



financial and benefit consulting, and a consultant of ALZA Corporation. He serves on the board of directors of DURECT Corporation. Mr. Hoffmann holds a B.S. in Business Administration from the University of Colorado.

George G.C. Parker, Ph.D. has served as a member of the Board since October 2004. Dr. Parker is the Dean Witter Distinguished Professor of Finance (Emeritus) and Management and previously Senior Associate Dean for Academic Affairs and Director of the MBA Program, Graduate School of Business, Stanford University. Dr. Parker joined the faculty at Stanford University in 1973. He serves on the board of directors of Continental Airlines, Inc., BGI Mutual Funds, Tejon Ranch Company and First Republic Bank. Dr. Parker received his B.A. from Haverford College and his M.B.A. and Ph.D. from Stanford University.

The following individuals will continue to serve on the Board after the Annual Meeting:

Michael F. Powell, Ph.D. has served as a member of the Board since 2001. He has been a Managing Director of Sofinnova Ventures, Inc., a venture capital firm, since 1997. Dr. Powell was Group Leader of Drug Delivery at Genentech, Inc. from 1990 to 1997. From 1987 to 1990, he was the Director of Product Development for Cytel Corporation, a biotechnology firm. He was recently an Adjunct Professor at the University of Kansas and an editorial board member of several pharmaceutical journals. Dr. Powell also serves on the board of directors of Anesiva Inc. and a number of private companies. He received his B.S. and Ph.D. from the University of Toronto and completed his post-doctorate work at the University of California.

Harold E. Selick, Ph.D. joined the Company as Chief Executive Officer in June 2002. Since June 2002, Dr. Selick has been a Venture Partner of Sofinnova Ventures, Inc., a venture capital firm. From January 1999 to April 2002, he was Chief Executive Officer of Camitro Corporation, a biotechnology company. From 1992 to 1999, he was at Affymax Research Institute, the drug discovery technology development center for Glaxo Wellcome plc, most recently as Vice President of Research. Prior to working at Affymax he held scientific positions at Protein Design Labs, Inc. and Anergen, Inc. As a staff scientist at Protein Design Labs, he co-invented the technology underlying the creation of fully humanized antibody therapeutics and applied that to PDL's first product, Zenapax® (daclizumab), which was developed and commercialized by Roche for treating kidney transplant rejection. Dr. Selick received his B.S. and Ph.D. from the University of Pennsylvania and was a Damon Runyon-Walter Winchell Cancer Fund Fellow and an American Cancer Society Senior Fellow at the University of California, San Francisco.

William A. Halter has served as a member of the Board since October 2004. Mr. Halter is the Lieutenant Governor of the State of Arkansas. Mr. Halter has been a business consultant providing services to corporate enterprises since 2001. Mr. Halter was Acting Commissioner and Deputy Commissioner of the Social Security Administration from 1999 to 2001. From 1993 to 1999, Mr. Halter served as Senior Advisor of the Office of Management and Budget in the Executive Office of the President of the United States. Mr. Halter also served as Economist for the Joint Economic Committee of Congress and as Chief Economist for the U.S. Senate Committee on Finance. Prior to entering public service, he was an Associate at McKinsey and Company. Mr. Halter is a Trustee Emeritus of Stanford University where he chaired the Academic Policy Committee and serves on the Humanities and Sciences Council. Mr. Halter also served on the board of directors of Akamai Technologies, Inc., Intermune, Inc., webMethods, Inc. and Xenogen, Inc. Mr. Halter received his B.A. from Stanford University and his M.Phil. in Economics from Oxford University where he was a Rhodes Scholar.

Wilfred E. Jaeger, M.D. has served as a member of the Board since 2001. He has been a Partner of Three Arch Partners, a venture capital firm, since 1993. Dr. Jaeger serves on the board of directors of a number of private companies. Dr. Jaeger received his B.S. from the University of British Columbia, his M.D. from the University of British Columbia School of Medicine and his M.B.A. from Stanford University.

There are no family relationships among any of the Company's directors or executive officers.

DIRECTOR NOMINATION

Criteria for Board Membership. In selecting candidates for appointment or re-election to the Board, the nominating and governance committee, or the nominating committee, considers the appropriate balance of experience, skills and characteristics required of the Board, and seeks to insure that at least a majority of the directors are independent under the rules of the Nasdaq Global Market, and that members of the Company's audit committee meet the financial literacy and sophistication requirements under the rules of the Nasdaq Global Market and at least one of them qualifies as an "audit committee financial expert" under the rules of the Securities and Exchange Commission. Nominees for director are selected on the basis of their depth and breadth of experience, integrity, ability to make independent analytical inquiries, understanding of the Company's business environment, and willingness to devote adequate time to Board duties.

Stockholder Nominees. The nominating committee will consider written proposals from stockholders for nominees for director. Any such nominations should be submitted to the nominating committee c/o the Secretary of the Company and should include the following information: (a) all information relating to such nominee that is required to be disclosed pursuant to Regulation 14A under the Securities Exchange Act of 1934 (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected); (b) the names and addresses of the stockholders making the nomination and the number of shares of the Company's common stock which are owned beneficially and of record by such stockholders; and (c) appropriate biographical information and a statement as to the qualification of the nominee, and should be submitted in the time frame described in the Company's Bylaws and under the caption, "Stockholder Proposals for 2008 Annual Meeting" below.

Process for Identifying and Evaluating Nominees. The nominating committee believes the Company is well-served by its current directors. If an incumbent director is not standing for re-election, or if a vacancy on the Board occurs between annual stockholder meetings, or if the Board desires to increase its size, the nominating committee will seek out potential candidates for Board appointment who meet the criteria for selection as a nominee and have the specific qualities or skills being sought. Director candidates will be selected based on input from members of the Board and, if the nominating committee deems appropriate, a third-party search firm. The nominating committee will evaluate each candidate's qualifications and check relevant references; in addition, such candidates will be interviewed by at least one member of the nominating committee. Candidates meriting serious consideration will meet with additional members of the Board. Based on this input, the nominating committee will evaluate whether the committee should recommend to the Board that this candidate be elected to fill a vacancy on the Board, or presented for the approval of the stockholders, as appropriate.

The Company has never received a proposal from a stockholder to nominate a director. Although the nominating committee has not adopted a formal policy with respect to stockholder nominees, the committee expects that the evaluation process for a stockholder nominee would be similar to the process outlined above.

Board Nominees for the 2007 Annual Meeting. Dr. Parker is a nominee standing for re-election. Mr. Cozadd and Mr. Hoffmann are nominees who were each recommended for appointment to the Board by the nominating committee in 2005 and 2007, respectively.

BOARD MEETINGS AND COMMITTEES

The Board met eight times during fiscal year 2006. The audit committee met six times during fiscal year 2006, the compensation committee met four times during fiscal year 2006 and the nominating committee met one time during fiscal year 2006. Each member of the Board attended 75% or more of the Board meetings, and each member of the Board who served on either the audit, compensation or nominating committee attended at least 75% of each such committee's meetings.

The Board has determined that the following directors are “independent” under the current rules of the Nasdaq Global Market: Mr. Cozadd, Mr. Halter, Mr. Hoffmann, Dr. Jaeger, Dr. Parker and Dr. Powell. Under applicable rules of Securities and Exchange Commission and the rules of the Nasdaq Global Market, the existence of certain “related party” transactions above certain thresholds between a director and the company are required to be disclosed and preclude a finding by the Board that the director is independent. In addition to transactions required to be disclosed under rules of the Securities and Exchange Commission, the Board considered certain other relationships in making its independence determinations, including the fact that a relative of Dr. Michael F. Powell is a non-executive employee of the Company, and determined in each case that such other relationships did not impair the director’s ability to make exercise independent judgment on behalf of the Company.

The Board has standing (i) audit, (ii) compensation and (iii) nominating and governance committees, each of which has a written charter, copies of which can be found at www.thresholdpharm.com.

Audit Committee. The audit committee currently consists of Mr. Hoffmann (chair), Dr. Jaeger and Dr. Powell. The Board has determined that all members of the audit committee are independent directors under the rules of the Nasdaq Global Market and each of them is able to read and understand fundamental financial statements. The Board has determined that Mr. Hoffmann qualifies as an “audit committee financial expert” as defined by the rules of the Securities and Exchange Commission.

The purpose of the audit committee is to oversee the accounting and financial reporting processes of the Company and audits of its financial statements. Although management has primary responsibility for the system of internal controls and the financial reporting process, the responsibilities of the audit committee include appointing and approving the compensation of the independent registered public accounting firm to conduct the annual audit of the Company’s accounts, reviewing and evaluating the scope and results of the annual audit, approving all professional services to be provided to the Company by its independent registered public accounting firm, meeting with management and the independent registered public accounting firm to discuss the Company’s financial statements and matters that may affect the Company’s financial statements, and approving all related party transactions.

Compensation Committee. The compensation committee currently consists of Dr. Jaeger (chair), Mr. Cozadd and Dr. Parker. The Board has determined that all members of the compensation committee are independent directors under the rules of the Nasdaq Global Market. The compensation committee develops and reviews compensation policies and practices applicable to executive officers, reviews and recommends goals for the Company’s Chief Executive Officer and evaluates his performance in light of these goals, reviews and evaluates goals and objectives for other officers, oversees and evaluates the Company’s equity incentive plans and reviews and approves the creation or amendment of the Company’s equity incentive plans.

Nominating and Governance Committee. The nominating committee currently consists of Mr. Halter (chair), Mr. Hoffmann and Dr. Powell. The Board has determined that all members of the nominating committee are independent directors under the rules of the Nasdaq Global Market. The nominating committee’s responsibilities include recommending to the Board nominees for possible election to the Board. Nominees for the Annual Meeting were recommended to the Board for nomination by the nominating committee and the Board subsequently approved these nominees at meetings of the Board on March 20, 2007 and on April 2, 2007.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

No member of the Board or the compensation committee serves as a member of the Board or compensation committee of any other entity that has one or more executive officers serving as a member of the Board or compensation committee.

CORPORATE GOVERNANCE

The Company maintains a corporate governance page on its website which includes key information about its corporate governance matters, including the Company's Code of Ethics and charters for each of committees of the Board. If there were any amendment or waiver to the Company's Code of Ethics, it would also be included on the corporate governance page. The corporate governance page can be found at www.thresholdpharm.com, by clicking first on "Investors," then clicking on "Corporate Governance."

The Company's policies and practices reflect corporate governance initiatives that it believes are compliant with the listing requirements of the Nasdaq Global Market and the corporate governance requirements of the Sarbanes-Oxley Act of 2002, including:

- A majority of the Board members are independent of the Company under the rules of the Nasdaq Global Market;
- All members of the key Board committees—the audit committee, the compensation committee and the nominating committee—are independent under the rules of the Nasdaq Global Market;
- The independent members of the Board meet regularly outside the presence of management;
- The Company has adopted a Code of Ethics that is monitored by management and that applies to all of its officers, directors and employees, including its principal executive officer and all members of its finance department, including its principal financial officer and its controller;
- The charters of the Board committees establish their respective roles and responsibilities;
- The Company's audit committee has procedures in place for the anonymous submission of employee complaints on accounting, internal controls, or auditing matters; and
- The Company encourages all directors to attend annual meetings of stockholders. Six of our directors attended the Company's 2006 Annual Meeting.

COMMUNICATIONS WITH THE BOARD OF DIRECTORS

Stockholders or other interested parties may communicate with any director or committee of the Board by writing to them c/o Secretary, Threshold Pharmaceuticals, Inc., 1300 Seaport Boulevard, Redwood City, California 94063. Comments or questions regarding the Company's accounting, internal controls or auditing matters will be referred to members of the audit committee. Comments or questions regarding the nomination of directors and other corporate governance matters will be referred to members of the nominating committee.

SECURITY OWNERSHIP BY CERTAIN BENEFICIAL HOLDERS AND MANAGEMENT

The following table sets forth information regarding ownership of the Company's common stock as of March 31, 2007 or earlier date for information based on filings with the Securities and Exchange Commission by (a) each person known to the Company to own more than 5% of the outstanding shares of the common stock, (b) each Named Executive Officer identified in the compensation tables appearing later in this proxy statement, (c) each director of the Company, and (d) all directors and executive officers as a group. The information in this table is based solely on statements in filings with the Securities and Exchange Commission or other information the Company believes to be reliable.

<u>Name and Address of Beneficial Owner⁽¹⁾</u>	<u>Amount and Nature of Beneficial Ownership⁽²⁾</u>	<u>Percent of Shares Beneficially Owned⁽²⁾</u>
Stockholders owning more than 5%		
Entities affiliated with Felix J. Baker and Julian C. Baker ⁽³⁾ 667 Madison Avenue New York, New York 10021	3,249,959	8.7%
Entities affiliated with Three Arch Partners ⁽⁴⁾ 3200 Alpine Road Portola Valley, California 94028	2,440,202	6.5%
Entities affiliated with Sutter Hill Ventures ⁽⁵⁾ 755 Page Mill Road, Suite A-200 Palo Alto, California 94304-1005	2,423,807	6.5%
Kevin C. Tang and entities affiliated with Tang Capital Partners ⁽⁶⁾ 4401 Eastgate Mall San Diego, California 92121	4,337,500	11.6%
Entities affiliated with Perry Corp. ⁽⁷⁾ 767 Fifth Avenue New York, New York 10153	3,698,118	9.9%
Directors and Executive Officers		
Harold E. Selick, <i>Ph.D.</i> ⁽⁸⁾	1,176,876	3.2%
Michael K. Brawer, <i>M.D.</i> ⁽⁹⁾	72,621	*%
Kevin R. Kaster, <i>J.D.</i> ⁽¹⁰⁾	229,133	*%
Cathleen P. Davis ⁽¹¹⁾	32,206	*%
Alan B. Colowick, <i>M.D., M.P.H.</i> **	75,735	*%
Michael S. Ostrach, <i>J.D.</i> **	—	—
Janet I. Swearson**	127,207	*%
Bruce C. Cozadd ⁽¹²⁾	8,888	*%
David R. Hoffmann ⁽¹³⁾	1,666	*%
William A. Halter ⁽¹⁴⁾	66,432	*%
Wilfred E. Jaeger, <i>M.D.</i> ⁽¹⁵⁾	2,470,202	6.6%
George G.C. Parker, <i>Ph.D.</i> ⁽¹⁶⁾	66,432	*%
Michael F. Powell, <i>Ph.D.</i> ⁽¹⁷⁾	908,201	2.4%
All current directors and executive officers as a group (10 persons) ⁽¹⁸⁾ . . .	5,032,657	13.5%

* Less than 1%.

** Indicates former executive officer. Beneficial ownership information for former executive officers is based on the most recent information made available to the Company by such former executive officer.

- (1) Unless otherwise indicated, the address of each of the named individuals is c/o Threshold Pharmaceuticals, Inc., 1300 Seaport Boulevard, Redwood City, California 94063.
- (2) Percentage ownership is based on 37,329,383 shares of the Company's common stock outstanding as of March 31, 2007. Beneficial ownership of shares is determined in accordance with the rules of the Securities and Exchange Commission and generally includes any shares over which a person exercises sole or shared voting or investment power, or of which a person has the right to acquire ownership within 60 days after March 31, 2007. Except as otherwise noted, each person or entity has sole voting and investment power with respect to the shares shown.
- (3) Baker Biotech Fund I, L.P. is the holder of 815,508 shares, Baker Brokers Life Sciences, L.P. is the holder of 2,338,877 shares, 14159, L.P. is the holder of 69,865 shares and Baker/Tisch Investments, L.P. is the holder of 25,709 shares. By virtue of their ownership of entities that have the power to control the investment decisions of the foregoing limited partnerships, Felix J. Baker and Julian C. Baker may each be deemed to be beneficial owners of the shares owned by such entities and may be deemed to have shared voting and investment power for such shares.
- (4) Includes 2,440,202 shares held of record by Three Arch Partners III, L.P. and Three Arch Associates III, L.P. Dr. Jaeger, who serves as a member of the Board, is a managing member of Three Arch Management III, L.L.C., or TAM III, which is the general partner for Three Arch Partners III, L.P. and Three Arch Associates III, L.P. TAM III may be deemed to have sole power to vote these shares, Mark A. Wan, a managing member of TAM III, may be deemed to have sole power to vote these shares, Dr. Jaeger, a managing member of TAM III, may be deemed to have sole power to vote these shares, and Barclay Nicholson, a managing member of TAM III, may be deemed to have sole power to vote these shares. Dr. Jaeger disclaims beneficial ownership of shares held by Three Arch Partners III, L.P., Three Arch Associates III, L.P. and Three Arch Management III, L.L.C., except to the extent of his pecuniary interest therein.
- (5) Includes 23,762 shares held by Sutter Hill Entrepreneurs Fund (AI), L.P., 60,170 shares held by Sutter Hill Entrepreneurs Fund (QP), L.P. and 2,339,875 shares held by Sutter Hill Ventures, a California limited partnership, over which a managing director of the general partner of the partnerships mentioned herein, shares voting and investment power with seven other managing directors of the general partner of the partnerships mentioned herein. The natural persons who have voting or investment power over the shares held of record by Sutter Hill Ventures are David L. Anderson, G. Leonard Baker, Jr., William H. Younger, Jr., Tench Coxe, Gregory P. Sands, James C. Gaither, Jeffrey W. Bird, David E. Sweet and James N. White.
- (6) Includes 3,987,500 held by Tang Capital Partners, L.P., a Delaware limited partnership, or TCP, of which Tang Capital Management, LLC, or TCM, is the general partner. TCM, as the general partner of TCP, may be deemed to beneficially hold the 3,987,500 shares held by TCP. Kevin C. Tang, as the manager of TCM, may be deemed to beneficially own 4,337,500 shares, including the 3,987,500 shares held by TCP, over which Mr. Tang shares voting and dispositive power with TCM and TCP, 28,300 shares owned by Mr. Tang's Individual Retirement Account, over which Mr. Tang has sole voting and dispositive power, 186,000 shares held by Mr. Tang and Haeyoung K. Tang, Trustees of The Tang Family Trust dated 8/27/02, or TFT, over which Mr. Tang shares voting and dispositive power with Ms. Tang, 12,100 shares owned by the Individual Retirement Account for the benefit of Chang L. Kong, or the Chang IRA, and 11,600 shares owned by the Individual Retirement Account for the benefit of Chung W. Kong, or the Chung IRA, over each of which Mr. Tang may be deemed to have shared dispositive power over, 39,400 shares owned by Julian K. Tang under the Uniform Transfers to Minors Act, or UTMA, for which Mr. Tang serves as trustee and over which Mr. Tang has sole voting and dispositive power, 48,000 shares owned by Justin L. Tang under the UTMA, for which Mr. Tang serves as trustee and over which Mr. Tang has sole voting and dispositive power, 5,000 shares owned by Noa Y. Tang under the UTMA, for which Mr. Tang serves as trustee and over which Mr. Tang has sole voting and dispositive power, 18,700 shares owned by the Tang Advisors, LLC Profit Sharing Plan, for which Mr. Tang serves as trustee and is a participant and over which Mr. Tang has sole voting and dispositive power, and 900 shares owned by the Tang Advisors, LLC Profit Sharing Plan – FBO DR, for which Mr. Tang serves as trustee and over which Mr. Tang has sole voting and

dispositive power. Mr. Tang disclaims beneficial ownership of all shares except to the extent of his pecuniary interest therein.

- (7) The natural person who has voting or investment power over the shares held of record by Perry Corp. is Richard C. Perry, the President and sole stockholder of Perry Corp.
- (8) Includes 125,236 shares which the Company has the right to repurchase as of the date that is 60 days after March 31, 2007 and 40,416 shares subject to options issued to Dr. Selick which are exercisable within 60 days of March 31, 2007. Includes 9,411 shares acquired by Dr. Selick under the 2004 Employee Stock Purchase Plan.
- (9) Includes 60,419 shares subject to options issued to Dr. Brawer which are exercisable within 60 days of March 31, 2007.
- (10) Includes 29,348 shares which the Company has the right to repurchase as of the date that is 60 days after March 31, 2007 and 13,124 shares subject to options issued to Mr. Kaster which are exercisable within 60 days of March 31, 2007. Includes 6,525 shares acquired by Mr. Kaster under the 2004 Employee Stock Purchase Plan.
- (11) Includes 23,357 shares subject to options issued to Ms. Davis which are exercisable within 60 days of March 31, 2007. Includes 2,682 shares acquired by Ms. Davis under the 2004 Employee Stock Purchase Plan.
- (12) Includes 8,888 shares subject to options issued to Mr. Cozadd which are exercisable within 60 days of March 31, 2007.
- (13) Includes 1,666 shares subject to options issued to Mr. Hoffmann which are exercisable within 60 days after March 31, 2007.
- (14) Includes 30,000 shares subject to options issued to Mr. Halter, all of which are exercisable within 60 days of March 31, 2007. Of the 36,432 shares owned by Mr. Halter, the Company has the right to repurchase 3,374 shares as of 60 days from March 31, 2007, which repurchase right lapses at the rate of 675 shares per month.
- (15) Includes 2,440,202 shares held of record by Three Arch Partners III, L.P. and Three Arch Associates III, L.P. Dr. Jaeger, who serves as a member of the Board, is a Managing Member of Three Arch Management III, L.L.C., or TAM III, which is the general partner for Three Arch Partners III, L.P. and Three Arch Associates III, L.P. TAM III may be deemed to have sole power to vote these shares, Mark A. Wan, a managing member of TAM III, may be deemed to have sole power to vote these shares, Dr. Jaeger, a managing member of TAM III, may be deemed to have sole power to vote these shares, and Barclay Nicholson, a managing member of TAM III, may be deemed to have sole power to vote these shares. Dr. Jaeger disclaims beneficial ownership of shares held by Three Arch Partners III, L.P., Three Arch Associates III, L.P. and Three Arch Management III, L.L.C., except to the extent of his pecuniary interest therein. Also included are 30,000 shares subject to options issued to Dr. Jaeger, which are exercisable within 60 days after March 31, 2007.
- (16) Includes 30,000 shares subject to options issued to Dr. Parker, all of which are exercisable within 60 days of March 31, 2007. Of the 36,432 shares owned by Dr. Parker, the Company has the right to repurchase 3,374 shares as of 60 days from March 31, 2007, which repurchase right lapses at the rate of 675 shares per month.
- (17) Includes 878,200 shares held of record by Sofinnova Venture Partners V, LP, Sofinnova Venture Affiliates V, LP and Sofinnova Venture Principals V, LP. The natural persons affiliated with Sofinnova Ventures, Inc. who has voting or investment power over the shares are Dr. Powell, a member of the Board and a Managing Member of Sofinnova Venture Partners, Alain L. Azan and James I. Healy. Dr. Powell disclaims beneficial ownership of the shares held by Sofinnova Venture Partners V, LP, Sofinnova Venture Affiliates V, LP and Sofinnova Venture Principals V, LP except to the extent of his pecuniary interest therein. Also included are 30,000 shares subject to options issued to Dr. Powell, all of which are exercisable within 60 days after March 31, 2007, and one share jointly owned by Dr. Powell and Tana B. Powell.
- (18) Total number of shares includes common stock held by entities affiliated with directors and executive officers, See footnotes 1 through 17 above. Total number of shares does not include shares held by Dr. Colowick, Mr. Ostrach or Ms. Swearson, each of whom resigned their respective positions with the Company during fiscal year 2006.

RELATED PARTY TRANSACTIONS

Procedures for Approval of Related Party Transactions

Pursuant to the Company's Code of Ethics and the Audit Committee Charter, our executive officers and directors must disclose transactions involving actual or apparent conflicts of interests, such as related party transactions, to the audit committee in writing and must obtain the audit committee's approval prior to entering into any such transaction. In approving or rejecting any proposed transaction, the audit committee considers the relevant facts and circumstances available and deemed relevant, including but not limited to, the risks, costs, and benefits to the Company, the terms of the transactions, the availability of other sources for comparable services or products, and, if applicable, the impact on director independence.

Related Party Transactions and Business Relationships

In November 2004, the Company entered into a Development Agreement with MediBIC Co. Ltd. The Chief Operating Officer and a director of Anexus Pharmaceuticals, Inc., a subsidiary of MediBIC, is the wife of Dr. Harold E. Selick, the Company's Chief Executive Officer and a member of the Board.

The Company's Senior Director of Investor Relations, Denise Powell, an employee of the Company, is the sister of Dr. Michael F. Powell, a member of the Board and a member of the audit committee and the nominating committee. Ms. Powell's annual salary is \$159,000. In addition, in January 2005, Ms. Powell was granted an option to purchase 45,540 shares of the Company's common stock, which vested as to 25% of the shares on January 13, 2006 and vest as to the remaining shares over the subsequent three years. In March 2006, Ms. Powell was granted an option to purchase 50,000 shares of the Company's common stock, which vest monthly over four years beginning on January 1, 2006. In September 2006, Ms. Powell participated in the Company's Option Exchange Program, as a result of which Ms. Powell exchanged her March 2006 option for an option to purchase an equal number of shares of the Company's common stock granted on September 29, 2006 with an exercise price of \$2.57. This option vests monthly such that it will be fully vested on the same date as the option for which it was exchanged would have been fully vested. In January 2007, Ms. Powell received an additional option to purchase 20,000 shares of the Company's common stock, which option vests monthly over four years beginning January 24, 2007. In February 2006, Ms. Powell received a bonus of \$12,000 and in January 2007, she received a bonus of \$22,500.

In fiscal year 2006, the Company paid \$381,752 to MedReviews, LLC for services rendered to the Company through July 2006 in connection with the planning of meetings with clinical advisors and investigators. MedReviews, LLC no longer provides these or other services to the Company. Dr. Michael K. Brawer, the Company's Interim Chief Medical Officer, owns 42.5% of the outstanding securities of MedReviews, LLC.

The Company's Amended and Restated Certificate of Incorporation and Bylaws provide that the Company will indemnify each of the Company's directors and officers to the fullest extent permitted by Delaware law. Further, the Company has entered into separate indemnification agreements with each of the Company's directors and executive officers.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Under Section 16(a) of the Securities Exchange Act of 1934, or the Exchange Act, and the rules promulgated by the Securities and Exchange Commission, the Company's directors, executive officers and beneficial owners of more than 10% of any class of equity security are required to file periodic reports of their ownership of the Company's equity securities, and changes in that ownership, with the Securities and Exchange Commission. To the Company's knowledge, based solely on its review of the copies of such reports received or written representations from such persons that no other reports were required, the Company believes that, with

the exception of the late filing by each of Messrs. Enright (a former member of the Board) and Halter and Drs. Jaeger, Parker and Powell of a Form 4 reflecting the automatic grant of stock options by the Company to each such director in May 2006, the Company's directors, executive officers and beneficial owners of more than 10% of the Company's equity securities complied with all applicable filing requirements.

CERTAIN INFORMATION WITH RESPECT TO EXECUTIVE OFFICERS

The following table sets forth, as of March 31, 2007, information about the Company's executive officers.

<u>Name</u>	<u>Age</u>	<u>Position(s)</u>
<i>Executive Officers</i>		
Harold E. Selick, <i>Ph.D.</i>	52	Chief Executive Officer and Director
Michael K. Brawer, <i>M.D.</i>	53	Interim Chief Medical Officer
Kevin R. Kaster, <i>J.D.</i>	47	Senior Vice President, Corporate Development
Cathleen P. Davis	53	Vice President, Finance and Controller

Biographical information for Dr. Selick is included above under the heading "Nominees and Continuing Directors."

Michael K. Brawer, M.D. has served as the Company's Interim Chief Medical Officer since November 2006. From March 2006 until November 2006, Dr. Brawer served as the Company's Senior Medical Strategist and Urology Therapeutic Area Head. From April 2003 to March 2006, Dr. Brawer served as a consultant to the Company and a member of its Scientific Advisory Board. Dr. Brawer is a director of the Northwest Prostate Institute at Northwest Hospital in Seattle, Washington. Dr. Brawer received a B.A. from the University of California, Los Angeles and a M.D. from the University of California, Los Angeles. He completed his internship and residency training at the Stanford University School of Medicine.

Kevin R. Kaster, J.D. has served as Senior Vice President, Corporate Development since March 2007. Mr. Kaster serves the Company on a part-time basis. From October 2002 to March 2007, Mr. Kaster served as the Company's Vice President, Intellectual Property. From August 1998, to October 2002, he served as the Vice President, Intellectual Property, to Kosan Biosciences Incorporated. Prior to that, Mr. Kaster held positions managing patent portfolios at Geron Corporation, Affymax, Inc. and Cetus Corporation. Mr. Kaster received his B.S. in Chemistry and Molecular Biology from Vanderbilt University and his J.D. from Indiana University School of Law.

Cathleen P. Davis has served as the Company's Vice President, Finance and Controller since August 2006. Ms. Davis served as the Company's Controller from July 2005 through August 2006. Prior to joining the Company, Ms. Davis served as Controller of Theravance Inc. from 2002 to 2005, and of ALZA Corporation from 1999 to 2002. Ms. Davis has been a Certified Public Accountant in California since 1993, and has a Bachelor of Science in Business Administration from California State University, Hayward.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Overview of Compensation Program

The following Compensation Discussion and Analysis describes the compensation committee of our Board and discusses our compensation practices to date. The compensation committee has responsibility for establishing, implementing and continually monitoring the Company's compensation practices in order to make sure the total compensation paid to the Company's directors, executive officers and key employees is fair, reasonable and competitive.

The main responsibilities of the compensation committee are:

- to develop and periodically review compensation policies and practices applicable to the Company's executive officers, to review and recommend goals for the Company's Chief Executive Officer and evaluate his or her performance in light of these goals;
- to review, recommend and evaluate goals and objectives for other officers of the Company;
- to review and evaluate any employment agreements, severance agreements, change-in-control arrangements or special or supplemental employee benefits, and any material amendments thereto applicable to the Company's executive officers and recommend the same for approval by the Board;
- to oversee and evaluate incentive, equity-based and other compensatory plans of the Company in which executive officers and key employees participate;
- to review periodically the compensation and benefits offered to nonemployee directors and recommend changes to the Board as appropriate; and
- to approve, subject to stockholder or Board approval as may be required, the creation or amendment of any incentive, equity-based and other compensatory plans.

The compensation committee operates under a written charter adopted by the Board on April 7, 2004. The charter also provides that the compensation committee may delegate such of its authority and responsibilities as the compensation committee deems proper to the members of the compensation committee or any subcommittee thereof. A copy of the charter can be found at www.thresholdpharm.com, by clicking first on "Investors," then clicking on "Corporate Governance."

Committee Members and Independence

The compensation committee currently consists of Dr. Jaeger (chair), Mr. Cozadd and Dr. Parker. The Board has determined that all members of the compensation committee are independent directors under the rules of the Nasdaq Global Market. No member of the Board or the compensation committee serves as a member of any board or compensation committee of any other entity that has one or more executive officers serving as a member of the Board or compensation committee.

Compensation Philosophy and Objectives

The compensation committee designs the Company's executive compensation practices with the following overall objectives in mind:

- attract, retain and motivate key executive talent;
- encourage high performance;
- promote employee accountability; and
- align employee incentives with the interests of stockholders.

The compensation committee evaluates individual executive performance with a goal of setting compensation at levels the compensation committee believes are comparable with executives in other companies of similar size and stage of development operating in the biotechnology industry while taking into account our relative performance and our own strategic goals. The Company strives to provide a total compensation package to senior management that is competitive in the marketplace, recognizes individual performance and provides opportunities to earn rewards based on achievement of short-term and long-term individual and corporate objectives.

In the biopharmaceutical industry, many traditional measures of corporate performance, such as earnings per share or sales growth, may not readily apply in reviewing performance of executives. Because of the Company's current stage of development, the Company has not used profitability or market value of our stock as a significant factor in review of executives' performance and setting compensation. As such, the Company evaluates other indications of performance, such as progress of the Company's research and development programs and corporate development activities, the Company's success in recruiting and retaining highly qualified personnel and the Company's success in securing capital sufficient to enable it to continue research and development activities. These considerations necessarily involve an assessment by the compensation committee of individual and corporate performance. In addition, total compensation paid by the Company to its executive officers is designed to be competitive with compensation packages paid to the management of similarly situated companies in the biopharmaceutical industry. Toward that end, the compensation committee may review both independent survey data, as well as data gathered internally, as described below in more detail.

Setting Executive Compensation

Given the foregoing objectives, the compensation committee has structured the Company's annual and long-term executive compensation to motivate executives to achieve the business goals set by the Company and to reward the executives for achieving these goals.

The Company does not believe that it is appropriate to establish compensation levels primarily based on benchmarking. The Company believes that information regarding pay practices at other companies is useful in two respects, however. First, the Company recognizes that our compensation practices must be competitive in the marketplace. Second, marketplace information is one of the many factors that the Company considers in assessing the reasonableness of compensation. Accordingly, even though the Company has not retained a compensation consultant to review its policies and procedures with respect to executive compensation, the Company does conduct an annual benchmark review of the aggregate level of our executive compensation, as well as the mix of elements used to compensate our executive officers. This review is based on a survey of executive compensation paid by 16 San Francisco bay area biotechnology companies considered "peers" of the Company conducted by an independent third party, Radford Surveys and Consulting, in which the Company participates. The Company benchmarks the base salaries of our executive officers against the compensation paid by biotechnology companies still in the pre-commercial stage of discovery. To remain consistent from year to year, the Company currently intends to use these same study groups (same industry, stage of development and geography) as part of the annual marketplace study. The specific companies included in these groups may change based on their size, relevance or other pertinent factors. In determining the compensation levels for each of our executive officers for fiscal year 2006, the specific companies included in the survey were Biomarin Pharmaceuticals Inc., Cell Genesys, Inc., Connetics Corporation, Corgentech, Inc., CV Therapeutics, Inc., Cytokinetics, Inc., Exelixis, Inc., Geron Corporation, Intermune, Inc., Kosan Biosciences Incorporated, Maxygen, Inc., Nuvelo, Inc., Renovis, Inc., Telik, Inc., Tercica, Inc. and Theravance, Inc.

Our compensation committee meets as often as necessary to perform its duties and responsibilities. The compensation committee held four meetings during fiscal 2006 and has held one meeting so far during fiscal 2007. Dr. Jaeger works with the Chief Executive Officer to establish the meeting agenda. The compensation committee typically meets with the Chief Executive Officer and, where appropriate, with the Company's principal financial officer and with outside advisors. The compensation committee also regularly meet in executive session without management.

Although many compensation decisions are made in the first quarter of the fiscal year, our compensation planning process neither begins nor ends with any particular compensation committee meeting. Compensation decisions are designed to promote our fundamental business objectives and strategy. Business and succession planning, evaluation of management performance and consideration of the business environment are year-round processes.

The Company's executive officers play a significant role in the compensation-setting process. The most significant aspects of the role of the Company's executive officers are:

- to evaluate employee performance, including the Chief Executive Officer's evaluation of the performance of the other executive officers;
- to establish business performance targets and objectives;
- to recommend salary levels and equity compensation awards;
- to provide background information regarding the Company's strategic objectives; and
- to propose compensation recommendations regarding the Company's executive officers (other than for the Chief Executive Officer and, as applicable, the Chief Financial Officer).

Targeted Compensation Levels

Together with the performance objectives, the Company established targeted total compensation levels (*i.e.*, maximum achievable compensation) for each of the executive officers. In making this determination, we are guided by the compensation philosophy described above. We also consider historical compensation levels, competitive pay practices at the companies in the study groups, and the relative compensation levels among the Company's executive officers. We may also consider industry conditions, corporate performance versus a peer group of companies and the overall effectiveness of our compensation program in achieving desired performance levels.

Performance Pay

As targeted total compensation levels are determined, we also determine the portion of total compensation that will be contingent, performance-based pay. Performance-based pay generally includes cash bonuses for efforts towards and the achievement of Company goals and stock-based compensation whose value is dependent upon long-term appreciation in stock price.

The compensation committee receives and reviews materials in advance of each of its meetings. These materials include information that management believes will be helpful to the compensation committee as well as materials that members of the compensation committee have specifically requested. Depending on the agenda for the particular meeting, these materials may include:

- financial reports on year-to-date performance versus budget and compared to prior year performance;
- calculations and reports on levels of achievement of individual and corporate performance objectives;
- reports on the Company's strategic objectives and budget for future periods;
- reports on the Company's five-year performance and current year performance versus a peer group of companies;
- information on the executive officers' stock ownership and option holdings;
- information regarding equity compensation plan dilution;
- estimated grant-date values of stock options (using the Black-Scholes valuation methodology); and
- tally sheets setting forth the total compensation of the named executive officers, including base salary, cash incentives, equity awards, perquisites and other compensation and any amounts payable to the executives upon voluntary or involuntary termination, early or normal retirement or following a change-in-control of the Company.

Elements of Compensation

Executive compensation is comprised of the following four components:

- base salaries competitive with comparable development-stage biopharmaceutical companies, including companies with which the Company competes for similar talented executives;
- annual variable compensation or bonuses which are designed to encourage executives to focus on the achievement of specific short-term corporate goals as well as longer-term strategic objectives and reward them for their impact on such achievement; and
- long-term equity based incentives in the form of stock options, to align the interests of management and stockholders and reward management for performance which benefits our stockholders.

Executive compensation at the Company consists of following main elements:

Base Salary. Base salaries for our executives are established based on the scope of their responsibilities, taking into account competitive market compensation paid by other companies for similar positions. Generally, the Company believes that base salaries of our executive officers should be in the range of salaries for executives in similar positions with similar responsibilities at comparable companies, in line with our compensation philosophy. Base salaries are reviewed annually, and adjusted from time to time to realign salaries with market levels after taking into account individual responsibilities, performance and experience. For 2007, this review occurred in the first quarter.

Discretionary Annual Bonus. The compensation committee has the authority to award discretionary annual bonuses to our executive officers. The annual incentive bonuses are intended to compensate officers for achieving financial and operational goals and for achieving individual annual performance objectives. These objectives vary depending on the individual executive, but relate generally to strategic factors determined year-by-year.

The amount of the discretionary annual bonus which each executive officer is eligible for the current fiscal year is generally reviewed and approved by the compensation committee in the first quarter of a given fiscal year. Our discretionary annual bonus is paid in cash in an amount reviewed and approved by the compensation committee and ordinarily is paid in a single installment in the first quarter following the completion of a given fiscal year. For fiscal years 2005 and 2006, each executive officer was eligible for a discretionary annual bonus up to an amount equal to 30% of such executive's base salary. However, the compensation committee may increase or decrease the discretionary annual bonus paid to our executive officers and the compensation committee does not generally fix a maximum payout for any officers' annual discretionary bonus. The actual amount of discretionary bonus, if any, will be determined following a review of each executive's individual performance and contribution to our strategic goals conducted during the first quarter of the fiscal year following the end of a given fiscal year. In March 2007, the compensation committee recommended and the Board approved the payment of discretionary annual bonuses for services rendered in fiscal year 2006 in the amounts shown below.

<u>Name</u>	<u>Position(s)</u>	<u>Target Bonus Amount</u> <u>(\$)</u>	<u>Amount of</u> <u>Bonus Awarded</u> <u>(\$)</u>
Harold E. Selick, <i>Ph.D.</i>	Chief Executive Officer and Director	150,000	100,000
Michael K. Brawer, <i>M.D.</i>	Interim Chief Medical Officer	81,250	50,000
Cathleen P. Davis	Vice President, Finance and Controller	N/A ⁽¹⁾	50,000

(1) Ms. Davis was promoted to become the Company's Vice President, Finance and Controller in August 2006. The compensation committee did not set a target bonus amount for Ms. Davis.

Options. Our 2004 Amended and Restated Equity Incentive Plan authorizes us to grant options to purchase shares of our common stock to employees, directors and consultants. Our compensation committee is the administrator of the stock option plan. Stock option grants are made at the commencement of employment and, occasionally, following a significant change in job responsibilities or to meet other special retention or performance objectives. The compensation committee reviews and approves stock option awards to executive officers based upon its assessment of individual performance, a review of each executive's existing long-term incentives, and retention considerations. Such review is usually undertaken during the first quarter of each fiscal year. Periodic stock option grants are made to non-officer employees and consultants at the discretion of the Chief Executive Officer within grant limits approved by the Board. In 2006, certain named executive officers were awarded stock options in the amounts indicated in the section entitled "Grants of Plan Based Awards". These grants included grants made on September 29, 2006, in connection with the Company's stock option tender offer in order to carry out the repricing of options.

Employee Stock Purchase Plan. Our 2004 Employee Stock Purchase Plan, or the Purchase Plan, provides our employees, including our executive officers, with an opportunity to purchase our common stock through accumulated payroll deductions. Amounts deducted and accumulated for the participating employee's account are used to purchase shares of our common stock on the last trading day of each purchase period at a price of 85% of the lower of the fair market values of the common stock at the beginning of the offering period and the end of the purchase period without interest. Participating employees may end their participation at any time during an offering period, and they will be paid their payroll deductions accumulated to that date. Participation ends automatically upon termination of employment and payroll deductions credited to the participating employee's account are returned to such employee without interest. In fiscal year 2006, Dr. Selick purchased 4,411 shares under the Purchase Plan, Ms. Davis purchased 1,897 shares under the Purchase Plan, Ms. Swearson purchased 4,086 shares under the Purchase Plan and Dr. Colowick purchased 4,391 shares under the Purchase Plan.

Restricted Stock Grants. Our compensation committee has and may in the future elect to make grants of restricted stock to our executive officers. There were no grants of restricted stock to our executive officers in fiscal year 2006.

Other Compensation. Consistent with our compensation philosophy, we intend to continue to maintain our current benefits and perquisites for our executive officers; *provided, however*, the compensation committee in its discretion may revise, amend or add to the executive officer's benefits and perquisites if it deems it advisable. We believe these benefits and perquisites are currently lower than median competitive levels for comparable companies. We currently have no plans to change (except as required by law or as required to clarify the benefits to which our executive officers are entitled as set forth herein) the levels of benefits and perquisites provided thereunder.

CEO Compensation

In fiscal 2006 and the first quarter of fiscal year 2007, we continued to apply the compensation principles described above in determining the compensation of our named executive officers, including our Chief Executive Officer. In the first quarter of fiscal year 2007, our decisions were also made in the context of the failure of the Company's two Phase 3 clinical trials to achieve their primary endpoints and the uncertainties surrounding our remaining drug development efforts.

In March 2006, as part of the annual officers' compensation review, Dr. Selick's annualized base salary was increased from \$400,000 to \$500,000 in recognition of his performance as CEO, competitive market salary levels and the Company's performance, and he received a bonus of \$120,000 (or 30% of his base salary). In the March 2007 annual officers' compensation review, Dr. Selick did not receive an increase in his annualized base salary, and received a bonus of \$100,000 (or 20% of his base salary).

We believe that these decisions and compensation decisions regarding the other named executive officers are consistent with our core compensation principles.

Accounting and Tax Considerations

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123 (revised 2004), "Share-Based Payment," or SFAS No. 123R. Under SFAS No. 123R, the Company is required to estimate and record an expense for each award of equity compensation over the vesting period of the award. Although the Company assessed the desirability of granting shares of restricted stock to the Company's executive officers and employees in lieu of stock option grants in light of the accounting impact of SFAS No. 123R, the Company ultimately determined to retain its stock option granting program as the sole component of its long-term compensation program as that program helps to align management performance with stockholder goals. Accounting rules also require the Company to record cash compensation as an expense at the time the obligation is incurred based upon reasonable assumptions.

Compliance with Internal Revenue Code Section 162(m)

Section 162(m) of the U.S. Internal Revenue Code limits the tax deductibility by a corporation of compensation in excess of \$1 million paid to any of its five most highly compensated executive officers. However, compensation which qualifies as "performance-based" is excluded from the \$1 million limit if, among other requirements, the compensation is payable only upon attainment of pre-established, objective performance goals under a plan approved by stockholders. The compensation committee does not presently expect total cash compensation payable for salaries to exceed the \$1 million limit for any individual executive. Having considered the requirements of Section 162(m), the compensation committee believes that stock option grants to date meet the requirement that such grants be "performance-based" and are, therefore, exempt from the limitations on deductibility. The compensation committee will continue to monitor the compensation levels potentially payable under the Company's cash compensation programs, but intends to retain the flexibility necessary to provide total cash compensation in line with competitive practice, the Company's compensation philosophy and its best interests. It is the current policy of the compensation committee to maximize, to the extent reasonably possible, our ability to obtain a corporate tax deduction for compensation paid to our executive officers to the extent consistent with the best interests of our company and our stockholders.

Summary Compensation Table

The following tables and descriptive materials set forth information concerning compensation earned for services rendered to the Company by (a) the principal executive officer, (b) the principal financial officer, (c) all persons serving as principal financial officer during fiscal year 2006, (d) the Company’s most highly compensated executive officer serving as an executive officer at the end of fiscal year 2006, and (e) one additional individual who would have been among the Company’s three most highly compensated executive officers had they been serving in such capacity at the end of fiscal year 2006. Collectively, this group is referred to in this proxy statement as Named Executive Officers.

<u>Name and Principal Position</u>	<u>Year(1)</u>	<u>Salary(2)(\$)</u>	<u>Bonus(3)(\$)</u>	<u>Option Awards(4)(\$)</u>	<u>All Other Compensation(\$)</u>	<u>Total(\$)</u>
Harold E. Selick, <i>Ph.D.</i> Chief Executive Officer	2006	500,000	100,000(5)	1,849,590(6)	431(7)	2,450,021
Michael K. Brawer, <i>M.D.</i> Interim Chief Medical Officer	2006	214,757	50,000(8)	355,523(9)	328(10)	620,608
Cathleen P. Davis Vice President, Finance and Controller	2006	201,420	62,000(11)	143,685(12)	408(13)	407,513
Michael S. Ostrach, <i>J.D.</i> * Former Chief Operating Officer, General Counsel and Chief Financial Officer	2006	309,896*	—	401,074(14)	30,021(15)	740,991
Janet I. Swearson* Former Chief Financial Officer	2006	216,667*	—	619,108(16)	369,298(17)	1,205,073
Alan B. Colowick, <i>M.D.* M.P.H.</i> Former Chief Medical Officer	2006	296,875*	—	700,775(18)	30,224(19)	1,027,874

* Mr. Ostrach, Ms. Swearson and Dr. Colowick each resigned as an executive officer of the Company during fiscal year 2006.

- (1) In accordance with the Securities and Exchange Commission transition rules, information is provided only for the most recently completed fiscal year.
- (2) Includes amounts deferred pursuant to the Company’s 401(k) plan.
- (3) The amounts in this column reflect the cash bonus awards to the named individual and are discussed in greater detail under the heading “Compensation Discussion and Analysis” beginning on page 13.
- (4) The amounts in this column represent the dollar amount recognized for financial statement reporting purposes with respect to the 2006 fiscal year in accordance with FAS 123R, disregarding any forfeiture assumptions. See Note 9 of the notes to our financial statements in our Annual Report on Form 10-K filed on March 15, 2007 for a discussion of all assumptions made by the Company in determining the FAS 123R values of its equity awards. Notwithstanding the foregoing, equity awards granted to consultants or that became vested during the period a current or former employee provided service to the Company as a consultant have been valued in accordance with EITF 98-16, “Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.” The value of option awards vesting in fiscal year 2006 is based upon the number of options granted and the fair market value of the option on the date of grant and can vary significantly by individual.
- (5) Represents the amount of a cash bonus to be paid to Dr. Selick in fiscal year 2007 for services rendered to the Company in fiscal year 2006.
- (6) In connection with the Company’s Option Exchange Program, on September 29, 2006, Dr. Selick was granted an option to purchase 150,000 shares of the Company’s common stock at a purchase price of \$2.57 per share in exchange for an option previously granted to Dr. Selick to purchase 150,000 shares of the Company’s common stock at a purchase price of \$14.51 per share. The Option Exchange Program is described in greater detail under the caption “Option Exchange Program” on page 22.

- (7) Represents \$431 in group term life insurance premiums paid by the Company on behalf of Dr. Selick for fiscal year 2006.
- (8) Represents the amount of a cash bonus to be paid to Dr. Brawer in fiscal year 2007 for services rendered to the Company in fiscal year 2006.
- (9) In connection with the Company's Option Exchange Program, on September 29, 2006, Dr. Brawer was granted an option to purchase 10,000 shares of the Company's common stock at a purchase price of \$2.57 per share and an option to purchase 100,000 shares of the Company's common stock at a purchase price of \$2.57, respectively, in exchange for options previously granted to Dr. Brawer to purchase 10,000 shares of the Company's common stock at a purchase price of \$6.26 per share and an option to purchase 100,000 shares of the Company's common stock at a purchase price of \$14.51 per share. The Option Exchange Program is described in greater detail under the caption "Option Exchange Program" on page 22.
- (10) Represents \$328 in group term life insurance premiums paid by the Company on behalf of Dr. Brawer for fiscal year 2006.
- (11) Includes the payment of a \$12,000 cash bonus in fiscal year 2006 for services rendered to the Company in fiscal year 2005, which was accrued in fiscal year 2005, and the payment of a \$50,000 cash bonus to be paid to Ms. Davis in fiscal year 2007 for services rendered to the Company in fiscal year 2006.
- (12) In connection with the Company's Option Exchange Program, on September 29, 2006, Ms. Davis was granted an option to purchase 40,000 shares of the Company's common stock at a purchase price of \$2.57 per share and an option to purchase 25,000 shares of the Company's common stock at a purchase price of \$2.57, respectively, in exchange for options previously granted to Ms. Davis to purchase 40,000 shares of the Company's common stock at a purchase price of 12.45 per share and an option to purchase 25,000 shares of the Company's common stock at a purchase price of \$14.04 per share. The Option Exchange Program is described in greater detail under the caption "Option Exchange Program" on page 22.
- (13) Represents \$408 in group term life insurance premiums paid by the Company on behalf of Ms. Davis for fiscal year 2006.
- (14) In connection with the Company's Option Exchange Program, on September 29, 2006, Mr. Ostrach was granted an option to purchase 250,000 shares of the Company's common stock at a purchase price of \$2.57 per share and an option to purchase 50,000 shares of the Company's common stock at a purchase price of \$2.57, respectively, in exchange for options previously granted to Mr. Ostrach to purchase 250,000 shares of the Company's common stock at a purchase price of \$12.45 per share and an option to purchase 50,000 shares of the Company's common stock at a purchase price of \$14.51 per share. The Option Exchange Program is described in greater detail under the caption "Option Exchange Program" on page 22.
- (15) Includes the payment of accrued paid time off, or PTO, of \$29,344 paid to Mr. Ostrach upon his departure from the Company on October 27, 2006 and \$677 in group term life insurance premiums paid by the Company on behalf of Mr. Ostrach for fiscal year 2006. Mr. Ostrach received a cash bonus payment of \$27,600 in fiscal year 2006 for services rendered to the Company in fiscal year 2005. The amount of this cash bonus payment was accrued in fiscal year 2005.
- (16) In connection with the Company's Option Exchange Program, on September 29, 2006, Ms. Swearson, then a consultant to the Company, was granted an option to purchase 75,000 shares of the Company's common stock at a purchase price of \$2.57 per share in exchange for an option previously granted to Ms. Swearson to purchase 75,000 shares of the Company's common stock at a purchase price of \$14.51 per share. The Option Exchange Program is described in greater detail under the caption "Option Exchange Program" on page 22.
- (17) Includes a severance payment of \$325,000 and the payment of PTO of \$43,750, paid to Ms. Swearson upon her departure from the Company on August 31, 2006 in accordance with a change of control and severance agreement by and between the Company and Ms. Swearson. Also includes \$548 in group term life insurance premiums paid by the Company on behalf of Mr. Swearson and her dependents for fiscal year 2006. Ms. Swearson received a cash bonus payment of \$98,500 in fiscal year 2006 for services rendered to the Company in fiscal year 2005. The amount of this cash bonus payment was accrued in fiscal year 2005.
- (18) In connection with the Company's Option Exchange Program, on September 29, 2006, Dr. Colowick was granted an option to purchase 150,000 shares of the Company's common stock at a purchase price of \$2.57 per share in exchange for an option previously granted to Dr. Colowick to purchase 150,000 shares of the

Company's common stock at a purchase price of \$14.51 per share. Dr. Colowick resigned as the Company's Chief Medical Officer prior to the commencement of vesting of such option. The Option Exchange Program is described in greater detail under the caption "Option Exchange Program" on page 22.

(19) Includes the payment of accrued PTO of \$28,631 and personal holiday hours of \$1,442 paid to Dr. Colowick upon his departure from the Company on October 13, 2006. Also includes \$150 in group term life insurance premiums paid by the Company on behalf of Dr. Colowick for fiscal year 2006. Dr. Colowick received a cash bonus payment of \$90,000 in fiscal year 2006 for services rendered to the Company in fiscal year 2005. The amount of this cash bonus payment was accrued in fiscal year 2005.

Grants of Plan-Based Awards

The following table sets forth information regarding grants of stock and option awards made to our Named Executive Officers during fiscal year 2006.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1)	All Other Option Awards: Number of Securities Underlying Options(#)	Exercise or Base Price of Option Awards(\$/Sh)	Grant Date Fair Value of Stock and Option Awards
		Target(\$)			
Harold E. Selick, <i>Ph.D.</i>	3/14/2006 ⁽²⁾		150,000 ⁽²⁾	14.51	1,546,755 ⁽²⁾
	9/29/2006		150,000*	2.57	127,500
		150,000 ⁽¹⁾			
Michael K. Brawer, <i>M.D.</i>	3/14/2006 ⁽²⁾		100,000 ⁽²⁾	14.51	1,031,170 ⁽²⁾
	9/28/2006		100,000	2.82	197,450
	9/29/2006		10,000*	2.57	4,900
	9/29/2006		100,000*	2.57	85,000
		97,500 ⁽¹⁾			
Cathleen P. Davis	3/10/2006 ⁽²⁾		25,000 ⁽²⁾	14.04	249,673 ⁽²⁾
	9/28/2006		50,000	2.82	98,275
	9/29/2006		40,000*	2.57	32,100
	9/29/2006		25,000*	2.57	20,750
Michael S. Ostrach, <i>J.D.</i> **	3/14/2006 ⁽²⁾		50,000 ⁽²⁾	14.51	515,585 ⁽²⁾
	9/29/2006		50,000*	2.57	42,500
	9/29/2006		250,000*	2.57	197,500
			112,500 ⁽¹⁾		
Janet I. Swearson**	3/14/2006 ⁽²⁾		75,000 ⁽²⁾	14.51	773,378 ⁽²⁾
	9/29/2006		75,000*	2.57	32,250
		97,500 ⁽¹⁾			
Alan B. Colowick, <i>M.D., M.P.H.</i> **	3/14/2006 ⁽²⁾		150,000 ⁽²⁾	14.51	1,546,755 ⁽²⁾
	9/29/2006		150,000*	2.57	127,500
	10/16/2006 ⁽³⁾		10,000 ⁽³⁾	3.45	26,400 ⁽³⁾
		112,500 ⁽¹⁾			

* Denotes Replacement Options granted by the Company to the named executive officer pursuant to the Option Exchange Program completed in September 2006, which is described in greater detail below.

** Indicates former executive officer.

(1) For fiscal year 2006, each Named Executive Officer was eligible for a discretionary annual bonus up to an amount equal to 30% of such individual's base salary. The amount of annual bonus actually awarded to each Named Executive Officer is set forth in the Summary Compensation Table above.

(2) Options granted to Ms. Davis on March 10, 2006 and Drs. Selick, Brawer and Colowick, Mr. Ostrach and Ms. Swearson on March 14, 2006 were exchanged on September 29, 2006 pursuant to the Company's Option Exchange Program, which is described in greater detail below.

- (3) Options granted to Dr. Colowick pursuant to an Advisory Board Agreement by and between the Company and Dr. Colowick dated October 14, 2006 and entered into following Dr. Colowick's resignation as our Chief Medical Officer on October 13, 2006.

Option Exchange Program

In connection with the Company's Option Exchange Program, eligible employees, executive officers and directors had the opportunity to make a one-time election to cancel certain outstanding grants of stock options, or Current Options, under our 2004 Amended and Restated Equity Incentive Plan, for an equal number of new unvested options to be granted under the Plan after the date of cancellation of the Current Options, or the Replacement Options. On September 26, 2006, the Company cancelled 2,172,000 options of 70 eligible employees, consultants and directors who elected to participate in the Option Exchange Program that had a weighted average exercise price of \$12.37 and re-granted 2,172,000 options at an exercise price of \$2.57, which was the Company's closing price on September 29, 2006.

Outstanding Equity Awards at Fiscal Year-End

The following table sets forth information regarding outstanding equity awards held by our Named Executive Officers at the end of fiscal year 2006.

Name	Option Awards				Stock Awards	
	Number of Securities Underlying Unexercised Options(#)	Number of Securities Underlying Unexercised Options(#)	Option Exercise Price(\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested(#)	Market Value of Shares or Units of Stock That Have Not Vested(1)(2)
	Exercisable	Unexercisable				
Harold E. Selick, <i>Ph.D.</i>	2,067	25,497	2.57	3/13/2016		
	9,182	113,254	2.57	3/13/2016	142,313	526,588
					43,010	159,137
Michael K. Brawer, <i>M.D.</i>	5,061		0.16	3/31/2013		
	3,921	2,151	0.53	5/11/2014		
	3,921	2,151	0.53	12/13/2014		
	6,250	93,750	2.82	9/27/2016		
	10,000		2.57	5/18/2015		
	5,621	94,379	2.57	3/13/2016		
Cathleen P. Davis	3,125	46,875	2.82	9/27/2016		
	3,758	36,242	2.57	9/13/2015		
	1,874	23,126	2.57	3/9/2016		
Michael S. Ostrach, <i>J.D.</i> *						
Janet I. Swearson*	2,067	25,497	2.57	3/13/2016		
	3,557	43,879	2.57	3/13/2016	65,464 ⁽²⁾	242,217
Alan B. Colowick, <i>M.D., M.P.H.</i> *	833	9,167	3.45	10/15/2016		

* Indicates former executive officer.

- (1) Calculated using the closing sales price of the Company's common stock of \$3.70 per share on the Nasdaq Global Market on December 29, 2006, the last trading day of fiscal year 2006. The actual value (if any) to be realized by the officer depends on whether the shares vest and on the future performance of our common stock.
- (2) Ms. Swearson's service to the Company ended on December 31, 2006. These shares of Company Common Stock have been repurchased by the Company for their purchase price.

Option Exercises and Stock Vested

The following table sets forth information regarding options exercised and shares of common stock acquired upon vesting by our Named Executive Officers during fiscal year 2006.

<u>Name</u>	<u>Stock Awards</u>	
	<u>Number of Shares Acquired on Vesting (#)</u>	<u>Value Realized on Vesting(1)(\$)</u>
Harold E. Selick, <i>Ph.D.</i>	202,243	1,768,412
Michael K. Brawer, <i>M.D.</i>	—	—
Cathleen P. Davis	—	—
Michael S. Ostrach, <i>J.D.</i> *	—	—
Janet I. Swearson*	85,767	625,952
Alan B. Colowick, <i>M.D., M.P.H.</i> *	66,412	757,352

* Indicates former executive officer.

- (1) Value realized is based on the fair market value of our common stock on the vesting date minus the applicable exercise price and does not necessarily reflect proceeds actually received by the officer.

Potential Payments Upon Termination or Change In Control

Change of Control Arrangements

In December 2004, the Company entered into change of control severance agreements with Dr. Selick, and in November 2006, the Company entered into a similar agreement with Dr. Brawer, and in April 2007, the Company entered into a similar agreement with each of Mr. Kaster and Ms. Davis. Each of these agreements provides that if such person's employment is terminated by the Company without cause or is involuntarily terminated, then such person will be entitled to a severance payment consisting of 12 months base salary as in effect as of the date of termination. If such person's employment is terminated without cause or involuntarily terminated within 18 months following a change of control, then such person will be entitled to the following severance benefits: 12 months base salary and any applicable allowances in effect as of the date of termination or, if greater, as in effect in the year in which the change of control occurs, immediate acceleration and vesting of all stock options granted prior to the change of control, the termination of the Company's right to repurchase shares of restricted stock purchased prior to the change of control, extension of the exercise period for stock options granted prior to the change of control to two years following the date of termination and up to 12 months of health benefits.

Under his change of control and severance agreement with the Company, if Dr. Selick's employment with the Company was terminated as of December 31, 2006 and he was entitled to receive the benefits set forth in his change of control agreement, Dr. Selick would have been eligible to receive a lump sum payment \$500,000 in severance in addition to being paid his accrued PTO. If Dr. Selick's employment with the Company was terminated as of December 31, 2006 and he was entitled to receive the benefits set forth in his change of control agreement, and such termination occurred within 18 months following a change of control of the Company, Dr. Selick would have been eligible to receive a lump sum payment of \$500,000 in severance plus his accrued PTO, full acceleration of vesting of all stock options having a value of \$842,114 as of December 31, 2006, based on the closing price of the Company's common stock on the Nasdaq Global Market of \$3.70 on December 29, 2006, the final trading day of fiscal year 2006, net of the applicable exercise price of such options, and approximately \$21,313 of health benefits.

Under his change of control and severance agreement with the Company, if Dr. Brawer's employment with the Company was terminated as of December 31, 2006 and he was entitled to receive the benefits set forth in his change of control agreement, Dr. Brawer would have been eligible to receive a lump sum payment of \$325,000 in severance in addition to being paid his accrued PTO. If Dr. Brawer's employment with the Company was

terminated as of December 31, 2006 and he was entitled to receive the benefits set forth in his change of control agreement, and such termination occurred within 18 months following a change of control of the Company, Dr. Brawer would have been eligible to receive a lump sum payment of \$325,000 in severance in addition to being paid his accrued PTO, full acceleration of vesting of all stock options having a value of \$202,786 as of December 31, 2006, based on the closing price of the Company's common stock on the Nasdaq Global Market of \$3.70 on December 29, 2006, the final trading day of fiscal year 2006, net of the applicable exercise price of such options, and approximately \$21,961 of health benefits.

Under his change of control and severance agreement with the Company, if Mr. Kaster's employment with the Company was terminated as of December 31, 2006 and he was entitled to receive the benefits set forth in his change of control agreement as of such date, Mr. Kaster would have been eligible to receive a lump sum payment of \$175,000 in severance in addition to being paid his accrued PTO. If Mr. Kaster's employment with the Company was terminated as of December 31, 2006 and he was entitled to receive the benefits set forth in his change of control agreement, and such termination occurred within 18 months following a change of control of the Company, Mr. Kaster would have been eligible to receive a lump sum payment of \$175,000 in severance in addition to being paid his accrued PTO, full acceleration of vesting of all stock options having a value of \$200,144 as of December 31, 2006, based on the closing price of the Company's common stock on the Nasdaq Global Market of \$3.70 on December 29, 2006, the final trading day of fiscal year 2006, net of the applicable exercise price of such options, and approximately \$6,674 of health benefits. The above description assumes that Mr. Kaster was an executive officer of the Company as of December 31, 2006 and that Mr. Kaster and the Company had entered into the change of control and severance agreement on or prior to such date.

Under her change of control and severance agreement with the Company, if Ms. Davis' employment with the Company was terminated as of December 31, 2006 and she was entitled to receive the benefits set forth in her change of control agreement as of such date, Ms. Davis would have been eligible to receive a lump sum payment of \$210,000 in severance in addition to being paid her accrued PTO. If Ms. Davis' employment with the Company was terminated as of December 31, 2006 and she was entitled to receive the benefits set forth in her change of control agreement, and such termination occurred within 18 months following a change of control of the Company, Ms. Davis would have been eligible to receive a lump sum payment of \$210,000 in severance in addition to being paid her accrued PTO, full acceleration of vesting of all stock options having a value of \$108,336 as of December 31, 2006, based on the closing price of the Company's common stock on the Nasdaq Global Market of \$3.70 on December 29, 2006, the final trading day of fiscal year 2006, net of the applicable exercise price of such options, and approximately \$12,859 of health benefits. The above description assumes that Ms. Davis was an executive officer of the Company as of December 31, 2006 and that Ms. Davis and the Company had entered into the change of control and severance agreement on or prior to such date.

Indemnification Agreements

The Company has entered into indemnification agreements with its directors and certain of its officers. Such agreements require the Company, among other things, to indemnify its directors and officers, other than for liabilities arising from willful misconduct of a culpable nature, and to advance their expenses incurred as a result of any proceedings against them as to which they could be indemnified.

Other Agreements

On August 31, 2006, Ms. Swearson ceased serving as our Chief Financial Officer, Vice President, Finance and Administration. On August 9, 2006, the Company entered into an agreement and general release with Ms. Swearson, pursuant to which Ms. Swearson agreed to provide consulting services to the Company from September 1, 2006 through December 31, 2006 and pursuant to which the Company and Ms. Swearson agreed to a general release of claims. During this period, Ms. Swearson's unvested stock options continued to vest and the right of repurchase by the Company with respect to certain shares of the Company's common stock held by Ms. Swearson continued to lapse, in accordance with their respective terms. In addition, the Company paid the

applicable premiums for Ms. Swearson and her eligible dependents' health benefits through December 31, 2006. No other consideration was provided to Ms. Swearson for her consulting services. Pursuant to the terms of the change of control severance agreement by and between the Company and Ms. Swearson, the Company paid Ms. Swearson a severance payment in the amount of \$325,000 in a lump sum, which was equivalent to 12 months of Ms. Swearson's regular pay, less applicable withholding taxes.

On October 13, 2006, Dr. Colowick resigned as our Chief Medical Officer. On October 14, 2006, the Company entered into an advisory board agreement, with Dr. Colowick, pursuant to which Dr. Colowick provided consulting services to the Company from October 14, 2006 through January 14, 2007 and served as a member of the Company's advisory board. Effective November 1, 2006, Dr. Colowick became a member of the advisory board and received \$2,500 as compensation in the form of a retainer and was granted an option to purchase 10,000 shares of the Company's common stock at a purchase price of \$3.45 per share, which option vested equally over a two-year period beginning November 14, 2006. In addition, the advisory board agreement provided that the amount due to Dr. Colowick in respect of shares of the Company's common stock which the Company had the right to repurchase would be used to offset the amount of Dr. Colowick's sign-on bonus owed to the Company. As a result, the Company and Dr. Colowick agreed that approximately \$12,958 was owed by Dr. Colowick to the Company, which amount was to be deducted from any fees earned by Dr. Colowick pursuant to the advisory board agreement. Pursuant to the advisory board agreement, Dr. Colowick also agreed, among other things, to not engage in any business activity competitive with that of the Company during the term of the advisory board agreement and for a period of one year thereafter. On March 8, 2007, the Company notified Dr. Colowick that it was terminating the advisory board agreement effective 30 days from the date of such notice.

On August 8, 2006, the Company entered into an offer letter with Ms. Davis outlining the terms of her employment and the elements of her compensation. This offer letter provides for employment at will.

Equity Compensation Plans

The following table provides certain information with respect to all of our equity compensation plans in effect as of December 31, 2006:

	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by stockholders	2,074,801	\$2.60	2,853,712
Equity compensation plans not approved by stockholders	—	—	—
Total	<u>2,074,801</u>	<u>\$2.60</u>	<u>2,853,712</u> ⁽¹⁾⁽²⁾

- (1) Includes 922,377 shares of common stock issuable under our 2004 Employee Stock Purchase Plan.
- (2) On January 1, 2006, and annually thereafter, the authorized shares for the 2004 Equity Incentive Plan will automatically be increased by a number of shares equal to the lesser of:
 - 5% of the number of the Company's shares issued and outstanding prior to the preceding December 31;
 - 1,214,402 shares; or
 - an amount determined by the Board.

DIRECTOR COMPENSATION

Each non-employee director receives an annual cash retainer of \$30,000. In addition, the chair of the audit committee receives an annual cash retainer of \$16,000 and the chairs of the nominating committee and the compensation committee each receive an annual retainer of \$14,000. Each other member of the audit committee, the nominating committee and the compensation committee receives an annual cash retainer of \$10,000. All of the Company's directors are entitled to reimbursement for all reasonable out-of-pocket expenses incurred in connection with attendance at Board and committee meetings.

All non-employee directors receive automatic stock option grants under the Company's 2004 Amended and Restated Equity Incentive Plan. In May 2006, each non-employee director received an automatic grant of an option to purchase 15,000 shares of the Company's common stock. In addition, all directors participated in the Company's Option Exchange Program completed in September 2006. In connection with the Option Exchange Program, eligible employees, executive officers and directors had the opportunity to make a one-time election to cancel certain outstanding grants of stock options, or Current Options, under our 2004 Amended and Restated Equity Incentive Plan, or the Plan, for an equal number of new unvested options to be granted under the Plan after the date of cancellation of the Current Options, or the Replacement Options. The number of options exchanged by each director pursuant to the Option Exchange Program is set forth below in the Director Summary Compensation Table.

All employee directors who are not 5% owners of the Company's common stock are also eligible to participate in the Company's 2004 Employee Stock Purchase Plan. In 2006, Dr. Selick purchased 5,000 shares of the Company's common stock under the 2004 Employee Stock Purchase Plan.

Director Summary Compensation Table

The following table sets forth all of the compensation awarded to, earned by, or paid to each person who served as a director during 2006, other than a director who also served as a Named Executive Officer.

<u>Name</u>	<u>Fees Earned or Paid in Cash(\$)</u>	<u>Option Awards\$(1)</u>	<u>Total(\$)</u>
Bruce C. Cozadd	40,000	109,272(2)	149,272
Patrick G. Enright*	56,000	53,334(3)	109,334
George G.C. Parker, <i>Ph.D.</i>	40,000	180,837(4)	220,837
Michael F. Powell, <i>Ph.D.</i>	50,000	53,334(5)	103,334
William A. Halter	44,000	180,837(6)	224,837
Wilfred E. Jaeger, <i>M.D.</i>	54,000	53,334(7)	107,334
George F. Tidmarsh, <i>M.D.</i> **	7,500	—(8)	7,500

* Mr. Enright resigned as a member of the Board on April 2, 2007.

** Dr. Tidmarsh resigned as a member of the Board on March 31, 2006.

- (1) The amounts in this column represent the dollar amount recognized for financial statement reporting purposes with respect to the 2006 fiscal year in accordance with FAS 123R. See Note 9 of the notes to our financial statements in our Annual Report on Form 10-K filed on March 15, 2007 for a discussion of all assumptions made by the Company in determining the FAS 123R values of its equity awards.
- (2) Mr. Cozadd exchanged an option to purchase 30,000 shares of the Company's common stock having an exercise price of \$14.93 per share for an option to purchase 30,000 shares of the Company's common stock having an exercise price of \$2.57 per share on September 29, 2006 as part of the Company's Option Exchange Program. As of December 31, 2006, Mr. Cozadd held options to purchase a total of 30,000 shares of the Company's common stock.
- (3) Mr. Enright exchanged an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$6.26 per share and an option to purchase 15,000 shares of the Company's common stock

- having an exercise price of \$4.13 per share for an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share for an option, respectively on September 29, 2006 as part of the Company's Option Exchange Program. As of December 31, 2006, Mr. Enright held options to purchase a total of 30,000 shares of the Company's common stock.
- (4) Dr. Parker exchanged an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$6.26 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$4.13 per share for an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share for an option, respectively, on September 29, 2006 as part of the Company's Option Exchange Program. As of December 31, 2006, Dr. Parker held options to purchase a total of 66,432 shares of the Company's common stock.
- (5) Dr. Powell exchanged an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$6.26 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$4.13 per share for an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share for an option, respectively, on September 29, 2006 as part of the Company's Option Exchange Program. As of December 31, 2006, Dr. Powell held options to purchase a total of 30,000 shares of the Company's common stock.
- (6) Mr. Halter exchanged an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$6.26 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$4.13 per share for an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share for an option, respectively, on September 29, 2006 as part of the Company's Option Exchange Program. As of December 31, 2006, Mr. Halter held options to purchase a total of 66,432 shares of the Company's common stock.
- (7) Dr. Jaeger exchanged an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$6.26 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$4.13 per share for an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share and an option to purchase 15,000 shares of the Company's common stock having an exercise price of \$2.57 per share for an option, respectively, on September 29, 2006 as part of the Company's Option Exchange Program. As of December 31, 2006, Dr. Jaeger held options to purchase a total of 30,000 shares of the Company's common stock.
- (8) Dr. Tidmarsh does not hold any options to purchase shares of the Company's common stock.

REPORT OF THE COMPENSATION COMMITTEE

The compensation committee reviewed and discussed with the management of the Company the foregoing Compensation Discussion and Analysis. Based on such review and discussion, the compensation committee has recommended to the Board that the Compensation Discussion and Analysis be included in this proxy statement and in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

COMPENSATION COMMITTEE

Dr. Wilfred E. Jaeger (chair)
Mr. Bruce C. Cozadd
Dr. George G. C. Parker

The compensation committee report shall not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, and shall not otherwise be deemed filed under these acts.

REPORT OF THE AUDIT COMMITTEE

Under the guidance of a written charter adopted by the Board (which charter is available at www.thresholdpharm.com), the purpose of the audit committee is to oversee the accounting and financial reporting processes of the Company and audits of its financial statements. The responsibilities of the audit committee include appointing and providing for the compensation of the independent registered public accounting firm. Each member of the audit committee meets the independence requirements of the Nasdaq Global Market.

Management has primary responsibility for the system of internal controls and the financial reporting process. The independent registered public accounting firm has the responsibility to express an opinion on the financial statements based on an audit conducted in accordance with generally accepted auditing standards.

In this context and in connection with the audited financial statements contained in the Company’s Annual Report on Form 10-K, the audit committee:

- reviewed and discussed the audited financial statements as of and for the fiscal year ended December 31, 2006 with the Company’s management and PricewaterhouseCoopers LLP, the Company’s independent registered public accounting firm;
- discussed with PricewaterhouseCoopers LLP the matters required to be discussed by Statement of Auditing Standards No. 61, Communication with Audit Committees, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T;
- reviewed the written disclosures and the letter from PricewaterhouseCoopers LLP required by the Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, as adopted by the Public Company Accounting Oversight Board in Rule 3600T, discussed with the auditors their independence, and concluded that the non-audit services performed by PricewaterhouseCoopers LLP are compatible with maintaining their independence; and
- based on the foregoing reviews and discussions, recommended to the Board that the audited financial statements be included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2006 be filed with the Securities and Exchange Commission.

AUDIT COMMITTEE

Mr. David R. Hoffmann (chair)*
 Dr. Wilfred E. Jaeger
 Dr. Michael F. Powell

**Note: Mr. Hoffmann was appointed to the Audit Committee in April 2007 and did not participate in Audit Committee functions for fiscal year 2006. Mr. Enright also served as a member of our Audit Committee until his resignation from the Board in April 2007.*

The audit committee report shall not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act Of 1934, and shall not otherwise be deemed filed under these acts.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

The audit committee appointed PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2006.

Auditor's Fees

The following table shows the fees paid or accrued by the Company for the audit and other services provided by PricewaterhouseCoopers LLP for fiscal years 2006 and 2005.

	2006	2005
Audit Fees ⁽¹⁾	\$475,326	\$487,265
Audit-Related Fees ⁽²⁾	—	—
Tax Fees ⁽³⁾	—	—
All other Fees ⁽⁴⁾	2,437	2,474
Total	\$477,763	\$489,739

The audit committee has delegated to the chair of the audit committee the authority to pre-approve audit-related and non-audit services not prohibited by law to be performed by the Company's independent registered public accounting firm and associated fees, provided that the chair shall report any decision to pre-approve such audit-related or non-audit services and fees to the full audit committee at its next regular meeting.

- (1) Audit fees represent fees for professional services provided in connection with the audit of the Company's financial statements, Sarbanes-Oxley Section 404 attestation, and review of the Company's quarterly financial statements and audit services provided in connection with other statutory or regulatory filings.
- (2) Audit-related fees consist primarily of accounting consultations, employee benefit plan audits and other attestation services. For fiscal years 2006 and 2005, respectively, no fees were paid to PricewaterhouseCoopers LLP for accounting consultations, employee benefit plan audits and other attestation services.
- (3) For fiscal years 2006 and 2005, respectively, no fees were paid to PricewaterhouseCoopers LLP for tax advice or tax return preparation services.
- (4) All other fees consisted of a subscription fee for an online accounting research tool.

PROPOSAL 1
ELECTION OF DIRECTORS

At the Annual Meeting, the stockholders will vote on the election of three Class III directors to serve for a three-year term until the annual meeting of stockholders in 2010 and until their successors are elected and qualified. The Board has unanimously nominated Mr. Bruce C. Cozadd, Mr. David R. Hoffmann and Dr. George G.C. Parker upon the recommendation of the nominating committee, for election to the Board as Class III directors. The nominees have indicated that they are willing and able to serve as directors. If any of either Mr. Bruce C. Cozadd, Mr. David R. Hoffmann or Dr. George G.C. Parker becomes unable or unwilling to serve, the accompanying proxy may be voted for the election of such other person as shall be designated by the Board. The proxies being solicited will be voted for no more than three nominees at the Annual Meeting. The Class III Directors will be elected by a plurality of the votes cast, in person or by proxy, at the Annual Meeting, assuming a quorum is present. Stockholders do not have cumulative voting rights in the election of directors.

The Board recommends a vote “FOR” the election of Mr. Bruce C. Cozadd, Mr. David R. Hoffmann and Dr. George G.C. Parker as Class III directors.

Unless otherwise instructed, it is the intention of the persons named in the accompanying proxy card to vote shares represented by properly executed proxy cards for the election of Mr. Bruce C. Cozadd, Mr. David R. Hoffmann and Dr. George G.C. Parker.

PROPOSAL 2
RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

At the Annual Meeting, the stockholders will be asked to ratify the appointment of PricewaterhouseCoopers LLP as the Company’s independent registered public accounting firm for the fiscal year ending December 31, 2007. Representatives of PricewaterhouseCoopers LLP are expected to be present at the Annual Meeting and will have the opportunity to make statements if they desire to do so. Such representatives are also expected to be available to respond to appropriate questions. The affirmative vote of the holders of a majority of the shares represented in person or by proxy and entitled to vote at the Annual Meeting will be required to approve the proposal to ratify the appointment of PricewaterhouseCoopers LLP as the Company’s independent registered public accounting firm for the fiscal year ending December 31, 2007.

The Board recommends a vote “FOR” the ratification of the appointment of PricewaterhouseCoopers LLP as the Company’s independent registered public accounting firm for the fiscal year ending December 31, 2007.

HOUSEHOLDING OF ANNUAL MEETING MATERIALS

Some banks, brokers and other nominee record holders may be participating in the practice of “householding” proxy statements and annual reports. This means that only one copy of the Company’s proxy statement or annual report may have been sent to multiple stockholders in a household. A stockholder may request the Company deliver a separate copy of either document by writing to the Secretary, Threshold Pharmaceuticals, Inc., 1300 Seaport Boulevard, Redwood City, California 94063 or by phoning the Company at (650) 474-8200 and asking for Investor Relations. In the event a stockholder wants to receive separate copies of the annual report and proxy statement in the future, or a stockholder that received multiple copies would like to receive only one copy for such stockholder’s household, such stockholder should contact their bank, broker, or other nominee record holder, or contact the Company at the above address and phone number.

OTHER MATTERS

As of the time of preparation of this proxy statement, neither the Board nor management intends to bring before the meeting any business other than the matters referred to in the Notice of Annual Meeting and this proxy statement. If any other business should properly come before the meeting, or any adjournment thereof, the persons named in the proxy will vote on such matters according to their best judgment.

FORM 10-K

The Company will mail without charge to any stockholder upon written request, a copy of the Company's Annual Report on Form 10-K for the year ended December 31, 2006 including the financial statements, schedules and a list of exhibits. Requests should be sent to: Secretary, Threshold Pharmaceuticals, Inc., 1300 Seaport Boulevard, Redwood City, California 94063.

STOCKHOLDER PROPOSALS FOR 2008 ANNUAL MEETING

The Company's Bylaws provide that advance notice of a stockholder's proposal must be delivered to the Corporate Secretary of the Company at the principal executive offices of the Company no earlier than November 18, 2007, or 150 days prior to the anniversary of the mailing date of the proxy materials for the previous year's annual meeting, and not later than December 18, 2007, or 120 days prior to the anniversary of the mailing date of the proxy materials for the previous year's annual meeting. However, the Bylaws also provide that in the event that no annual meeting was held in the previous year or the date of the annual meeting is advanced by more than 30 days or delayed by more than 60 days from the date contemplated at the time of the previous year's proxy statement, this advance notice must be received not earlier than or 150 days prior to such annual meeting and not later than the 10th day following the day on which public announcement of the date of such meeting is first made. Each stockholder's notice must contain the following information as to each matter the stockholder proposes to bring before the annual meeting: (a) as to each person whom the stockholder proposes to nominate for election or reelection as a director all information relating to such person that is required to be disclosed pursuant to Regulation 14A under the Exchange Act (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected) and appropriate biographical information and a statement as to the qualification of the nominee; (b) as to any other business that the stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such stockholder and the beneficial owner, if any, on whose behalf the proposal is made; and (c) as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (i) the name and address of such stockholder, as they appear on the Company's books, and of such beneficial owner and (ii) the number of shares of the Company's common stock which are owned beneficially and of record by such stockholder and such beneficial owner.

A copy of the full text of the provisions of the Company's Bylaws dealing with stockholder nominations and proposals is available to stockholders from the Secretary of the Company upon written request.

Under the rules of the Securities and Exchange Commission, stockholders who wish to submit proposals for inclusion in the proxy statement of the Board for the Annual Meeting must submit such proposals so as to be received by the Company at 1300 Seaport Boulevard, Redwood City, California 94063, on or before December 18, 2007. In addition, if the Company is not notified by December 18, 2007 of a proposal to be brought before the 2008 Annual Meeting by a stockholder, then proxies held by management may provide the discretion to vote against such proposal even though it is not discussed in the proxy statement for such meeting.

By Order of the Board of Directors



Dr. Harold E. Selick
Chief Executive Officer

Redwood City, California
April 16, 2007

YOUR VOTE IS IMPORTANT!

WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE COMPLETE, SIGN, DATE AND MAIL PROMPTLY THE ACCOMPANYING PROXY CARD IN THE ENCLOSED RETURN ENVELOPE, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES. THIS WILL ENSURE THE PRESENCE OF A QUORUM AT THE MEETING. ALTERNATIVELY, YOU MAY VOTE YOUR SHARES ON THE INTERNET OR BY TELEPHONE BY FOLLOWING THE INSTRUCTIONS ON YOUR PROXY CARD. IF YOU ATTEND THE MEETING, YOU MAY VOTE IN PERSON IF YOU WISH TO DO SO EVEN IF YOU HAVE PREVIOUSLY SENT IN YOUR PROXY CARD OR VOTED.

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

**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: 001-32979

THRESHOLD PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
1300 Seaport Boulevard, Redwood City, CA
(Address of principal executive office)

94-3409596
(IRS employer
Identification number)
94063
(Zip Code)

(650) 474-8200

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) if the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange On Which Registered</u>
Common Stock \$0.001 Par Value	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the act: **None**

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No

Indicate by check mark 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 Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting stock held by non-affiliates of the registrant based upon the closing price of the Common Stock on the Nasdaq National Market on June 30, 2006 was \$77,975,552 Shares of Common Stock held by each executive officer and director and by each person or group who owns 5% or more of the outstanding Common Stock at June 30, 2006 have been excluded. Exclusion of such shares should not be construed to indicate that any such person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the registrant or that such person is controlled by or under common control with the registrant.

On February 28, 2007 there were 37,407,750 shares of the registrant's common stock outstanding.

Documents incorporated by reference: Portions of the Proxy Statement for Registrant's Annual Meeting of Stockholders to be held May 16, 2007, or the Proxy Statement, are incorporated herein by reference into Part III.

Threshold Pharmaceuticals, Inc.
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PART I

This annual report on Form 10-K, including the sections entitled “Business,” “Risk Factors,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We may, in some cases, use words such as “project,” “believe,” “anticipate,” “plan,” “expect,” “estimate,” “intend,” “should,” “would,” “could,” “potentially,” “will,” or “may,” or other words that convey uncertainty of future events or outcomes to identify these forward-looking statements. Forward-looking statements may include statements about:

- our ability to commence, and the timing of, clinical trials for our glufosfamide, 2DG and TH-302 development programs;
- the completion and success of any clinical trials that we commence;
- the timing of results of our clinical trials;
- our receipt of regulatory approvals;
- our ability to establish and maintain intellectual property rights in our product candidates;
- whether any product candidates that we are able to commercialize are safer or more effective than other marketed products, treatments or therapies;
- our research and development activities, including development of new product candidates, and projected expenditures;
- our ability to complete preclinical and clinical testing successfully for new product candidates that we may develop or license;
- our ability to have manufactured sufficient supplies of active pharmaceutical ingredient, or API, and drug product for clinical testing and commercialization;
- our ability to obtain licenses to any necessary third party intellectual property;
- our ability to retain and hire necessary employees and appropriately staff our development programs;
- our cash needs; and
- our financial performance.

There are a number of important factors that could cause actual results to differ materially from the results anticipated by these forward-looking statements. These important factors include those that we discuss in this annual report on Form 10-K under the caption “Risk Factors.” You should read these factors and the other cautionary statements made in this annual report on Form 10-K as being applicable to all related forward-looking statements wherever they appear in this annual report on Form 10-K. If one or more of these factors materialize, or if any underlying assumptions prove incorrect, our actual results, performance or achievements may vary materially from any future results, performance or achievements expressed or implied by these forward-looking statements. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. Unless the context requires otherwise, in this annual report on Form 10-K the terms “Threshold,” “Threshold Pharmaceuticals,” “we,” “us” and “our” refer to Threshold Pharmaceuticals, Inc. Threshold Pharmaceuticals, Inc., our logo and Metabolic Targeting are our trademarks. Other trademarks, trade names and service marks used in this annual report on Form 10-K are the property of their respective owners.

ITEM 1. BUSINESS

Overview

We are a biotechnology company focused on the discovery and development of drugs based on Metabolic Targeting, an approach that targets fundamental differences in metabolism between normal and certain diseased

cells. Two of our product candidates are designed to utilize Metabolic Targeting through the potential targeting of the increased uptake of glucose in cancer cells relative to most normal cells. These product candidates, glufosfamide and 2-deoxyglucose (“2DG”), share certain structural characteristics with glucose but act instead as poisons when taken up by a cancer cell. Our other product candidate, TH-302, and the other compounds our scientists are creating and testing in our laboratories, use Metabolic Targeting by targeting the decreased blood supply and oxygenation of most tumor tissues relative to normal tissue. These compounds are relatively non-toxic when oxygen is present, as in healthy tissues, but undergo a chemical conversion in the presence of low levels of oxygen that converts them into toxic compounds that may kill cancer cells. This pipeline of drug candidates is designed to target tumor cells selectively, and we believe that our drugs could be more efficacious and less toxic to healthy tissues than conventional drugs, and thereby provide significant improvement over current therapies.

Our clinical focus is on product candidates for the treatment of cancer. We have three product candidates for which we have exclusive worldwide marketing rights:

- Glufosfamide is our lead product candidate for the potential treatment of cancer. We initiated a pivotal Phase 3 clinical trial of glufosfamide for the second-line treatment of pancreatic cancer in September 2004, and completed enrollment in August 2006. In February 2007, we announced that this Phase 3 clinical trial failed to reach its primary endpoint of survival benefit for patients with metastatic pancreatic cancer that had relapsed following chemotherapy with gemcitabine. In July 2006, we completed enrollment in the Phase 2 stage of a study of glufosfamide plus gemcitabine for the first-line treatment of pancreatic cancer. Top line results were announced in December 2006 and final results are expected in the third quarter of 2007. We have initiated Phase 2 trials of glufosfamide in platinum-resistant ovarian and recurrent sensitive small cell lung cancer, and plan to initiate a Phase 2 trial in soft-tissue sarcoma in the first half of 2007. Enrollment in these trials is expected to be completed in 2007, with results reported in 2008.
- 2DG, our second product candidate for the potential treatment of cancer, is being evaluated in a Phase 1 clinical trial alone and in combination with docetaxel as a combination therapy. This trial began in the first quarter of 2004 and we expect to complete enrollment for this trial in the first half of 2007. Top-line results are expected in the third quarter of 2007.
- TH-302 is a hypoxically activated prodrug for the potential treatment of solid tumors, and is in late-stage preclinical testing. TH-302, which was discovered by Threshold, is a novel drug candidate that is activated under the metabolic conditions typical of certain cancer cells. If the preclinical tests are supportive, we plan to file an IND (Investigational New Drug) with the FDA in the first half of 2007.

We also are working to discover novel drug candidates that will specifically target cancer cells and are actively seeking to in-license other promising compounds or programs.

For the treatment of cancer, we believe that our product candidates, based on Metabolic Targeting, can be applied to the treatment of many solid tumors and will have the potential to increase the effectiveness of existing therapies significantly. Metabolic Targeting provides the opportunity to treat slowly dividing tumor cells that generally evade traditional chemotherapy and radiation therapies and ultimately contribute to relapse. We believe that our focus on Metabolic Targeting, combined with our expertise in medicinal chemistry and drug development, provides us with the capability to identify, discover and develop novel therapies for treating cancer.

Our product candidates are focused on treating patients with significant unmet medical needs. Cancer is the second leading cause of death in the United States after cardiovascular disease. Many cancers, such as pancreatic, lung and liver cancer, currently have few effective treatments and very low survival rates.

Metabolic Targeting for Cancer

Metabolic Targeting is a therapeutic approach that targets fundamental differences in energy metabolism between normal and certain diseased cells. Cells generate energy needed for survival in two ways: the citric acid cycle and glycolysis. The citric acid cycle is a highly efficient process that provides the majority of cellular

energy under normal conditions. Oxygen is essential for energy production through the citric acid cycle. Glycolysis is much less efficient in producing energy than the citric acid cycle. Unlike the citric acid cycle, oxygen is not required for glycolysis, and cells that rely primarily on glycolysis for energy production consume large quantities of glucose. Some diseased cells, including cancer cells rely predominantly or exclusively on glycolysis for their energy needs. When these cells shift energy production to glycolysis, they must increase the levels of the proteins needed to transport and metabolize glucose. Metabolic Targeting takes advantage of these metabolic differences to selectively target certain diseased cells.

Cancer cells require large amounts of glucose for energy production and growth. This increased consumption of glucose has two causes: the process of a normal cell becoming a rapidly dividing cancer cell; and the exposure of a cell to the low oxygen conditions, called hypoxia, within regions of most solid tumors. First, when cells become cancerous, they require more energy and the level of proteins needed for glucose transport and metabolism increases. Second, as a tumor grows, it rapidly outgrows its blood supply, leaving portions of the tumor with regions where the oxygen concentration is significantly lower than in healthy tissues. As a consequence, tumor cells in these hypoxic zones rely on glycolysis for energy production and therefore further increase the levels of proteins responsible for glucose transport and metabolism.

We are focused on developing new cancer therapies by targeting the uptake and metabolism of glucose by cells. In one application of Metabolic Targeting, we use a cancer-killing drug linked to glucose designed to take advantage of the potential for increased glucose intake by cancer cells, thereby delivering the drug more selectively to cancer cells. In another application of Metabolic Targeting, we use compounds that interfere with specific steps of glycolysis. Because cancer cells are believed to have increased dependence on glycolysis to survive, these compounds should substantially reduce energy production, leading to cell death.

We believe that our product candidates may prove effective for treating rapidly dividing cancer cells, because these cells require large amounts of energy and thus metabolize more glucose than do normal cells. Glufosfamide is designed to target the increased glucose intake by these cells by linking a cancer-killing drug to glucose. Our product candidate 2-DG targets glucose metabolism directly and provides the opportunity to increase the effectiveness of current therapies that treat the rapidly dividing cells in the tumor by reducing energy production in those cells. Radiation therapy, as well as the vast majority of chemotherapy drugs, kills cells by damaging DNA or affecting DNA synthesis to prevent cell replication. However, highly energy-dependent DNA repair mechanisms can repair damage to a cell's DNA. The balance between the extent of DNA damage and the efficiency of cellular DNA repair thus largely determines the effectiveness of therapy. 2-DG, which reduces cellular energy production, is believed to inhibit these repair mechanisms, shifting the balance from repair to damage, and may increase the efficacy of current treatments. Furthermore, cancer cells become resistant to many conventional chemotherapy drugs by a highly energy-dependent process that pumps these drugs out of the cell, reducing their effect. Interference with cellular energy production can disrupt this multidrug resistance, resulting in increased chemotherapy drug accumulation within the cell. We believe our 2-DG product candidate could therefore increase the effectiveness of chemotherapy drugs by interfering with cellular energy production.

In addition to treating rapidly dividing cancer cells, we believe that compounds based on Metabolic Targeting provide the opportunity to kill cancer cells within hypoxic regions, which are poorly treated by current therapies that primarily target the rapidly dividing cells. Cell proliferation in hypoxic regions is greatly inhibited due to insufficient blood supply, leading to insufficient nutrient supply and a lack of oxygen. Slowly dividing cells within the hypoxic region also undergo genetic changes that, as they accumulate in cells, can lead to the development of still more aggressive tumor cells that are resistant to therapy. Following treatment with radiation or chemotherapy, rapidly dividing cells in the vicinity of blood vessels are destroyed, providing room for these more aggressive cells from hypoxic regions to gain access to blood vessels and oxygen. These cells, which may have become resistant to treatment, are then able to grow and proliferate, ultimately contributing to relapse. Thus, current cancer therapies leave the slowly proliferating cells in the hypoxic zones largely untreated while our product candidates are designed to kill these slowly dividing cells by targeting either their increased glucose transport or glucose metabolism. Our hypoxic-activated compounds are designed to specifically target these oxygen-deficient cells within tumors.

Our Product Development Programs

The following table summarizes the status of our current and ongoing product development programs:

Product Candidate	Indication	Development Status	Expected Milestones
Glufosfamide	Pancreatic cancer		
	2 nd line monotherapy	<ul style="list-style-type: none"> Phase 3 completed in Q1 2007 	<ul style="list-style-type: none"> Results announced in 2007—Data analysis ongoing
	1 st line combination with gemcitabine	<ul style="list-style-type: none"> Phase 2 	<ul style="list-style-type: none"> Results in Q3 2007
	Ovarian cancer	<ul style="list-style-type: none"> Phase 2 	<ul style="list-style-type: none"> Complete enrollment in 2007, results in 2008
	Small cell lung cancer	<ul style="list-style-type: none"> Phase 2 	<ul style="list-style-type: none"> Complete enrollment in 2007, results in 2008
	Soft tissue sarcoma	<ul style="list-style-type: none"> Phase 2 	<ul style="list-style-type: none"> Complete enrollment in 2007, results in 2008
2DG	Various solid tumors	<ul style="list-style-type: none"> Phase 1 	<ul style="list-style-type: none"> Results Q3 2007
TH-302	Various solid tumors	<ul style="list-style-type: none"> Pre-IND 	<ul style="list-style-type: none"> IND filing first half 2007

Glufosfamide

Market Opportunity

Pancreatic Cancer

The American Cancer Society estimates that 37,170 patients will be diagnosed with pancreatic cancer in the United States in 2007, and approximately 33,370 patients will die from the disease. Only 15-20% of newly diagnosed patients are eligible for surgery, which is typically followed by radiation and chemotherapy. Patients with inoperable pancreatic cancer are treated with radiation and chemotherapy, or in the case of advanced disease, chemotherapy alone as the advantages of radiation are reduced. Gemcitabine is the standard of care for the first-line therapy of advanced metastatic pancreatic cancer. Tarceva was recently approved as a combination therapy with gemcitabine for the first line treatment of pancreatic cancer. Eli Lilly reported worldwide sales of Gemzar (gemcitabine) for all indications to be over \$1.3 billion in 2005.

Ovarian Cancer

The American Cancer Society estimates that 22,430 women will be diagnosed with ovarian cancer in the United States in 2007, and approximately 15,280 women will die from the disease. Ovarian cancer is the eighth most common cancer among women, and is the fifth most common cause of cancer death among women. Virtually all newly diagnosed patients undergo surgery, which is typically followed by radiation and chemotherapy. Almost half of all ovarian cancers do not respond at all because of an innate resistance to platinum-based drugs.

Small-cell Lung Cancer

The American Cancer Society estimates that 213,380 people will be diagnosed with lung cancer in the United States in 2007, and approximately 160,390 people will die from the disease. Small cell lung cancer is less common than non-small cell lung cancer. About 15 to 20 percent of all lung cancers are the small cell type. This cancer usually starts in the bronchi near the center of the chest but has often spread outside of the lung by the time of diagnosis. Small cell lung cancer is strongly associated with a history of cigarette smoking.

Soft Tissue Sarcoma

The American Cancer Society estimates that 9,220 people will be diagnosed with soft tissue sarcoma in the United States in 2007, and approximately 3,560 people will die from the disease. Soft tissue sarcomas is a rare and diverse form of cancer originating in various soft tissues such as fat, muscle, nerve, vascular tissue and other connective tissues. Soft tissue sarcomas patients are treated with surgery whenever possible with or without radiation and chemotherapy. Radiation and chemotherapy alone or a combination is also used for advance or recurrent disease or used when surgery is not possible.

Current Therapies for Cancer

Many different approaches are used in treating cancer, including surgery, radiation and drugs or a combination of these approaches. Drugs used to treat cancer include chemotherapeutics, hormones and immune-based therapies. Traditionally, strategies for designing cancer therapies have focused on killing cancer cells that exhibit rapid division and growth, and most conventional cancer drugs have been evaluated and optimized using cellular and animal models that reflect rapid cell growth. However, most solid tumors are actually composed of both rapidly and slowly dividing cells. Conventional cancer treatments are not designed to target the slowly dividing cells found in large portions of solid tumors and therefore rarely succeed in killing all cancerous cells. These slowly dividing cells, which can evade treatment, often contribute to relapse.

Another disadvantage of current cancer therapies that target rapidly dividing cells is their toxic side effects. Because rapidly dividing cells are also found in many healthy tissues, particularly the gastrointestinal tract, bone marrow and hair follicles, nearly all conventional chemotherapy drugs cause severe side effects, such as diarrhea and reduction in blood cell production, which may lead to bleeding, infection and anemia, as well as other side effects, such as hair loss. Likewise, radiation generally cannot be administered without causing significant damage to healthy tissue surrounding a tumor. The toxic and potentially fatal side effects of chemotherapy and radiation therapy are controlled by carefully balancing dose and dosing schedules to minimize toxicity to healthy cells and maximize cancer cell death. Unfortunately, achieving such a balance may permit rapidly dividing cancer cells to survive treatment, resulting in inadequate therapy.

Pancreatic Cancer

With respect to pancreatic cancer, current therapies have limited efficacy. In gemcitabine's Phase 3 registrational trial, median survival was 5.7 months, and no patient survived beyond two years. In this study, patients treated with 5-fluorouracil, or 5-FU, the previous standard of care, had a median survival of 4.2 months, and no patient survived beyond two years during the study. None of the 126 patients treated in both arms of this study achieved a confirmed objective response as measured by tumor shrinkage. Erlotinib was recently approved in first-line pancreatic cancer in combination with gemcitabine with only about two weeks improvement in median survival and 23% improvement in overall survival.

Ovarian Cancer

Treatment of ovarian cancer is rarely curative. The age-adjusted death rate from ovarian cancer has remained unchanged over the past 20 years. Platinum based therapy is the most widely used chemotherapy to treat ovarian cancer, but some women develop resistance to it. When women develop resistance, it is very difficult to treat and to cure them. The current standards of care in treating platinum-resistant ovarian cancer are a variety of single agent and combination regimens including topotecan, anthracyclines such as doxorubicin, gemcitabine, cyclophosphamide, vinorelbine, hexamethylmelamine, ifosfamide and etoposide.

Small-cell Lung Cancer

Although small cell lung cancer (SCLC) is highly responsive to chemotherapy, the responses are short-lived. Response rate for first-line therapy for etoposide and cisplatin or CAV (cyclophosphamide, doxorubicin and vincristine), ranges from 65% to 90% but nearly all patients relapse in less than 12 months. Patients who

relapse more than two to three months after initial therapy are termed sensitive and are considered for second-line therapy. The only approved treatment for second-line sensitive SCLC is topotecan. In a Phase 3 trial in patients with relapse sensitive disease, topotecan induced response rate of 24%, median survival of 25 weeks, and a median time to progression of 13 weeks. Other chemotherapeutic agents used in treating recurrent, sensitive small cell lung cancer include a variety of single agent and combination regimens including topotecan, cyclophosphamide, doxorubicin, vincristine, irinotecan, ifosfamide and cisplatin.

Soft Tissue Sarcoma

The outcome of chemotherapy for advanced soft tissue sarcomas may be influenced by multiple factors, including type of sarcoma, tumor burden, tumor grade, metastatic pattern, performance status and type and intensity of treatment itself. Results of first-line chemotherapy in adult advanced soft tissue sarcoma remain disappointing. The most active chemotherapy agents against soft tissue sarcomas, doxorubicin and ifosfamide, have demonstrated a relatively consistent single-agent activity yielding response rates of 10% to 25%.

Development Plan for Glufosfamide

Our lead product candidate for cancer, glufosfamide, is a small molecule in clinical development for the treatment of pancreatic and a variety of other cancers. Glufosfamide combines the active part of an approved alkylator, a member of a widely used class of chemotherapy drugs, isophosphoramidate, with a glucose molecule. Because of its glucose component and a tumor cell's increased need for glucose, glufosfamide may be preferentially transported into tumors compared to most normal tissues. Most cancers and isolated cancer cell lines over-express the family of glucose transporters due to the increased energy requirement needed to feed uncontrolled proliferation of cancer cells. While the functional role of many of the glucose transporters is not well established, it has been shown that malignant tumors, including soft tissue sarcomas, pancreatic, ovarian, lung, colorectal, breast and bladder cancer tumors express more glucose transporters and are assumed to undergo enhanced glucose metabolism. Inside cells, the linkage between glucose and the alkylator is thought to be cleaved to release the active drug. With glucose as the major side product, glufosfamide has fewer side effects than other drugs in its class, which are known to cause hemorrhagic cystitis, a serious condition characterized by severe bladder bleeding, unless another protective drug is co-administered.

We believe that the potential unique mechanism of action of glufosfamide, its advantage of generating less toxic metabolites, and demonstrated activity in combination with gemcitabine in animal studies make it well-positioned to potentially replace conventional alkylating agents used in combination with gemcitabine. We are developing glufosfamide for pancreatic cancer based on activity seen in previous clinical trials, a known increase in glucose uptake in pancreatic cancer cells and the extreme hypoxia in tumors of this type. We believe it may offer an improvement over conventional therapies for the indications where activity has been observed.

Glufosfamide has also shown activity against other tumor types in animal models. We believe it may offer an improvement over conventional therapies for the indications where activity has been observed or where other drugs in its class are active. Based on human clinical data, the activity of approved alkylators and our understanding of the mechanism of action of glufosfamide, we believe that ovarian, small cell lung and soft tissue carcinoma represent the most promising indications.

Prior Clinical Trials

Glufosfamide has been evaluated in two Phase 1, five Phase 2 clinical trials and one Phase 3 trial that together enrolled over 500 patients with a variety of advanced-stage cancers. In the two Phase 1 trials, escalating doses of glufosfamide were administered to 72 patients with solid tumors not amenable to established treatments. Although Phase 1 trials are designed primarily to assess safety, tumor shrinkage was observed in patients with breast cancer, non-small cell lung cancer, pleural mesothelioma, renal cell carcinoma and cancers of unknown primary origin.

The five Phase 2 studies of glufosfamide were multi-center studies to evaluate tumor response in patients with locally advanced or metastatic pancreatic cancer, relapsed non-small cell lung cancer, a type of brain cancer called glioblastoma, locally advanced or metastatic colon cancer not amenable to surgery and relapsed metastatic breast cancer. Glufosfamide was well tolerated and showed anti-tumor activity against breast, colon, and pancreatic cancers, marginal activity against non-small cell lung cancer and no activity for the treatment of glioblastoma.

In the Phase 2 trial in patients with advanced pancreatic cancer, two of 34 patients achieved a partial response (defined as 30% or greater tumor diameter shrinkage) and 11 of 34 patients achieved stable disease (defined as less than 30% tumor diameter shrinkage and less than 20% growth in tumor diameter). Overall median survival with glufosfamide was estimated at 5.6 months, and two-year survival was estimated at 9%. The preliminary results of this study, published in the *European Journal of Cancer* in November 2003, reported a median survival of 5.3 months.

In the Phase 1 and Phase 2 trials, glufosfamide was generally well tolerated, with few drug-related serious adverse events. In particular, glufosfamide's adverse effects on bone marrow and the kidneys were generally reversible without requiring treatment of the side effects. Only 1% of patients developed severe lowering of the blood platelets, which help to stop bleeding. Toxicity to the kidney, as measured by serum elevation in waste products normally excreted by the kidney, was severe in only 1% of patients. Nausea and vomiting is the most common side effect of glufosfamide treatment. There have been no reports of hemorrhagic cystitis in patients treated with glufosfamide.

These Phase 1 and Phase 2 trials of glufosfamide were conducted by ASTA Medica Oncology, which was subsequently acquired by a subsidiary of Baxter International, Inc. We exclusively licensed worldwide rights to the compound and associated clinical data from Baxter.

Ongoing Clinical Trials

Pancreatic Cancer

We have been developing glufosfamide as a single agent for the second-line treatment of metastatic pancreatic cancer, and in combination with gemcitabine for the first-line treatment of inoperable, locally advanced and/or metastatic pancreatic cancer.

In August 2006, we completed enrollment in a pivotal Phase 3 trial of glufosfamide for the treatment of patients with metastatic pancreatic cancer who have failed treatment with gemcitabine. This two-arm trial, initiated in September 2004, has evaluated approximately 300 previously-treated patients with metastatic pancreatic cancer who receive glufosfamide (4500mg/m²) once every 3 weeks or best supportive care, because there is no approved second-line treatment for pancreatic cancer. Best supportive care includes all medical or surgical interventions that a pancreatic cancer patient should receive to palliate the cancer but excludes treatment with systemic therapies intended to kill the cancer cells. The primary endpoint of this trial was overall survival as measured by time from randomization to death. The timing of the final analysis was therefore event-driven and was conducted after the 261st death had occurred. In addition, the trial investigated the potential efficacy of glufosfamide as determined by response rate, duration of response and progression-free survival, pain score, as well as safety. This trial was conducted under a Special Protocol Assessment. The special protocol assessment is a process that allows for official FDA evaluation of the proposed design of a Phase 3 clinical trial. It provides trial sponsors with an agreement on trial design and analysis required to support a new drug application submission, if the study is performed according to the special protocol assessment and meets its primary endpoint and is statistically persuasive. In addition, glufosfamide for the treatment of second-line pancreatic cancer was granted Fast Track designation by the FDA in 2004, which provides for expedited regulatory review for new drugs that demonstrate the potential to address unmet medical needs for the treatment of serious or life-threatening conditions. In September 2006, we received orphan drug designation for glufosfamide from the FDA.

On February 26, 2007, we announced the results of our Phase 3 trial in patients with metastatic pancreatic cancer who had relapsed after gemcitabine chemotherapy. While the overall survival in patients in the

glufosfamide arm was 18% higher compared to those who received best supportive care alone, the result was not statistically significant. The primary efficacy comparison of overall survival was based on 261 deaths and did not reach statistical significance ($p=0.19$); the hazard ratio of glufosfamide to BSC was 0.85 (95% confidence interval of 0.66 to 1.08). The median survival of patients who were treated with glufosfamide was 105 days versus 84 days for the patients who received BSC.

No new or unexpected safety signals were observed. Adverse events, including renal toxicity and hematologic toxicity, were similar to those observed in previous clinical trials of glufosfamide. The most common drug-related toxicities in the glufosfamide-treated patients were nausea and vomiting. The full analysis of the clinical trial is ongoing. When completed, the results may be discussed with the FDA to seek guidance and agreement of a revised regulatory strategy towards approval of glufosfamide in patients with pancreatic cancer.

In December 2005, we completed the Phase 1 portion of a Phase 1/2 dose-escalation study of glufosfamide in combination with gemcitabine for the treatment of advanced solid tumors and pancreatic cancer. The primary objective of the Phase 1 portion of the trial was to evaluate safety and to determine the maximum tolerated dose of glufosfamide when administered in combination with gemcitabine. The 19 patients in this portion of the trial received the standard dose of gemcitabine ($1000\text{mg}/\text{m}^2$) weekly for three of every four weeks and one of four doses of glufosfamide ($1500\text{ mg}/\text{m}^2$, $2500\text{ mg}/\text{m}^2$, $3500\text{ mg}/\text{m}^2$ or $4500\text{ mg}/\text{m}^2$) administered once every 4 weeks. The maximum tolerated dose was established at $4500\text{ mg}/\text{m}^2$. No unanticipated adverse events based on previous experience with glufosfamide administered as a single agent were observed. Glufosfamide in combination with gemcitabine was shown to be well tolerated, no significant interaction between glufosfamide and gemcitabine was shown in the pharmacokinetics analysis and the dose of $4500\text{ mg}/\text{m}^2$ of glufosfamide in combination with gemcitabine was reached. This dose is the dose that is being used in both the Phase 2 stage of this trial of glufosfamide in combination with gemcitabine for first-line treatment of pancreatic cancer and in our recently completed Phase 3 trial of glufosfamide for the second-line treatment of pancreatic cancer.

In January 2006, we began the Phase 2 stage of this clinical trial, which is evaluating patients with locally advanced and/or metastatic pancreatic adenocarcinoma previously untreated with chemotherapy. Patients receive the standard dose of gemcitabine plus glufosfamide. In addition to safety, the trial is investigating the efficacy of glufosfamide in combination with gemcitabine as determined by response rate, duration of response, progression-free survival, overall survival, six- and twelve-month survival and change in serum tumor marker levels (CA19-9). Patients in the trial receive the standard dose of gemcitabine ($1000\text{mg}/\text{m}^2$) weekly for three of every four weeks and $4500\text{mg}/\text{m}^2$ of glufosfamide administered once every four weeks.

In December 2006, we announced top-line results from the Phase 2 clinical trial of glufosfamide in combination with gemcitabine for the treatment of advanced pancreatic cancer. Glufosfamide was generally well tolerated in combination with gemcitabine with no new unexpected adverse events. In the Phase 2 clinical trial, 29 patients were treated, of which 28 patients with pancreatic adenocarcinoma previously untreated with chemotherapy were evaluated for response. Overall, 5 patients achieved a confirmed partial response and one other patient achieved an unconfirmed partial response for a response rate of 21%. In addition, 10 patients (36%) experienced stable disease. Objective response was assessed radiologically after every two cycles of therapy. A partial response is characterized as a decrease in size by 30% of the sum of the longest diameters of target lesions, the absence of progression of all non-target lesions and no new lesions. Preliminary analysis of the safety data in this Phase 2 glufosfamide and gemcitabine combination trial suggests the incidence of treatment-related nephrotoxicity may be slightly higher than what was observed in previous experience with either of these agents used individually. This clinical trial remains ongoing. Final survival and safety results will be reported at the completion of the trial, estimated to occur during the third quarter of 2007.

Even though our immediate efforts are focused on pancreatic cancer, the results of Phase 1 and Phase 2 clinical trials suggest that glufosfamide may also be useful for the treatment of other cancers. Based on human clinical data, the activity of approved alkylators and our understanding of the mechanism of action of glufosfamide, we believe that breast, small cell lung, ovarian and colon cancers, as well as lymphomas and sarcomas, represent the most promising indications.

Ovarian Cancer

In January 2007, we initiated patient enrollment for a Phase 2 clinical trial evaluating the dosing, safety and activity of glufosfamide in patients with platinum-resistant ovarian cancer. The clinical trial will evaluate two dosing schedules of glufosfamide, a once weekly schedule and the schedule currently utilized in pancreatic cancer trials which is once every three weeks. The trial will explore the administration of slightly higher aggregate doses utilizing the weekly schedule as compared to every three week dosing. All patients may receive up to six 21-day cycles. Overall, 45 women with ovarian cancer who have previously relapsed after up to four prior chemotherapy regimens including one or two prior platinum-containing regimens and who have demonstrated resistance to their last platinum-containing regimen will be enrolled in the Phase 2, open-label, clinical trial at various sites in the U.S.

In addition to safety, the trial is investigating the efficacy of glufosfamide as determined by response rate, duration of response and progression-free survival based on changes in the serum tumor marker level CA-125 and based on tumor assessments and overall survival.

Small-cell Lung Cancer

In February 2007, we initiated patient enrollment for a Phase 2 clinical trial evaluating the efficacy and safety of glufosfamide in patients with recurrent, sensitive small cell lung cancer. Approximately 50 patients with extensive recurrent sensitive small cell lung cancer, who have progressed at least 60 days after completing chemotherapy, are planned to enroll in the Phase 2, open-label, clinical trial at various sites in the United States, Ukraine and Russia. All patients are to receive 5000 mg/m² of glufosfamide every three weeks for up to six cycles. The primary efficacy endpoint of the trial is objective response rate. The secondary endpoints of the trial will evaluate duration of response, progression-free survival, overall survival, time to response and various safety and pharmacokinetic parameters. The study will also evaluate the effects of glufosfamide on lung cancer symptoms utilizing the Lung Cancer Symptom Scale (LCSS).

The clinical trial will utilize a two stage design to ensure there is an adequate response rate to justify complete enrollment. The first stage will enroll 21 patients and, at the end of this stage, the trial will be stopped if fewer than three patients have a response. If three or more responses are observed, an additional 29 patients will be enrolled. Tumor response will be evaluated at baseline and every six weeks using the Response Evaluation Criteria In Solid Tumors (RECIST).

2DG

2DG, our product candidate for the treatment of solid tumors, is in a Phase 1 trial. 2DG is an orally administered small molecule that employs Metabolic Targeting to treat solid tumors by directly inhibiting glycolysis. Because tumor cells in general, and those in hypoxic zones in particular, are dependent on glycolysis for survival, tumor cells are particularly sensitive to the effect of 2DG. This compound is a synthetic glucose analog that distributes selectively to tumor tissue because of metabolic changes related to increased glucose consumption. Because tumor cells exhibit increased levels of glucose transport proteins, these cells actively transport 2DG into the cells. Once inside the cell, 2DG interferes with cellular mechanisms for generating energy by competing with glucose for key enzymes in glycolysis. The *in vivo* efficacy of 2DG has been studied in mouse and rat models of certain cancers, including sarcomas, adenocarcinomas, leukemias, melanomas and bladder, colon and breast tumors. In particular, treatment with 2DG, alone and in combination with other chemotherapy resulted in increased lifespan or a reduction in tumor growth in many of these models.

We are conducting a Phase 1 trial of daily 2DG as a single agent and in combination with docetaxel to evaluate the safety, blood levels and maximum tolerated dose in patients with solid tumors. Animal studies suggest that 2DG and docetaxel may work together to kill cancer cells with greater efficacy than either drug alone, without increased risk of side-effects. We are developing 2DG based on its specificity for targeting tumor cells and extensive human safety data, as well as demonstrated animal efficacy that we and our collaborators at the University of Miami published in *Cancer Research* in January 2004.

2DG has been administered in clinical trials to approximately 600 people principally to evaluate the hormonal and metabolic effects of glucose deprivation. Collectively, these studies have shown that single intravenous doses of 2DG as high as 200 mg/kg do not cause any serious adverse events. Although these support the safe use of 2DG in humans, we have not yet obtained human safety data for the cumulative dose of oral administration of 2DG we intend to use in our clinical trials. The FDA may require such data before allowing us to proceed into pivotal clinical trials that will support approval.

We launched a Phase 1 clinical trial of 2DG in January 2004. This trial is a dose-escalation study to determine the safety, blood levels and maximum tolerated dose of daily oral doses of 2DG given alone or in combination with docetaxel. The study is intended to enroll up to 50 patients with previously treated refractory advanced solid tumors. The study is designed to evaluate the effect of 2DG alone and in combination with docetaxel on tumor growth, and provide a preliminary assessment of efficacy, as assessed by computer tomography. Initial data from this study, reported at American Society of Clinical Oncology, or ASCO, 2005, suggest that 2DG is well tolerated when administered daily for one week every other week, and we intend to evaluate 2DG administered daily, the schedule we believe will ultimately give 2DG the best opportunity to demonstrate efficacy in this setting. We expect to complete enrollment in this study in the first half of 2007, with top line results expected in the third quarter of 2007.

Provided our safety study yields favorable results, we may initiate at least one Phase 2 study that will be a randomized, blinded, multiple-dose study designed to evaluate the safety and efficacy of 2DG given continuously in combination with chemotherapy. We will choose indications and appropriate combination therapies for our Phase 2 program based on the results of the ongoing Phase 1 trial.

TH-302

We also have a preclinical candidate (TH-302) that is a hypoxically activated prodrug for the potential treatment of solid tumors. TH-302, discovered by Threshold, is a novel drug candidate that is activated under the low oxygen conditions typical of cancer cells in the hypoxic regions of tumors. The hypoxic regions of tumors are known to be the most difficult to treat with standard therapies. TH-302 combines a 2-nitroimidazole oxygen sensing trigger with a masked DNA crosslinker. Upon activation in oxygen deficient zones, TH-302 releases an active toxin, poisoning the hypoxic zone of the tumor. TH-302 has demonstrated dramatic antitumor effects in several animal models. If the preclinical results are supportive, Threshold plans to file an Investigational New Drug (“IND”) application for TH-302 with the FDA in the first half of 2007.

Discontinuation of TH-070 Program

In July 2006, we announced we were discontinuing development of TH-070 for benign prostatic hyperplasia (“BPH”) based on safety and efficacy results of the Phase 2 and Phase 3 trials.

The Phase 2 randomized, placebo controlled, double-blind trial, which was initiated in July 2005, enrolled men with moderate to severe BPH. After a two-week placebo run-in period, 216 patients were randomized to receive placebo or one of four doses of TH-070 (5mg, 25mg, 50mg, 150mg) daily for four weeks and to be followed off therapy for three months. The primary objectives of this study were to determine the dose-response relationship of TH-070 with respect to symptomatic improvement as measured by International Prostate Symptom Score (I-PSS) and to evaluate other efficacy endpoints and the safety at the different doses.

The Phase 3 randomized, placebo controlled, double-blind trial, which was initiated in August 2005, also enrolled men with moderate to severe BPH. After a two-week placebo run-in period, 567 patients were randomized to receive placebo or one of two doses of TH-070 (50mg or 150mg) daily for twelve weeks and to be followed off therapy for one additional month. The primary objective was to evaluate the efficacy of TH-070 compared to placebo as measured by I-PSS. Dosing in this trial was prematurely discontinued at the same time that we announced the partial clinical hold in the U.S. TH-070 program due to certain adverse events relating to elevated liver enzymes.

The interim analysis of the Phase 2 data did not demonstrate a clear dose response in IPSS at four weeks of treatment. The mean I-PSS change from baseline as measured following placebo run-in to one month of treatment ranged from -2.1 to -2.5 across the five dose groups, including the placebo control.

The interim analysis of the Phase 3 data did not demonstrate a statistically significant difference in I-PSS between either of the two drug dose groups (50mg and 150mg) and placebo. The mean I-PSS change from baseline as measured following the placebo run-in to four weeks of treatment ranged from -1.9 to -2.9 and to twelve weeks of treatment ranged from -4.4 to -5.4. There was no statistically significant difference in any of the secondary endpoints with the exception of change in prostate specific antigen (“PSA”) which did show statistical significance at certain time points.

The interim safety results from the Phase 2 and Phase 3 trials include seven cases of myalgia and four cases of testicular pain. Across all TH-070 clinical trials, there were 15 patients who had elevations in liver enzymes (as defined by elevations greater than three times the upper limit of normal), two of whom were in the placebo group. Six of the patients with elevated liver enzymes were deemed to have experienced serious adverse events.

As a result of discontinuing the TH-070 program, in August 2006, we adopted a plan to reduce our operating expenses. The plan included eliminating 29 full-time employees, or approximately a 35% reduction in staff affecting all areas of the Company, and to reduce other expenses.

Discovery Research

We have research programs focused on targeting the hypoxic microenvironment of solid tumors. Solid tumors possess chaotic and insufficient blood flow resulting in regions which are starved for oxygen, or hypoxic. These extremely low oxygen conditions are not found in normal tissue and these hypoxic zones are found in virtually all solid tumors. The hypoxic zones of tumors are known to be resistant to standard chemotherapeutics and to radiation therapy. Tumor hypoxia correlates with poor prognosis in cancer patients and represent a significant unmet medical need. The general nature of hypoxia in solid tumors offers the possibility for cancer therapeutics which are useful in many indications and hence a large market opportunity.

Our most advanced efforts targeting these regions are the design and development of novel cytotoxic prodrug compounds. A prodrug is an inactive compound that is converted in the human body by enzymatic processes that result in the formation of an active drug. The prodrug concept is well established in chemotherapy, but it was initially only employed to modify the pharmacokinetic properties of compounds through non-specific activation processes. Only more recently has the concept been put to use in the design of agents that are selectively activated in tumor tissues through specific activation processes.

Our prodrugs have two distinct parts, a toxic portion and an attached trigger molecule. To prevent general toxicity, the trigger molecule masks the toxin until the prodrug is activated by low oxygen concentration in the hypoxic zones of solid tumors. Once activated, the toxin kills cells in its vicinity. We have designed prodrugs that are triggered only at the very low oxygen levels found in these hypoxic regions. Our experiments indicate that we can achieve a greater than 100-fold difference in cytotoxicity between cells in normal oxygen levels and hypoxic cells. We have identified a clinical candidate, TH-302, which is highly selective and produces a conventional DNA cross-linking toxin upon activation. Hypoxically activated prodrugs of other toxin classes are being pursued. Lead compounds have demonstrated promising *in vitro* data, and additional characterization, evaluation and optimization of these compounds is currently underway.

Our expertise includes broad capabilities in lead synthesis, assay development and *in vitro* and *in vivo* compound evaluation. Our medicinal chemistry expertise allows us to turn initially promising compounds generated by our chemists into drug candidates. We believe that our research focus combined with our medicinal chemistry expertise provide us with the capacity to identify, discover and develop novel therapies.

During the years ended December 31, 2006, 2005 and 2004, we spent \$46.3 million, \$36.0 million and \$16.3 million, respectively, on research and development activities.

Our Strategy

Our goal is to create a leading biotechnology company that develops and commercializes drugs based on Metabolic Targeting with an initial focus on cancer. Key elements of our strategy are to:

- *Develop glufosfamide, 2DG and TH-302 successfully.* For glufosfamide, we have ongoing Phase 2 trials in pancreatic cancer, small cell lung and ovarian cancer. The Phase 3 trial for the second-line treatment of metastatic pancreatic cancer did not meet its primary endpoint for overall survival. The data from the trial will be fully analyzed and the safety database leveraged for other ongoing studies. For 2DG, we have an ongoing Phase 1 trial to evaluate the safety, blood levels and maximum tolerated dose in patients with solid tumors. For TH-302, if the preclinical tests are supportive, we expect to file an IND in the first half of 2007. We intend to advance all of our clinical programs aggressively and are also exploring additional indications for these product candidates.
- *Continue to broaden our pipeline by sourcing, identifying, discovering and developing new compounds.* We are actively pursuing research programs to discover and develop novel therapies that address major currently unmet medical needs. We also plan to continue to evaluate additional in-licensing opportunities that build on our expertise and complement our current pipeline.
- *Build on our expertise in Metabolic Targeting through continued research in cellular metabolism.* We intend to continue our focused approach in research and clinical development. We believe our expertise in Metabolic Targeting gives us an advantage in the identification of new product candidates, therapeutic indications and technologies. We will also leverage the expertise of our scientific and clinical advisors and continue to enter into collaborations with other experts in the field.
- *Execute our commercialization strategy by developing sales and marketing capabilities in selected markets and strategic collaborations in other markets.* We intend to retain commercial rights to our products for indications and territories where we believe we can effectively market them. For all other indications and territories, we intend to pursue strategic collaborations.

Manufacturing and Supply

The production of glufosfamide, 2DG and TH-302 employs small molecule organic chemistry procedures that are standard for the pharmaceutical industry. We currently rely on contract manufacturers for the manufacture of active pharmaceutical ingredient, or API, and final drug product of glufosfamide, 2DG, TH-302 and any other products or investigational drugs for development and commercial purposes. We intend to continue to use our financial resources to accelerate the development of our product candidates rather than diverting resources to establish our own manufacturing facilities.

Our initial supplies of glufosfamide were prepared by a subsidiary of Baxter International, Inc. and were used to initiate our current clinical trials. We are currently using glufosfamide API and drug product that were manufactured by other suppliers and we believe this material will be sufficient to complete our currently ongoing Phase 2 trials. We are in the process of identifying and qualifying an additional vendor to manufacture glufosfamide API. If we experience unexpected delays, or if the API or finished product does not meet specifications, we may experience a significant delay in completion of existing trials and the initiation of additional trials.

While we have sufficient supply of 2DG API, our existing supply of clinical trial material may not be sufficient for our ongoing clinical trials through 2007. We are currently in the process of manufacturing additional 2DG drug product, but if we are not successful we may experience a significant delay in our 2DG clinical program.

We are currently using a contract manufacturer to manufacture TH-302 API and are in the process of final drug product formulation for the initiation of our planned Phase 1 trial in 2007. If we are not successful in manufacturing sufficient quantities of TH-302 API and drug product, we may experience a significant delay in our TH-302 clinical program.

We will need to enter into additional agreements for additional supplies of each of our product candidates to complete clinical development and/or commercialize them. These products will need to satisfy all cGMP manufacturing requirements, including passing product specifications. Our inability to satisfy these requirements could delay our clinical programs.

Sales and Marketing

We currently intend to build our own sales force to market our cancer drugs and to maintain commercial rights to our cancer products in the United States and potentially in Europe. Because the United States cancer market is relatively concentrated, we believe we can effectively target it with a small specialized sales force. We may pursue strategic collaborations to commercialize or co-promote our products for cancer in other territories and on a worldwide basis for indications treated by large physician populations. We currently have no marketing, sales or distribution capabilities. In order to commercialize any of our drug candidates, we must develop these capabilities internally or through collaborations with third parties.

License and Development Agreements

Glufosfamide License

In August 2003, we entered into an agreement with Baxter International, Inc., and Baxter Healthcare S.A., or together, Baxter, for the licensing and development of glufosfamide. Under this agreement, we have an exclusive worldwide license and/or sublicense under Baxter's patent rights, proprietary information, and know-how relating to glufosfamide to develop and commercialize products containing glufosfamide for the treatment of cancer. Baxter's patent rights include one issued United States patent and 24 foreign counterparts related to glufosfamide, as well as one foreign patent related to its manufacture. Baxter has agreed to provide us with all of its information related to glufosfamide, including animal study data.

In consideration for our licenses under this agreement, we paid an upfront license fee of \$100,000 and development milestone payments of \$100,000 and \$1.3 million. We are obligated to make certain additional development milestone payments, with the next such payment of \$1.0 million due in connection with the filing of a new drug application with the FDA for glufosfamide. Future milestone payments in connection with the development of glufosfamide and United States and foreign regulatory submissions and approvals could equal \$8.0 million, and sales-based milestone payments could total up to \$17.5 million. Following regulatory approval, we will be obligated to pay up to mid-single digit royalties to Baxter based on sales of glufosfamide products.

This agreement remains in effect until terminated by either party. We may terminate the agreement at will upon 60 days prior written notice to Baxter. Baxter may terminate this agreement if we:

- fail to meet our obligations under the agreement to develop and commercialize a glufosfamide product, and we have not cured this breach within 90 days after receiving a notice from Baxter;
- discontinue development of glufosfamide products for a continuous period of 12 months, in a manner that is inconsistent with our then-current plan to develop glufosfamide products, and we have not cured this breach within 90 days after receiving a notice from Baxter;
- are in material breach of any other term of the agreement, which is not cured within 60 days of any notice by Baxter; or
- become insolvent.

Glufosfamide Asian Development Agreement

In November 2004, we entered into a Development Agreement with MediBIC Co. Ltd. MediBIC is a publicly traded Japanese biotechnology company focused on developing therapeutic compounds in partnership with non-Japanese biotechnology firms and providing consulting services in the design, management, and data analysis of clinical trials using pharmacogenomic platforms developed internally and in collaboration with other companies. By working with MediBIC, we believe that we will be able to develop glufosfamide in Asian countries more quickly than by undertaking such efforts on our own or with other third parties. Pursuant to this agreement, we agreed with MediBIC on a development plan for glufosfamide for the treatment of pancreatic cancer in certain Asian countries, including Japan, South Korea, India, China, Taiwan and Hong Kong. We have also received an exclusive, royalty-free license to MediBIC's know-how for the manufacture, sale, and distribution of glufosfamide products for the treatment of cancer worldwide. In connection with the Development Agreement, we granted to MediBIC a non-exclusive license to use our confidential information relating to glufosfamide for the limited purpose of preparing the development plan and any associated marketing plans as authorized under the Development Agreement, and a non-exclusive license to use our confidential information for the time necessary for MediBIC to perform its obligations under the development plan.

Under this agreement, in December 2004 we received an upfront payment of \$4.75 million to support the development of glufosfamide in the Asian countries covered by the agreement and, under a separate but related agreement, an option payment of \$250,000. We are responsible for all development activities and MediBIC has no other funding obligations. We have agreed to pay MediBIC a percentage of net sales or net revenues from the sales of glufosfamide products for the treatment of cancer by us or third parties in the Asian countries covered by the agreement. We may also be required to pay MediBIC a percentage of up-front or milestone payments we receive from any third-party sublicensee of ours for the development of a glufosfamide product for the treatment of cancer in those Asian countries.

We may terminate the agreement at any time by making certain payments to MediBIC ranging from \$7.0 million to \$15.0 million, depending on the stage of development of the glufosfamide product. Otherwise, the agreement will continue until the expiration of the last-to-expire patent in a country in the Asian countries covered by the agreement that is owned or controlled by us and claims glufosfamide, its use for the treatment of cancer or a process to make such compound in such country.

2DG License

In November 2002, we entered into an exclusive license agreement with Dr. Theodore J. Lampidis and Dr. Waldemar Priebe. This agreement gives us exclusive worldwide rights to international patent application US01/07173, to all of its United States counterpart and priority applications, and any United States and foreign patents and patent applications that claim priority from such applications. Two United States patents and one foreign patent licensed under this agreement have been issued. These patents and the related applications cover the treatment of cancer with 2DG or certain other glycolytic inhibitors, alone or in combination with certain other cancer drugs.

In consideration for this license, we have reimbursed Drs. Lampidis and Priebe for patent costs and will bear all future patent costs incurred under this agreement. We are also obligated to make certain milestone payments, including milestone payments of up to \$700,000 in connection with the filing and approval of a new drug application, or NDA, for the first product covered by the licensed patents, as well as royalties based on sales of such products. This license terminates upon the last to expire issued patent covering the technology licensed under it. We have the right to terminate the license at will upon written notice to Drs. Lampidis and Priebe.

The United States government funded research conducted by Drs. Lampidis and Priebe and, therefore, the research is subject to certain federal regulations. For example, under the "march-in" provisions of the Bayh-Dole Act, which governs the transfer of technology developed under federal grants and contracts, the government may have the right under limited circumstances to grant licenses to the technology.

Patents and Proprietary Rights

Our policy is to patent the technologies, inventions and improvements that we consider important to the development of our business. As of December 31, 2006, we owned four issued United States and three issued foreign patents, 34 pending United States patent applications (including both provisional and utility patent applications); 13 international, or PCT, patent applications; and 90 pending foreign national patent applications; and held exclusive commercial rights to one issued United States patent and 24 issued foreign counterparts of this patent, and one additional foreign patent relating to our glufosfamide product candidate; and to one issued United States patent and one issued foreign patent and two foreign applications and two United States continuation counterpart applications (one of which was issued in January 2007) of these issued patents and one United States provisional patent application relating to our 2DG product candidate or certain other glycolytic inhibitors. Fifty-nine of the 137 pending US, PCT, and foreign national patent applications and 3 of the 7 issued US and foreign patents owned by us as of December 31, 2006, relate to our now discontinued TH-070 program; many of the pending applications and some of the issued patents may be abandoned to reduce patent expenses.

Intellectual Property Related to Glufosfamide

Our glufosfamide product candidate is covered by one issued United States patent and 24 issued foreign counterpart patents, as well as one issued foreign patent relating to a method for its manufacture. These patents are owned by Baxter, which has exclusively licensed them to us. The major European market counterparts of the United States patent expire in 2009, and the United States patent expires in 2014. Under the Hatch-Waxman Act in the United States, and similar laws in Europe, there are opportunities to extend the term of a patent for up to five years. Although we believe that our glufosfamide product candidate will meet the criteria for patent term extension, there can be no assurance that we will obtain such extension. Based on our current clinical timeline, if such an extension were obtained, then we expect that it would be for approximately three years or less in the United States. We also own one United States patent application and seven counterpart foreign patent applications describing methods for the identification of patients likely to be most responsive to glufosfamide therapy. We also own one United States patent application and seven counterpart foreign patent applications and three international patent applications describing the use of glufosfamide, alone or in combination with other cancer drugs, including gemcitabine, to treat pancreatic cancer, including gemcitabine-resistant pancreatic cancer and certain other types of cancer. In addition, we own two United States provisional patent applications, one for a new unit dose form and the other for a new method of synthesis, relating to our glufosfamide product candidate.

Intellectual Property Related to 2DG

Our 2DG product candidate is protected by two issued United States patents and one foreign claiming methods for treating breast and other specific cancer with 2DG in combination with either paclitaxel or docetaxel or certain other cancer drugs, as well as two United States continuation patent applications and two foreign counterpart patent applications claiming the use of 2DG or certain other glycolytic inhibitors alone or in combination with certain other drugs to treat cancer. The term of any patent that issues on these applications is not expected to lapse until 2020, assuming patent term extension is not available. We have licensed exclusive commercial rights to these patents from the inventors. In addition, we have licensed a United States provisional patent application from the University of Miami focused on the use of 2DG and certain other compounds as inhibitors of glycosylation (not glycolysis) for the treatment of cancer. We are not currently pursuing such an indication in our clinical trial. In addition, we own one issued United States patent that claims methods for administering 2DG to treat cancer and one United States continuation patent application of this application and 16 foreign counterpart patent applications that claim methods for dosing, administering, and formulating 2DG to treat cancer. We also own one United States provisional patent application relating to a method for purifying 2DG; one international patent application relating to the use of 2DG in the treatment of Metabolic Syndrome; one United States patent application relating to a method for analyzing the purity of 2DG; and two United States provisional patent applications relating to the use of 2-DG in the treatment of specific types of cancer. The term of any patent that issues on these applications is not expected to lapse until 2024, assuming patent term extension is not available.

Intellectual Property Related to Our Discovery Research

We own three United States patent applications, seven United States provisional patent applications, three international patent applications, and 15 foreign national counterparts of one of the United States patent applications, and one foreign national counterpart of one of the international patent applications based on our research on hypoxia-activated prodrugs, claiming compounds and their use as cancer drugs. Our TH-302 clinical product candidate and its use in the treatment of cancer are claimed in one of these international patent applications and a corresponding foreign national counterpart of that application. We are seeking compound per se patent protection for our TH-302 clinical product as well as claims directed to its use, alone or in combination with other cancer drugs, in the treatment of cancer.

The patent positions of companies like ours are generally uncertain and involve complex legal and factual questions. Our ability to maintain and solidify our proprietary position for our technology will depend on our success in obtaining effective claims and enforcing those claims once granted. We do not know whether any of our patent applications will result in the issuance of any patents, even for patent applications that have been allowed. Moreover, an issued patent does not guarantee us the right to practice the patented technology or commercialize the patented product. Other parties may have blocking patents that could be used to prevent us from commercializing our patented products and practicing our patented technology. Our issued patents and those that may be issued in the future may be challenged, invalidated or circumvented, which could limit our ability or render us unable to stop competitors from marketing related products as well as shorten the term of patent protection that we may have for our products. In addition, the rights granted under any issued patents may not provide us with proprietary protection or competitive advantages against competitors with similar technology. Furthermore, our competitors may independently develop similar technologies that do not infringe our intellectual property rights. For these reasons, we may have competition for our products. Moreover, because of the extensive time required for development, testing and regulatory review of a potential therapeutic product, it is possible that, before any of our products can be commercialized, any related patent may expire or remain in force for only a short period following commercialization, thereby reducing any advantage of the patent.

We also rely on trade secrets, technical know-how and continuing innovation to develop and maintain our competitive position. We seek to protect our proprietary information by requiring our employees, consultants, contractors, outside scientific collaborators and other advisors to execute non-disclosure and assignment of invention agreements on commencement of their employment or engagement. Agreements with our employees also forbid them from using third party trade secret or other confidential information in their work. We also require confidentiality or material transfer agreements from third parties that receive our confidential data or proprietary materials.

The biotechnology and biopharmaceutical industries are characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. For so long as our product candidates are in clinical trials, we believe our clinical activities fall within the scope of the exemptions provided by 35 U.S.C. Section 271(e) in the United States, which exempts from patent infringement liability activities reasonably related to the development and submission of information to the FDA. This exemption does not apply to commercialization activities, however, if our product candidates are commercialized, the possibility of a patent infringement claim against us increases. While we attempt to ensure that our clinical product candidates and the methods we employ to manufacture them, as well as the methods for their use we intend to promote, do not infringe other parties' patents and other proprietary rights, there can be no assurance that they do not, and competitors or other parties may assert that we infringe their proprietary rights in any event.

Competition

We operate in the highly competitive segment of the pharmaceutical market comprised of pharmaceutical and biotechnology companies that research, develop and commercialize products designed to treat cancer. Many of our competitors have significantly greater financial, manufacturing, marketing and product development resources than we do. Large pharmaceutical companies in particular have extensive experience in clinical testing

and in obtaining regulatory approval for drugs. These companies also have significantly greater research capabilities than we do. In addition, many universities and private and public research institutes are active in cancer research, some in direct competition with us. We also compete with these organizations to recruit scientists and clinical development personnel.

Each cancer indication for which we are developing products has a number of established medical therapies with which our candidates will compete. Most major pharmaceutical companies and many biotechnology companies are aggressively pursuing cancer development programs, including traditional therapies and therapies with novel mechanisms of action. Our glufosfamide product candidate for pancreatic cancer will compete with Gemzar, Tarceva and 5-fluorouracil (“5-FU”), and other approved chemotherapy drugs from other pharmaceutical and biotech companies used off-label in pancreatic cancer. A number of biotechnology and pharmaceutical companies are marketing and/or developing cancer therapeutics competing in ovarian, small cell lung and soft tissue carcinoma. Such companies include: AstraZeneca PLC, Genentech, Bristol-Myers Squibb, Eli Lilly and Company, GlaxoSmithKline plc, Hoffmann LaRoche & Co., Johnson & Johnson, Merck KGaA, Novartis AG, Pfizer, Inc., Amgen Inc., ImClone Systems, Inc., Millennium Pharmaceuticals, Inc., OSI Pharmaceuticals, Inc., Telik, Inc., Sunesis, Ariad and Ziopharma.

Governmental Regulation and Product Approval

The manufacturing and marketing of our potential products and our ongoing research and development activities are subject to extensive regulation by the FDA and comparable regulatory agencies in state and local jurisdictions and in foreign countries.

United States Regulation

Before any of our products can be marketed in the United States, they must secure approval by the FDA. To secure this approval, any drug we develop must undergo rigorous preclinical testing and clinical trials that demonstrate the product candidate’s safety and effectiveness for each chosen indication for use. This extensive regulatory process controls, among other things, the development, testing, manufacture, safety, efficacy, record keeping, labeling, storage, approval, advertising, promotion, sale, and distribution of biopharmaceutical products.

In general, the process required by the FDA before investigational drugs may be marketed in the United States involves the following steps:

- pre-clinical laboratory and animal tests;
- submission of an IND, which must become effective before human clinical trials may begin;
- adequate and well-controlled human clinical trials to establish the safety and efficacy of the proposed drug for its intended use;
- pre-approval inspection of manufacturing facilities and selected clinical investigators; and
- FDA approval of a NDA, or of a NDA supplement (for subsequent indications).

Preclinical Testing

In the United States, drug candidates are tested in animals until adequate proof of safety is established. These preclinical studies generally evaluate the mechanism of action of the product and assess the potential safety and efficacy of the product. Tested compounds must be produced according to applicable current good manufacturing practice, or cGMP, requirements and preclinical safety tests must be conducted in compliance with FDA and international regulations regarding good laboratory practices, or GLP. The results of the preclinical tests, together with manufacturing information and analytical data, are generally submitted to the FDA as part of an IND, which must become effective before human clinical trials may commence. The IND will automatically become effective 30 days after receipt by the FDA, unless before that time the FDA requests an

extension or raises concerns about the conduct of the clinical trials as outlined in the application. If the FDA has any concerns, the sponsor of the application and the FDA must resolve the concerns before clinical trials can begin. Submission of an IND may not result in FDA authorization to commence a clinical trial. A separate submission to the existing IND must be made for each successive clinical trial conducted during product development, and the FDA must grant permission for each clinical trial to start and continue. Regulatory authorities may require additional data before allowing the clinical studies to commence or proceed from one Phase to another, and could demand that the studies be discontinued or suspended at any time if there are significant safety issues. Furthermore, an independent institutional review board, or IRB, for each medical center proposing to participate in the conduct of the clinical trial must review and approve the clinical protocol and patient informed consent before the center commences the study.

Clinical Trials

Clinical trials for new drug candidates are typically conducted in three sequential phases that may overlap. In Phase 1, the initial introduction of the drug candidate into human volunteers, the emphasis is on testing for safety or adverse effects, dosage, tolerance, metabolism, distribution, excretion, and clinical pharmacology. Phase 2 involves studies in a limited patient population to determine the initial efficacy of the drug candidate for specific targeted indications, to determine dosage tolerance and optimal dosage and to identify possible adverse side effects and safety risks. Once a compound shows evidence of effectiveness and is found to have an acceptable safety profile in Phase 2 trials, pivotal Phase 3 trials are undertaken to more fully evaluate clinical outcomes and to establish the overall risk/benefit profile of the drug, and to provide, if appropriate, an adequate basis for product labeling. During all clinical trials, physicians monitor patients to determine effectiveness of the drug candidate and observe and report any reactions or safety risks that may result from use of the drug candidate. The FDA, the IRB, or the sponsor may suspend a clinical trial at any time on various grounds, including a finding that the subjects are being exposed to an unacceptable health risk.

The data from the clinical trials, together with preclinical data and other supporting information that establishes a drug candidate's safety, are submitted to the FDA in the form of a NDA or NDA supplement (for approval of a new indication if the product candidate is already approved for another indication). Under applicable laws and FDA regulations, each NDA submitted for FDA approval is usually given an internal administrative review within 45 to 60 days following submission of the NDA. If deemed complete, the FDA will "file" the NDA, thereby triggering substantive review of the application. The FDA can refuse to file any NDA that it deems incomplete or not properly reviewable. The FDA has established internal substantive review goals of six months for priority NDAs (for drugs addressing serious or life threatening conditions for which there is an unmet medical need) and 10 months for regular NDAs. The FDA, however, is not legally required to complete its review within these periods, and these performance goals may change over time. Moreover, the outcome of the review, even if generally favorable, is not typically an actual approval, but an "action letter" that describes additional work that must be done before the NDA can be approved. The FDA's review of a NDA may involve review and recommendations by an independent FDA advisory committee. The FDA may deny approval of a NDA or NDA supplement if the applicable regulatory criteria are not satisfied, or it may require additional clinical data and/or an additional pivotal Phase 3 clinical trial. Even if such data are submitted, the FDA may ultimately decide that the NDA or NDA supplement does not satisfy the criteria for approval.

Data Review and Approval

Satisfaction of FDA requirements or similar requirements of state, local, and foreign regulatory agencies typically takes several years and requires the expenditure of substantial financial resources. Information generated in this process is susceptible to varying interpretations that could delay, limit, or prevent regulatory approval at any stage of the process. Accordingly, the actual time and expense required to bring a product to market may vary substantially. We cannot be certain that we will submit applications for required authorizations to manufacture and/or market potential products or that any such application will be reviewed and approved by the appropriate regulatory authorities in a timely manner, if at all. Data obtained from clinical activities is not always conclusive and may be susceptible to varying interpretations, which could delay, limit, or prevent

regulatory approval. Success in early stage clinical trials does not ensure success in later stage clinical trials. Even if a product candidate receives regulatory approval, the approval may be significantly limited to specific disease states, patient populations, and dosages, or have conditions placed on them that restrict the commercial applications, advertising, promotion, or distribution of these products.

Once issued, the FDA may withdraw product approval if ongoing regulatory standards are not met or if safety problems occur after the product reaches the market. In addition, the FDA may require testing and surveillance programs to monitor the effect of approved products which have been commercialized, and the FDA has the power to prevent or limit further marketing of a product based on the results of these post-marketing programs. The FDA may also request additional clinical trials after a product is approved. These so-called Phase 4 studies may be made a condition to be satisfied after a drug receives approval. The results of Phase 4 studies can confirm the effectiveness of a product candidate and can provide important safety information to augment the FDA's voluntary adverse drug reaction reporting system. The product may be subject to withdrawal of the approval if effectiveness is not confirmed in the Phase 4 studies. Any products manufactured or distributed by us pursuant to FDA approvals would be subject to continuing regulation by the FDA, including record-keeping requirements and reporting of adverse experiences with the drug. Drug manufacturers and their subcontractors are required to register their establishments with the FDA and certain state agencies, and are subject to periodic unannounced inspections by the FDA and certain state agencies for compliance with good manufacturing practices, which impose certain procedural and documentation requirements upon us and our third-party manufacturers. We cannot be certain that we or our present or future suppliers will be able to comply with the cGMP regulations and other FDA regulatory requirements. If our present or future suppliers are not able to comply with these requirements, the FDA may halt our clinical trials, require us to recall a drug from distribution, or withdraw approval of the NDA for that drug. Furthermore, even after regulatory approval is obtained, later discovery of previously unknown problems with a product may result in restrictions on the product or even complete withdrawal of the product from the market.

The FDA closely regulates the marketing and promotion of drugs. Approval may be subject to post-marketing surveillance and other record keeping and reporting obligations, and involve ongoing requirements. Product approvals may be withdrawn if compliance with regulatory standards is not maintained or if problems occur following initial marketing. A company can make only those claims relating to safety and efficacy that are approved by the FDA. Failure to comply with these requirements can result in adverse publicity, warning letters, corrective advertising, and potential civil and criminal penalties. Physicians may prescribe legally available drugs for uses that are not described in the product's labeling and that differ from those tested by us and approved by the FDA. Such off-label uses are common across medical specialties. Physicians may believe that such off-label uses are the best treatment for many patients in varied circumstances. The FDA does not regulate the behavior of physicians in their choice of treatments. The FDA does, however, restrict manufacturers' communications on the subject of off-label use.

Fast Track Approval

The Federal Food, Drug and Cosmetic Act, as amended, and FDA regulations provide certain mechanisms for the accelerated "Fast Track" approval of potential products intended to treat serious or life-threatening illnesses that have been studied for safety and effectiveness and that demonstrate the potential to address unmet medical needs. The procedures permit early consultation and commitment from the FDA regarding the preclinical and clinical studies necessary to gain marketing approval. Provisions of this regulatory framework also permit, in certain cases, NDAs to be approved on the basis of valid indirect measurements of benefit of product effectiveness, thus accelerating the normal approval process. Certain potential products employing our technology might qualify for this accelerated regulatory procedure. Even if the FDA agrees that these potential products qualify for accelerated approval procedures, the FDA may deny approval of our drugs or may require additional studies before approval. The FDA may also require us to perform post-approval, or Phase 4, studies as a condition of such early approval. In addition, the FDA may impose restrictions on distribution and/or promotion in connection with any accelerated approval, and may withdraw approval if post-approval studies do not confirm the intended clinical benefit or safety of the potential product.

Orphan Drug Designation

Under the Orphan Drug Act, the FDA may grant orphan drug designation to drugs intended to treat a rare disease or condition, which is generally a disease or condition that affects fewer than 200,000 individuals in the United States. Orphan drug designation must be requested before submitting a NDA. After the FDA grants orphan drug designation, the identity of the therapeutic agent and its potential orphan use are disclosed publicly by the FDA. Orphan drug designation does not convey any advantage in or shorten the duration of the regulatory review and approval process. If a product that has orphan drug designation subsequently receives FDA approval for the disease for which it has such designation, the product is entitled to orphan product exclusivity, which means that the FDA may not approve any other applications to market the same drug for the same disease, except in limited circumstances, for seven years. These circumstances are an inability to supply the drug in sufficient quantities or a situation in which a new formulation of the drug has shown superior safety or efficacy. This exclusivity, however, also could block the approval of our product for seven years if a competitor obtains earlier approval of the same drug for the same indication.

In September 2006, the FDA granted orphan drug designation to glufosfamide, for the treatment of pancreatic cancer. For those indications meeting the orphan drug requirements, we intend to seek orphan drug designation for the cancer indications that our glufosfamide and 2DG product candidates are intended to treat. Obtaining FDA approval to market a product with orphan drug exclusivity may not provide us with a material commercial advantage.

Anti-Kickback and False Claims Laws

In the United States, we are subject to various federal and state laws pertaining to healthcare “fraud and abuse,” including anti-kickback and false claims laws. The federal Anti-Kickback Law makes it illegal for any person, including a prescription drug manufacturer (or a party acting on its behalf) to knowingly and willfully solicit, offer, receive or pay any remuneration, directly or indirectly, in exchange for, or to induce, the referral of business, including the purchase, order or prescription of a particular drug, for which payment may be made under federal healthcare programs such as Medicare and Medicaid. Violations of the law are punishable by up to five years in prison, criminal fines, administrative civil money penalties, and exclusion from participation in federal healthcare programs. In addition, many states have adopted laws similar to the federal Anti-Kickback Law. Some of these state prohibitions apply to referral of patients for healthcare services reimbursed by any source, not only the Medicare and Medicaid programs. Due to the breadth of these laws, and the potential for additional legal or regulatory change addressing some of our practices, it is possible that our practices or our relationships with physicians might be challenged under anti-kickback laws, which could harm us.

False claims laws prohibit anyone from knowingly presenting, or causing to be presented, for payment to third-party payors (including Medicare and Medicaid) claims for reimbursed items or services, including drugs, that are false or fraudulent, claims for items or services not provided as claimed, or claims for medically unnecessary items or services. Our future activities relating to the reporting of wholesaler or estimated retail prices for our products, the reporting of Medicaid rebate information and other information affecting federal, state and third-party reimbursement of our products, and the sale and marketing of our products, are subject to scrutiny under these laws. In addition, pharmaceutical companies have been prosecuted under the federal False Claims Act in connection with their off-label promotion of drugs. Penalties for a violation include three times the actual damages sustained by the government, plus mandatory civil penalties of between \$5,500 and \$11,000 for each separate false claim. In addition, certain states have enacted laws modeled after the federal False Claims Act. If the government were to allege that we were, or convict us of, violating these false claims laws, we could be subject to a substantial fine and suffer a decline in our stock price.

Drug Price Competition and Patent Term Restoration Act of 1984

Under the Drug Price Competition and Patent Term Restoration Act of 1984, known as the Hatch-Waxman Amendments, a portion of a product’s patent term that was lost during clinical development and application

review by the FDA may be restored. The Hatch-Waxman Amendments also provide for a statutory protection, known as nonpatent market exclusivity, against the FDA's acceptance or approval of certain competitor applications. The Hatch-Waxman Amendments also provide the legal basis for the approval of abbreviated new drug applications, or ANDAs, for generic drugs.

Patent term restoration can compensate for patent life lost during product development and the regulatory review process by returning up to five years of patent life for a patent that covers a new product or its use. This period is generally one-half the time between the effective date of an IND (falling after issuance of the patent) and the submission date of a NDA, plus the time between the submission date of a NDA and the approval of that application. Patent term restorations, however, are subject to a maximum extension of five years, and the patent term restoration cannot extend the remaining term of a patent beyond a total of 14 years. The application for patent term extension is subject to approval by the United States Patent and Trademark Office in conjunction with the FDA. It takes at least six months to obtain approval of the application for patent term extension. Up to five years of interim one year extensions are available if a product is still undergoing development or FDA review at the time of its expiration.

The Hatch-Waxman Amendments also provide for a period of statutory protection for new drugs that receive NDA approval from the FDA. If a new drug receives NDA approval as a new chemical entity, meaning that the FDA has not previously approved any other new drug containing the same active moiety, then the Hatch-Waxman Amendments prohibit an abbreviated new drug application or a NDA where the applicant does not own or have a legal right of reference to all of the data required for approval, or a "505(b)(2)" NDA, to be submitted by another company for a generic version of such drug, with some exceptions, for a period of five years from the date of approval of the NDA. The statutory protection provided pursuant to the Hatch-Waxman Amendments will not prevent the filing or approval of a full NDA. In order to gain approval of a full NDA, however, a competitor would be required to conduct its own preclinical investigations and clinical trials. If NDA approval is received for a new drug containing an active ingredient that was previously approved by the FDA but the NDA is for a drug that includes an innovation over the previously approved drug, for example, a NDA approval for a new indication or formulation of the drug with the same active ingredient, and if such NDA approval was dependent upon the submission to the FDA of new clinical investigations, other than bioavailability studies, then the Hatch-Waxman Amendments prohibit the FDA from making effective the approval of an ANDA or a 505(b)(2) NDA for a generic version of such drug for a period of three years from the date of the NDA approval. This three year exclusivity, however, only covers the innovation associated with the NDA to which it attaches. Thus, the three year exclusivity does not prohibit the FDA, with limited exceptions, from approving ANDAs or 505(b)(2) NDAs for drugs containing the same active ingredient but without the new innovation.

While the Hatch-Waxman Amendments provide certain patent term restoration and exclusivity protections to innovator drug manufacturers, it also permits the FDA to approve ANDAs for generic versions of their drugs. The ANDA process permits competitor companies to obtain marketing approval for a drug with the same active ingredient for the same uses but does not require the conduct and submission of clinical studies demonstrating safety and effectiveness for that product. Instead of safety and effectiveness data, an ANDA applicant needs only to submit data demonstrating that its product is bioequivalent to the innovator product as well as relevant chemistry, manufacturing and control data. The Hatch-Waxman Amendments also instituted a third type of drug application that requires the same information as a NDA including full reports of clinical and preclinical studies except that some of the information from the reports required for marketing approval comes from studies which the applicant does not own or have a legal right of reference. This type of application, a "505(b)(2) NDA," permits a manufacturer to obtain marketing approval for a drug without needing to conduct or obtain a right of reference for all of the required studies.

Finally, the Hatch-Waxman Amendments require, in some circumstances, an ANDA or a 505(b)(2) NDA applicant to notify the patent owner and the holder of the approved NDA of the factual and legal basis of the applicant's opinion that the patent listed by the holder of the approved NDA in FDA's Orange Book is not valid or will not be infringed (the patent certification process). Upon receipt of this notice, the patent owner and the

NDA holder have 45 days to bring a patent infringement suit in federal district court and obtain a 30-month stay against the company seeking to reference the NDA. The NDA holder could still file a patent suit after the 45 days, but if they did, they would not have the benefit of the 30-month stay. Alternatively, after this 45-day period, the applicant may file a declaratory judgment action, seeking a determination that the patent is invalid or will not be infringed. Depending on the circumstances, however, the applicant may not be able to demonstrate a controversy sufficient to confer jurisdiction on the court. The discovery, trial and appeals process in such suits can take several years. If such a suit is commenced, the Hatch-Waxman Act provides a 30-month stay on the approval of the competitor's ANDA or 505(b)(2) NDA. If the litigation is resolved in favor of the competitor or the challenged patent expires during the 30-month period, unless otherwise extended by court order, the stay is lifted and the FDA may approve the application. Under regulations recently issued by the FDA, and essentially codified under the recent Medicare prescription drug legislation, the patent owner and the NDA holder have the opportunity to trigger only a single 30-month stay per ANDA or 505(b)(2) NDA.

Foreign Approvals

In addition to regulations in the United States, we will be subject to a variety of foreign regulations governing clinical trials and commercial sales and distribution of our products. Whether or not we obtain FDA approval for a product, we must obtain approval of a product by the comparable regulatory authorities of foreign countries before we can commence clinical trials or marketing of the product in those countries. The approval process varies from country to country, and the time may be longer or shorter than that required for FDA approval. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary greatly from country to country.

Under European Union regulatory systems, we may submit marketing authorizations either under a centralized or decentralized procedure. The centralized procedure provides for the grant of a single marketing authorization that is valid for all European Union member states. The decentralized procedure provides for mutual recognition of national approval decisions. Under this procedure, the holder of a national marketing authorization may submit an application to the remaining member states. Within 90 days of receiving the applications and assessment report, each member state must decide whether to recognize approval.

The policies of the FDA and foreign regulatory authorities may change and additional government regulations may be enacted which could prevent or delay regulatory approval of our investigational drugs or approval of new diseases for our existing products. We cannot predict the likelihood, nature or extent of adverse governmental regulation that might arise from future legislative or administrative action, either in the United States or abroad.

Other Government Regulation

Our research and development activities use biological and hazardous materials that are dangerous to human health and safety or the environment. We are subject to a variety of federal, state and local laws and regulations governing the use, generation, manufacture, storage, handling and disposal of these materials and wastes resulting from these materials. We are also subject to regulation by the Occupational Safety and Health Administration, or OSHA, the California and federal environmental protection agencies and to regulation under the Toxic Substances Control Act. OSHA or the California or federal EPA may adopt regulations that may affect our research and development programs. We are unable to predict whether any agency will adopt any regulations that could have a material adverse effect on our operations. We have incurred, and will continue to incur, capital and operating expenditures and other costs in the ordinary course of our business in complying with these laws and regulations.

Employees

As of December 31, 2006, we had 52 employees, including 17 who hold Ph.D. and/or M.D. degrees. Thirty-seven of our employees are engaged in research and development, and our remaining employees are management

or administrative staff. None of our employees is subject to a collective bargaining agreement. We believe that we have good relations with our employees.

Our Corporate Information

We were incorporated in Delaware on October 17, 2001. Our principal executive offices are located at 1300 Seaport Boulevard, Redwood City, California, 94063. Our telephone number is (650) 474-8200.

Available Information

We file electronically with the Securities and Exchange Commission, or SEC, our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. The SEC maintains an Internet site that contains reports, proxy information and information statements, and other information regarding issuers that file electronically with the SEC. The address of that website is <http://www.sec.gov>. The materials are also available at the SEC's Public Reference Room, located at 100 F Street, Washington, D.C. 20549. The public may obtain information through the public reference room by calling the SEC at 1-800-SEC-0330.

You may obtain a free copy of our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports on the day of filing with the SEC on our website at <http://www.thresholdpharm.com> or by contacting the Investor Relations Department at our corporate offices by calling (650) 474-8200.

ITEM 1A. RISK FACTORS

RISKS RELATED TO OUR BUSINESS

Risks Related to Drug Discovery, Development and Commercialization

We are substantially dependent upon the success of our glufosfamide product candidate. Clinical trials for this product may not demonstrate efficacy or lead to regulatory approval.

We will not be able to commercialize our lead product candidate, glufosfamide, until we obtain FDA approval in the United States or approval by comparable regulatory agencies in Europe and other countries. To satisfy FDA or foreign regulatory approval standards for the commercial sale of our product candidates, we must demonstrate in adequate and controlled clinical trials that our product candidates are safe and effective. Success in preclinical testing and early clinical trials does not ensure that later clinical trials will be successful. A number of companies in the pharmaceutical industry, including us, have suffered significant setbacks in advanced clinical trials, even after obtaining promising results in earlier clinical trials.

Our Phase 3 trial for the second-line treatment of metastatic pancreatic cancer, which was intended to be a pivotal trial, the results of which would have supported FDA approval, did not meet its primary endpoint for overall survival. Earlier Phase 1 and Phase 2 safety trials of glufosfamide were conducted on small numbers of patients and were designed to evaluate the activity of glufosfamide on a preliminary basis. However, these trials were not designed to demonstrate the efficacy of glufosfamide as a therapeutic agent. No drug for second line pancreatic cancer has been approved in the United States. Although we may discuss the results from our Phase 3 glufosfamide trial with the FDA to seek guidance and agreement of a revised regulatory strategy towards approval of glufosfamide in patients with pancreatic cancer, such approval will likely require additional clinical trials of uncertain duration and significant additional expense. In Phase 2 studies, glufosfamide has not shown clinical activity for the treatment of glioblastoma and has only demonstrated marginal activity for the treatment of non-small cell lung cancer. We are conducting additional Phase 2 clinical trials of glufosfamide in patients with ovarian cancer, small cell lung cancer and soft tissue sarcoma, but we cannot be certain that glufosfamide will show clinical activity in these trials. The FDA will likely require us to conduct additional clinical trials or other studies prior to accepting our NDA or granting marketing approval.

Our product candidates must undergo rigorous clinical testing, the results of which are uncertain and could substantially delay or prevent us from bringing them to market.

Before we can obtain regulatory approval for a product candidate, we must undertake extensive clinical testing in humans to demonstrate safety and efficacy to the satisfaction of the FDA or other regulatory agencies. Clinical trials of new drug candidates sufficient to obtain regulatory marketing approval are expensive and take years to complete.

We cannot be certain of successfully completing clinical testing within the time frame we have planned, or at all. We may experience numerous unforeseen events during, or as a result of, the clinical trial process that could delay or prevent us from receiving regulatory approval or commercializing our product candidates, including the following:

- our clinical trials may produce negative or inconclusive results, and we may decide, or regulators may require us, to conduct additional clinical and/or preclinical testing or to abandon programs;
- the results obtained in earlier stage testing may not be indicative of results in future trials;
- trial results may not meet the level of statistical significance required by the FDA or other regulatory agencies;
- enrollment in our clinical trials for our product candidates may be slower than we anticipate, resulting in significant delays;
- we, or regulators, may suspend or terminate our clinical trials if the participating patients are being exposed to unacceptable health risks; and
- the effects of our product candidates on patients may not be the desired effects or may include undesirable side effects or other characteristics that may delay or preclude regulatory approval or limit their commercial use, if approved.

Completion of clinical trials depends, among other things, on our ability to enroll a sufficient number of patients, which is a function of many factors, including:

- the therapeutic endpoints chosen for evaluation;
- the eligibility criteria defined in the protocol;
- the size of the patient population required for analysis of the trial's therapeutic endpoints;
- our ability to recruit clinical trial investigators and sites with the appropriate competencies and experience;
- our ability to obtain and maintain patient consents; and
- competition for patients by clinical trial programs for other treatments.

We may experience difficulties in enrolling patients in our clinical trials, which could increase the costs or affect the timing or outcome of these trials. This is particularly true with respect to diseases with relatively small patient populations, such as pancreatic cancer, which is the indication we are currently testing for our glufosfamide product candidate.

We are subject to significant regulatory approval requirements, which could delay, prevent or limit our ability to market our product candidates.

Our research and development activities, preclinical studies, clinical trials and the anticipated manufacturing and marketing of our product candidates are subject to extensive regulation by the FDA and other regulatory agencies in the United States and by comparable authorities in Europe and elsewhere. We require the approval of the relevant regulatory authorities before we may commence commercial sales of our product candidates in a

given market. The regulatory approval process is expensive and time-consuming, and the timing of receipt of regulatory approval is difficult to predict. Our product candidates could require a significantly longer time to gain regulatory approval than expected, or may never gain approval. We cannot be certain that, even after expending substantial time and financial resources, we will obtain regulatory approval for any of our product candidates. A delay or denial of regulatory approval could delay or prevent our ability to generate product revenues and to achieve profitability.

Changes in regulatory approval policies during the development period of any of our product candidates, changes in, or the enactment of, additional regulations or statutes, or changes in regulatory review practices for a submitted product application may cause a delay in obtaining approval or result in the rejection of an application for regulatory approval.

Regulatory approval, if obtained, may be made subject to limitations on the indicated uses for which we may market a product. These limitations could adversely affect our potential product revenues. Regulatory approval may also require costly post-marketing follow-up studies. In addition, the labeling, packaging, adverse event reporting, storage, advertising, promotion and record-keeping related to the product will be subject to extensive ongoing regulatory requirements. Furthermore, for any marketed product, its manufacturer and its manufacturing facilities will be subject to continual review and periodic inspections by the FDA or other regulatory authorities. Failure to comply with applicable regulatory requirements may, among other things, result in fines, suspensions of regulatory approvals, product recalls, product seizures, operating restrictions and criminal prosecution.

Our product candidates are based on Metabolic Targeting, which is an unproven approach to therapeutic intervention.

All of our product candidates are based on Metabolic Targeting, a therapeutic approach that targets fundamental differences in energy metabolism between normal and certain diseased cells. We have not, nor to our knowledge has any other company, received regulatory approval for a drug based on this approach. We cannot be certain that our approach will lead to the development of approvable or marketable drugs.

In addition, the FDA or other regulatory agencies may lack experience in evaluating the safety and efficacy of drugs based on Metabolic Targeting, which could lengthen the regulatory review process, increase our development costs and delay or prevent commercialization of our product candidates.

Our product candidates may have undesirable side effects that prevent or delay their regulatory approval or limit their use if approved.

Glufosfamide is known to cause reversible toxicity to the bone marrow and kidneys, as well as nausea and vomiting. These side effects or others identified in the course of our clinical trials or that may otherwise be associated with our product candidates may outweigh the benefits of our product candidates. Side effects may prevent or delay regulatory approval or limit market acceptance if our products are approved.

Delays in clinical testing could result in increased costs to us and delay our ability to obtain regulatory approval and commercialize our product candidates.

Significant delays in clinical testing could materially impact our product development costs and delay regulatory approval of our product candidates. We do not know whether planned glufosfamide and 2DG clinical trials will begin on time, will need to be redesigned or will be completed on schedule, if at all. Clinical trials can be delayed for a variety of reasons, including adverse safety events experienced during our trials and delays in:

- obtaining regulatory approval to commence a trial;
- obtaining clinical materials;
- reaching agreement on acceptable clinical study agreement terms with prospective sites;

- obtaining institutional review board approval to conduct a study at a prospective site; and
- recruiting patients to participate in a study.

Orphan drug exclusivity affords us limited protection, and if another party obtains orphan drug exclusivity for the drugs and indications we are targeting, we may be precluded from commercializing our product candidates in those indications.

In September 2006, the FDA granted orphan drug designation to glufosfamide, for the treatment of pancreatic cancer. For those drugs that meet the eligible requirements, we intend to seek orphan drug designation for the cancer indications that our glufosfamide and 2DG product candidates are intended to treat. Under the Orphan Drug Act, the FDA may grant orphan drug designation to drugs intended to treat a rare disease or condition, which is defined by the FDA as a disease or condition that affects fewer than 200,000 individuals in the United States. The company that obtains the first FDA approval for a designated orphan drug indication receives marketing exclusivity for use of that drug for that indication for a period of seven years. Orphan drug exclusive marketing rights may be lost if the FDA later determines that the request for designation was materially defective, or if the manufacturer is unable to assure sufficient quantity of the drug. Orphan drug designation does not shorten the development or regulatory review time of a drug.

Orphan drug exclusivity may not prevent other market entrants. A different drug, or, under limited circumstances, the same drug may be approved by the FDA for the same orphan indication. The limited circumstances include an inability to supply the drug in sufficient quantities or where a new formulation of the drug has shown superior safety or efficacy. As a result, if our product is approved and receives orphan drug status, the FDA can still approve other drugs for use in treating the same indication covered by our product, which could create a more competitive market for us.

Moreover, due to the uncertainties associated with developing pharmaceutical products, we may not be the first to obtain marketing approval for any orphan drug indication. Even if we obtain orphan drug designation, if a competitor obtains regulatory approval for glufosfamide or 2DG for the same indication we are targeting before we do, we would be blocked from obtaining approval for that indication for seven years, unless our product is a new formulation of the drug that has shown superior safety or efficacy, or the competitor is unable to supply sufficient quantities.

Even if we obtain regulatory approval, our marketed drugs will be subject to ongoing regulatory review. If we fail to comply with continuing United States and foreign regulations, we could lose our approvals to market drugs and our business would be seriously harmed.

Following initial regulatory approval of any drugs we may develop, we will be subject to continuing regulatory review, including review of adverse drug experiences and clinical results that are reported after our drug products become commercially available. This would include results from any post-marketing tests or vigilance required as a condition of approval. The manufacturer and manufacturing facilities we use to make any of our drug candidates will also be subject to periodic review and inspection by the FDA. If a previously unknown problem or problems with a product or a manufacturing and laboratory facility used by us is discovered, the FDA or foreign regulatory agency may impose restrictions on that product or on the manufacturing facility, including requiring us to withdraw the product from the market. Any changes to an approved product, including the way it is manufactured or promoted, often require FDA approval before the product, as modified, can be marketed. We and our contract manufacturers will be subject to ongoing FDA requirements for submission of safety and other post-market information. If we and our contract manufacturers fail to comply with applicable regulatory requirements, a regulatory agency may:

- issue warning letters;
- impose civil or criminal penalties;
- suspend or withdraw our regulatory approval;

- suspend or terminate any of our ongoing clinical trials;
- refuse to approve pending applications or supplements to approved applications filed by us;
- impose restrictions on our operations;
- close the facilities of our contract manufacturers; or
- seize or detain products or require a product recall.

The FDA and foreign regulatory authorities may impose significant restrictions on the indicated uses and marketing of pharmaceutical products.

FDA rules for pharmaceutical promotion require that a company not promote an unapproved drug or an approved drug for an unapproved use. In addition to FDA requirements, regulatory and law enforcement agencies, such as the United States Department of Health and Human Services' Office of Inspector General and the United States Department of Justice, monitor and investigate pharmaceutical sales, marketing and other practices. For example, sales, marketing and scientific/educational grant programs must comply with the Medicare-Medicaid Anti-Fraud and Abuse Act, as amended, the False Claims Act, as amended, and similar state laws. In recent years, actions by companies' sales forces and marketing departments have been scrutinized intensely to ensure, among other things, that actions by such groups do not qualify as "kickbacks" to healthcare professionals. A "kickback" refers to the provision of any item of value to a healthcare professional or other person in exchange for purchasing, recommending, or referring an individual for an item or service reimbursable by a federal healthcare program. These kickbacks increase the expenses of the federal healthcare program and may result in civil penalties, criminal prosecutions, and exclusion from participation in government programs, any of which would adversely affect our financial condition and business operations. In addition, even if we are not determined to have violated these laws, government investigations into these issues typically require the expenditure of significant resources and generate negative publicity, which would also harm our financial condition. Comparable laws also exist at the state level.

We are, and in the future may be, subject to new federal and state requirements to submit information on our open and completed clinical trials to public registries and databases.

In 1997, a public registry of open clinical trials involving drugs intended to treat serious or life-threatening diseases or conditions was established under the Food and Drug Administration Modernization Act, or FDMA, in order to promote public awareness of and access to these clinical trials. Under FDMA, pharmaceutical manufacturers and other trial sponsors are required to post the general purpose of these trials, as well as the eligibility criteria, location and contact information of the trials. Since the establishment of this registry, there has been significant public debate focused on broadening the types of trials included in this or other registries, as well as providing for public access to clinical trial results. A voluntary coalition of medical journal editors has adopted a resolution to publish results only from those trials that have been registered with a no-cost, publicly accessible database, such as www.clinicaltrials.gov. The Pharmaceuticals and Research Manufacturers of America has also issued voluntary principles for its members to make results from certain clinical studies publicly available and has established a website for this purpose. Other groups have adopted or are considering similar proposals for clinical trial registration and the posting of clinical trial results. The state of Maine has enacted legislation, with penalty provisions, requiring the disclosure of results from clinical trials involving drugs marketed in the state, and similar legislation has been introduced in other states. Federal legislation was introduced in the fall of 2004 to expand www.clinicaltrials.gov and to require the inclusion of study results in this registry. In some states, such as New York, prosecutors have alleged that a lack of disclosure of clinical trial information constitutes fraud, and these allegations have resulted in settlements with pharmaceutical companies that include agreements to post clinical trial results. Our failure to comply with any clinical trial posting requirements could expose us to negative publicity, fines, and other penalties, all of which could materially harm our business.

Risks Related to Our Financial Performance and Operations

We have incurred losses since our inception and anticipate that we will incur significant continued losses for the next several years, and our future profitability is uncertain.

We are a development stage company with a limited operating history and no current source of revenue from the sale of our product candidates. We have incurred losses in each year since our inception in 2001. We have devoted substantially all of our resources to research and development of our product candidates. Prior to our initial public offering in February 2005, we financed our operations primarily through private placements of our equity securities. For the year ended December 31, 2006, we had a net loss of \$55.7 million and we had an accumulated deficit of \$134.7 million. Clinical trials are costly. We do not expect to generate any revenue from the sale of our product candidates at least within the next couple of years. Therefore we expect to continue to have significant losses for at least the next several years.

To attain profitability, we will need to develop products successfully and market and sell them effectively. We have never generated revenue from the sale of our product candidates, and there is no guarantee that we will be able to do so in the future. If our glufosfamide product candidate fails to show positive results in our ongoing clinical trials, or we do not receive regulatory approval, or if glufosfamide does not achieve market acceptance even if approved, we may not become profitable. If we fail to become profitable, or if we are unable to fund our continuing losses, we may be unable to continue our clinical development programs.

We may need substantial additional funding and may be unable to raise capital when needed, which could force us to delay, reduce or eliminate our drug discovery, product development and commercialization activities.

Developing drugs, conducting clinical trials, and commercializing products is expensive. Our future funding requirements will depend on many factors, including:

- the terms and timing of any collaborative, licensing, acquisition or other arrangements that we may establish;
- the progress and cost of our clinical trials and other research and development activities;
- the costs and timing of obtaining regulatory approvals;
- the costs of filing, prosecuting, defending and enforcing any patent applications, claims, patents and other intellectual property rights;
- the cost and timing of securing manufacturing capabilities for our clinical product candidates and commercial products, if any;
- the costs of lawsuits involving us or our product candidates; and
- the costs of establishing sales, marketing and distribution capabilities.

We believe that our cash, cash equivalents and marketable securities will be sufficient to fund our projected operating requirements through at least mid-2008, including completing our current and planned clinical trials, conducting research and discovery efforts towards additional product candidates, working capital and general corporate purposes. Additional funds will be required to in-license or otherwise acquire and develop additional products or programs. We expect to seek funds through arrangements with collaborators or others that may require us to relinquish rights to certain products candidates that we might otherwise seek to develop or commercialize independently. We cannot be certain that we will be able to enter into any such arrangements on reasonable terms, if at all.

We may need or choose to raise additional capital or incur indebtedness to continue to fund our operations in the future. Our ability to raise additional funds will depend on financial, economic and market conditions, our clinical events and other factors, many of which are beyond our control. We cannot be certain that sufficient

funds will be available to us when required or on satisfactory terms. If necessary funds are not available, we may have to delay, reduce the scope or eliminate some of our development programs, which could delay the time to market for any or all of our product candidates.

Raising additional funds may cause dilution to existing stockholders or require us to relinquish valuable rights.

We may raise additional funds through public or private equity offerings, debt financings or corporate collaboration and licensing arrangements. We cannot be certain that additional funding will be available on acceptable terms, or at all. To the extent that we raise additional funds by issuing equity securities, our stockholders may experience dilution. Debt financing, if available, may subject us to restrictive covenants that could limit our flexibility in conducting future business activities. To the extent that we raise additional funds through collaboration and licensing arrangements, it will be necessary to relinquish some rights to our clinical product candidates.

If we are unable to establish sales and marketing capabilities, we may be unable to successfully commercialize our product candidates.

If our cancer product candidates are approved for commercial sale, we plan to establish our own sales force to market them in the United States and potentially Europe. We currently have no experience in selling, marketing or distributing pharmaceutical products and do not have a sales force to do so. Before we can commercialize any products, we must develop our sales, marketing and distribution capabilities, which is an expensive and time consuming process and our failure to do this successfully, could delay any product launch. Our efforts to develop internal sales and marketing capabilities could face a number of risks, including:

- we may not be able to attract a sufficient number of qualified sales and marketing personnel;
- the cost of establishing a marketing or sales force may not be justifiable in light of the potential revenues for any particular product; and
- our internal sales and marketing efforts may not be effective.

Our success depends in part on retaining and motivating key personnel and, if we fail to do so, it may be more difficult for us to execute our business strategy. As a small organization we are dependent on key employees and may need to hire additional personnel to execute our business strategy successfully.

Our success depends on our continued ability to attract, retain and motivate highly qualified management, clinical and scientific personnel and on our ability to develop and maintain important relationships with leading academic institutions, clinicians and scientists. We are highly dependent upon our senior management and scientific staff, particularly our Chief Executive Officer, Dr. Harold E. Selick. We do not have an employment contract with Dr. Selick. The loss of the services of Dr. Selick or one or more of our other key employees could delay or have an impact on the successful completion of our clinical trials or the commercialization of our product candidates.

In August 2006, we announced a plan to reduce the number of full-time employees by 29 employees. As of December 31, 2006, we had 52 employees. Our success will depend on our ability to retain and motivate remaining personnel and hire additional qualified personnel when required. Competition for qualified personnel in the biotechnology field is intense. We face competition for personnel from other biotechnology and pharmaceutical companies, universities, public and private research institutions and other organizations. We may not be able to attract and retain qualified personnel on acceptable terms given the competition for such personnel. If we are unsuccessful in our retention, motivation and recruitment efforts, we may be unable to execute our strategy.

The reduction in our work force may cause difficulties in conducting operations and maintaining an effective work environment.

The reduction in our work force in August 2006 imposed significant added responsibilities on remaining management and other employees, including the need to consolidate job functions and to conduct operation with fewer employees. We expect that we will need to increase our use of various third parties, including contract research organizations, manufacturers and others, including potential collaborators, in order to continue and conduct some operations. Our ability to manage our operations and outside relationships will require us to continue to improve our operational, financial and management controls, reporting systems and procedures. If we are unable to do this effectively, it may be difficult for us to execute our business strategy.

Our facilities in California are located near an earthquake fault, and an earthquake or other natural disaster or resource shortage could disrupt our operations.

Important documents and records, such as hard copies of our laboratory books and records for our product candidates, are located in our corporate headquarters at a single location in Redwood City, California, near active earthquake zones. In the event of a natural disaster, such as an earthquake, drought or flood, or localized extended outages of critical utilities or transportation systems, we do not have a formal business continuity or disaster recovery plan, and could therefore experience a significant business interruption. In addition, California from time to time has experienced shortages of water, electric power and natural gas. Future shortages and conservation measures could disrupt our operations and could result in additional expense. Although we maintain business interruption insurance coverage, the policy specifically excludes coverage for earthquake and flood.

Risks Related to Our Dependence on Third Parties

We rely on third parties to manufacture glufosfamide, 2DG and TH-302. If these parties do not manufacture the active pharmaceutical ingredients or finished products of satisfactory quality, in a timely manner, in sufficient quantities or at an acceptable cost, clinical development and commercialization of our product candidates could be delayed.

We do not currently own or operate manufacturing facilities; consequently, we rely and expect to continue to rely on third parties for the production of clinical and commercial quantities of our product candidates. We have not yet entered into any long term manufacturing or supply agreement for any of our product candidates. Our current and anticipated future dependence upon others for the manufacture of our product candidates may adversely affect our ability to develop and commercialize any product candidates on a timely and competitive basis.

Our initial supplies of glufosfamide were prepared by a subsidiary of Baxter International, Inc. and were used to initiate our current clinical trials. We are currently using glufosfamide API and drug product that were manufactured by our primary contract manufacturer and we believe this material will be sufficient to complete our currently ongoing Phase 2 and Phase 3 trials. We are in the process of identifying and qualifying an additional vendor to manufacture glufosfamide API. If we experience unexpected delays, or if the API or finished product does not meet specifications, we may experience a significant delay in completion of existing trials and the initiation of additional trials.

While we have sufficient supply of 2DG API, our existing supply of clinical trial material may not be sufficient for our ongoing clinical trials through 2007. We are currently in the process of manufacturing additional 2DG drug product, but if we are not successful we may experience a significant delay in our 2DG clinical program.

We are currently using a contract manufacturer to manufacture TH-302 API and are in the process of final drug product formulation for the initiation of our planned Phase 1 trial in 2007. If we are not successful in manufacturing sufficient quantities of TH-302 API and drug product, we may experience a significant delay in our TH-302 clinical program.

We will need to enter into additional agreements for additional supplies of each of our product candidates to complete clinical development and/or commercialize them. We cannot be certain that we can do so on favorable terms, if at all. The products will need to satisfy all cGMP manufacturing requirements, including passing specifications. Our inability to satisfy these requirements could delay our clinical programs.

To date, our product candidates have been manufactured in quantities sufficient for preclinical studies or clinical trials. If any of our product candidates is approved by the FDA or other regulatory agencies for commercial sale, we will need to have it manufactured in commercial quantities. We may not be able to increase the manufacturing capacity for any of our product candidates in a timely or economic manner successfully or at all. Significant scale-up of manufacturing may require additional validation studies, which the FDA and other regulatory agencies must review and approve. If we are unable to successfully increase the manufacturing capacity for a product candidate, the regulatory approval or commercial launch of that product candidate may be delayed, or there may be a shortage of supply which could limit our sales.

In addition, if the facility or the equipment in the facility that produces our product candidates is significantly damaged or destroyed, or if the facility is located in another country and trade or commerce with such country is interrupted, we may be unable to replace the manufacturing capacity quickly or inexpensively. The inability to obtain manufacturing agreements, the damage or destruction of a facility on which we rely for manufacturing or any other delays in obtaining supply would delay or prevent us from completing our clinical trials and commercializing our current product candidates.

We have no control over our manufacturers' and suppliers' compliance with manufacturing regulations, and their failure to comply could result in an interruption in the supply of our product candidates.

The facilities used by our contract manufacturers must undergo an inspection by the FDA for compliance with current good manufacturing practice, or cGMP regulations, before the respective product candidates can be approved. In the event these facilities do not receive a satisfactory cGMP inspection for the manufacture of our product candidates, we may need to fund additional modifications to our manufacturing process, conduct additional validation studies, or find alternative manufacturing facilities, any of which would result in significant cost to us as well as a delay of up to several years in obtaining approval for such product candidate. In addition, our contract manufacturers, and any alternative contract manufacturer we may utilize, will be subject to ongoing periodic inspection by the FDA and corresponding state and foreign agencies for compliance with cGMP regulations, similar foreign regulations and other regulatory standards. We do not have control over our contract manufacturers' compliance with these regulations and standards. Any failure by our third-party manufacturers or suppliers to comply with applicable regulations could result in sanctions being imposed on them (including fines, injunctions and civil penalties), failure of regulatory authorities to grant marketing approval of our product candidates, delays, suspension or withdrawal of approvals, license revocation, seizures or recalls of product candidates or products, operating restrictions and criminal prosecution.

We rely on third parties to conduct our clinical trials, and their failure to perform their obligations in a timely or competent manner may delay development and commercialization of our product candidates.

We are using clinical research organizations to oversee our ongoing glufosfamide clinical trials and expect to use the same or similar organizations for our future clinical trials. There are numerous alternative sources to provide these services. However, we may face delays outside of our control if these parties do not perform their obligations in a timely or competent fashion or if we are forced to change service providers. This risk is heightened for our clinical trials conducted outside of the United States, where it may be more difficult to ensure that studies are conducted in compliance with FDA requirements. Completion of our ongoing and future studies of glufosfamide are and will be dependent upon the accrual of patients at clinical sites outside the United States. Any third-party that we hire to conduct clinical trials may also provide services to our competitors, which could compromise the performance of their obligations to us. If we experience significant delays in the progress of our clinical trials and in our plans to file NDAs, the commercial prospects for product candidates could be harmed and our ability to generate product revenue would be delayed or prevented.

We may rely on strategic collaborators to market and sell our products.

We have no sales and marketing experience. We may contract with strategic collaborators to sell and market our products, when and if approved. We may not be successful in entering into collaborative arrangements with third parties for the sale and marketing of any products. Any failure to enter into collaborative arrangements on favorable terms could delay or hinder our ability to develop and commercialize our product candidates and could increase our costs of development and commercialization. Dependence on collaborative arrangements will subject us to a number of risks, including:

- we may not be able to control the amount or timing of resources that our collaborators may devote to the product candidates;
- we may be required to relinquish important rights, including intellectual property, marketing and distribution rights;
- we may have lower revenues than if we were to market and distribute such products ourselves;
- should a collaborator fail to commercialize one of our product candidates successfully, we may not receive future milestone payments or royalties;
- a collaborator could separately move forward with a competing product candidate developed either independently or in collaboration with others, including our competitors;
- our collaborators may experience financial difficulties;
- business combinations or significant changes in a collaborator's business strategy may also adversely affect a collaborator's willingness or ability to complete its obligations under any arrangement; and
- our collaborators may operate in countries where their operations could be adversely affected by changes in the local regulatory environment or by political unrest.

Risks Related to Our Intellectual Property

2DG is a known compound that is not protected by patents on the composition of the molecule.

2DG is a known compound that is no longer eligible for patent protection on the composition of the molecule. A patent of this nature, known as a compound per se patent, excludes others from making, using or selling the patented compound, regardless of how or for what purpose the compound is formulated or intended to be used. Consequently, this compound and certain of its uses are in the public domain.

We have an issued U.S. patent for the use of orally administered 2DG for the treatment of cancer at certain doses and administration schedules, and we have in-licensed one issued patent that covers the treatment of breast cancer with 2DG in combination with paclitaxel or docetaxel. We also have applications related to the issued licensed patent that cover other 2DG combination therapies, but we cannot be certain that any other patent application under this license will be issued. Others may develop and market 2DG for the treatment of cancer, however, if they develop treatments using dosing and administration schedules or combination therapies outside the scope of our patents or in contravention of our patent rights.

Metabolic Targeting is not protected by patents, and others may be able to develop competitive drugs using this approach.

We have not issued patents or patent applications that would prevent others from taking advantage of Metabolic Targeting generally to discover and develop new therapies for cancer or other diseases. Consequently, our competitors may seek to discover and develop potential therapeutics that operate by mechanisms of action that are the same or similar to the mechanisms of action of our product candidates.

We are dependent on patents and proprietary technology, both our own and those licensed from others. If we or our licensors fail to adequately protect this intellectual property or if we otherwise do not have exclusivity for the marketing of our products, our ability to commercialize products could suffer.

Our commercial success will depend in part on our ability and the ability of our licensors to obtain and maintain patent protection sufficient to prevent others from marketing our product candidates, as well as to successfully defend and enforce these patents against infringement and to operate without infringing the proprietary rights of others. We will only be able to protect our product candidates from unauthorized use by third parties to the extent that valid and enforceable patents cover our product candidates or they are effectively protected by trade secrets. If our patent applications do not result in issued patents, or if our patents, or those patents we have licensed are found to be invalid, we will lose the ability to exclude others from making, using or selling the inventions claimed therein. We have a limited number of patents and pending patent applications.

The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions. No consistent policy regarding the breadth of claims allowed in biotechnology patents has emerged to date in the United States. The laws of many countries may not protect intellectual property rights to the same extent as United States laws, and those countries may lack adequate rules and procedures for defending our intellectual property rights. Changes in either patent laws or in interpretations of patent laws in the United States and other countries may diminish the value of our intellectual property. We do not know whether any of our patent applications will result in the issuance of any patents and we cannot predict the breadth of claims that may be allowed in our patent applications or in the patent applications we license from others.

The degree of future protection for our proprietary rights is uncertain because legal means afford only limited protection and may not adequately protect our rights or permit us to gain or keep our competitive advantage. For example:

- we or our licensors might not have been the first to make the inventions covered by each of our or our licensors' pending patent applications and issued patents, and we may have to participate in expensive and protracted interference proceedings to determine priority of invention;
- we or our licensors might not have been the first to file patent applications for these inventions;
- others may independently develop similar or alternative product candidates or duplicate any of our or our licensors' product candidates;
- our or our licensors' pending patent applications may not result in issued patents;
- our or our licensors' issued patents may not provide a basis for commercially viable products or may not provide us with any competitive advantages or may be challenged by third parties;
- others may design around our or our licensors' patent claims to produce competitive products that fall outside the scope of our or our licensors' patents;
- we may not develop or in-license additional patentable proprietary technologies related to our product candidates; or
- the patents of others may prevent us from marketing one or more of our product candidates for one or more indications that may be valuable to our business strategy.

Moreover, an issued patent does not guarantee us the right to practice the patented technology or commercialize the patented product. Third parties may have blocking patents that could be used to prevent us from commercializing our patented products and practicing our patented technology. Our issued patents and those that may be issued in the future may be challenged, invalidated or circumvented, which could limit our ability to prevent competitors from marketing related product candidates or could limit the length of the term of patent protection of our product candidates. In addition, the rights granted under any issued patents may not

provide us with proprietary protection or competitive advantages against competitors with similar technology. Furthermore, our competitors may independently develop similar technologies. Moreover, because of the extensive time required for development, testing and regulatory review of a potential product, it is possible that, before any of our product candidates can be commercialized, any related patent may expire or remain in force for only a short period following commercialization, thereby reducing any advantage of the patent. For glufosfamide, the major European counterparts to the U.S. patent expire in 2009 and the U.S. patent expires in 2014. Patent term extension may not be available for these patents.

We rely on trade secrets and other forms of non-patent intellectual property protection. If we are unable to protect our trade secrets, other companies may be able to compete more effectively against us.

We rely on trade secrets to protect our technology, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to protect, especially in the pharmaceutical industry, where much of the information about a product must be made public during the regulatory approval process. Although we use reasonable efforts to protect our trade secrets, our employees, consultants, contractors, outside scientific collaborators and other advisors may unintentionally or willfully disclose our information to competitors. Enforcing a claim that a third party illegally obtained and is using our trade secrets is expensive and time consuming, and the outcome is unpredictable. In addition, courts outside the United States may be less willing to or may not protect trade secrets. Moreover, our competitors may independently develop equivalent knowledge, methods and know-how.

If we are sued for infringing intellectual property rights of third parties or if we are forced to engage in an interference proceeding, it will be costly and time consuming, and an unfavorable outcome in that litigation or interference would have a material adverse effect on our business.

Our ability to commercialize our product candidates depends on our ability to develop, manufacture, market and sell our product candidates without infringing the proprietary rights of third parties. Numerous United States and foreign issued patents and pending patent applications, which are owned by third parties, exist in the general field of cancer therapies or in fields that otherwise may relate to our product candidates. We are also aware of a patent that claims certain agents, including 2DG, to inhibit the import of glucose-6-phosphate into the endoplasmic reticulum of a cell. We do not know whether administration of 2DG for our intended uses inhibits such import. If it does, we would be required to license the patent or risk that a claim of infringement could be made. If we are shown to infringe, we could be enjoined from use or sale of the claimed invention if we are unable to prove that the patent is invalid. In addition, because patent applications can take many years to issue, there may be currently pending applications, unknown to us, which may later result in issued patents that our product candidates or any other compound that we may develop, may infringe, or which may trigger an interference proceeding regarding one of our owned or licensed patents or applications. There could also be existing patents of which we are not aware that our product candidates may inadvertently infringe or which may become involved in an interference proceeding.

The biotechnology and biopharmaceutical industries are characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. For so long as our product candidates are in clinical trials, we believe our clinical activities fall within the scope of the exemptions provided by 35 U.S.C. Section 271(e) in the United States, which exempts from patent infringement liability activities reasonably related to the development and submission of information to the FDA. As our clinical investigational drugs progress toward commercialization, the possibility of a patent infringement claim against us increases. While we attempt to ensure that our active clinical investigational drugs and the methods we employ to manufacture them, as well as the methods for their use we intend to promote, do not infringe other parties' patents and other proprietary rights. However, we cannot be certain they do not, and competitors or other parties may assert that we infringe their proprietary rights in any event.

We may be exposed to future litigation based on claims that our product candidates, or the methods we employ to manufacture them, infringe the intellectual property rights of others. Our ability to manufacture and

commercialize our product candidates may depend on our ability to demonstrate that the manufacturing processes we employ and the use of our product candidates do not infringe third-party patents. If third-party patents were found to cover our product candidates or their use or manufacture, we could be required to pay damages or be enjoined and therefore unable to commercialize our product candidates, unless we obtained a license. A license may not be available to us on acceptable terms, if at all.

RISKS RELATED TO OUR INDUSTRY

If our competitors are able to develop and market products that are more effective, safer or more affordable than ours, or obtain marketing approval before we do, our commercial opportunities may be limited.

Competition in the biotechnology and pharmaceutical industries is intense and continues to increase, particularly in the area of cancer treatment. Most major pharmaceutical companies and many biotechnology companies are aggressively pursuing oncology development programs, including traditional therapies and therapies with novel mechanisms of action. Our cancer product candidates face competition from established biotechnology and pharmaceutical companies, including sanofi-aventis Group, Eli Lilly and Company and Pfizer and from generic pharmaceutical manufacturers. In particular, our glufosfamide product candidate for pancreatic cancer will compete with Gemzar, marketed by Eli Lilly and Company, and 5-fluorouracil, or 5-FU, a generic product which is sold by many manufacturers. In addition, several drugs marketed for different indications, such as Camptosar®, marketed by Pfizer, Erbitux®, marketed by Imclone Systems Incorporated and Bristol-Myers Squibb Company, Taxotere®, marketed by the sanofi-aventis Group, Xeloda®, marketed by Roche, and Alimta®, marketed by Eli Lilly and Company, are under investigation as possible combination therapies for first-line treatment of pancreatic cancer and other compounds are under investigation as first or second line treatments for pancreatic cancer. Additionally OSI Pharmaceuticals and Genentech market Tarceva® as a combination therapy with gemcitabine for the first-line treatment of pancreatic cancer.

We also face potential competition from academic institutions, government agencies and private and public research institutions engaged in the discovery and development of drugs and therapies. Many of our competitors have significantly greater financial resources and expertise in research and development, preclinical testing, conducting clinical trials, obtaining regulatory approvals, manufacturing, sales and marketing than we do. Smaller or early-stage companies may also prove to be significant competitors, particularly through collaborative arrangements with large and established pharmaceutical companies.

Our competitors may succeed in developing products that are more effective, have fewer side effects and are safer or more affordable than our product candidates, which would render our product candidates less competitive or noncompetitive. These competitors also compete with us to recruit and retain qualified scientific and management personnel, establish clinical trial sites and patient registration for clinical trials, as well as to acquire technologies and technology licenses complementary to our programs or advantageous to our business. Moreover, competitors that are able to achieve patent protection obtain regulatory approvals and commence commercial sales of their products before we do, and competitors that have already done so, may enjoy a significant competitive advantage.

There is a substantial risk of product liability claims in our business. If we do not obtain sufficient liability insurance, a product liability claim could result in substantial liabilities.

Our business exposes us to significant potential product liability risks that are inherent in the development, manufacturing and marketing of human therapeutic products. Regardless of merit or eventual outcome, product liability claims may result in:

- delay or failure to complete our clinical trials;
- withdrawal of clinical trial participants;
- decreased demand for our product candidates;

- injury to our reputation;
- litigation costs;
- substantial monetary awards against us; and
- diversion of management or other resources from key aspects of our operations.

If we succeed in marketing products, product liability claims could result in an FDA investigation of the safety or efficacy of our products, our manufacturing processes and facilities or our marketing programs. An FDA investigation could also potentially lead to a recall of our products or more serious enforcement actions, or limitations on the indications, for which they may be used, or suspension or withdrawal of approval.

We have product liability insurance that covers our clinical trials up to an \$8 million annual aggregate limit. We intend to expand our insurance coverage to include the sale of commercial products if marketing approval is obtained for our product candidates or any other compound that we may develop. However, insurance coverage is increasingly expensive. We may not be able to maintain insurance coverage at a reasonable cost or at all, and the insurance coverage that we obtain may not be adequate to cover potential claims or losses.

Even if we receive regulatory approval to market our product candidates, the market may not be receptive to our product candidates upon their commercial introduction, which would negatively affect our ability to achieve profitability.

Our product candidates may not gain market acceptance among physicians, patients, healthcare payors and the medical community. The degree of market acceptance of any approved products will depend on a number of factors, including:

- the effectiveness of the product;
- the prevalence and severity of any side effects;
- potential advantages or disadvantages over alternative treatments;
- relative convenience and ease of administration;
- the strength of marketing and distribution support;
- the price of the product, both in absolute terms and relative to alternative treatments; and
- sufficient third-party coverage or reimbursement.

If our product candidates receive regulatory approval but do not achieve an adequate level of acceptance by physicians, healthcare payors and patients, we may not generate product revenues sufficient to attain profitability.

If third-party payors do not adequately reimburse patients for any of our product candidates, if approved for marketing, we may not be successful in selling them.

Our ability to commercialize any products successfully will depend in part on the extent to which reimbursement will be available from governmental and other third-party payors, both in the United States and in foreign markets. Even if we succeed in bringing one or more products to the market, the amount reimbursed for our products may be insufficient to allow us to compete effectively and could adversely affect our profitability.

Reimbursement by a governmental and other third-party payor may depend upon a number of factors, including a governmental or other third-party payor's determination that use of a product is:

- a covered benefit under its health plan;
- safe, effective and medically necessary;
- appropriate for the specific patient;

- cost-effective; and
- neither experimental nor investigational.

Obtaining reimbursement approval for a product from each third-party and governmental payor is a time-consuming and costly process that could require us to provide supporting scientific, clinical and cost-effectiveness data for the use of our products to each payor. We may not be able to provide data sufficient to obtain reimbursement.

Eligibility for coverage does not imply that any drug product will be reimbursed in all cases or at a rate that allows us to make a profit. Interim payments for new products, if applicable, may also not be sufficient to cover our costs and may not become permanent. Reimbursement rates may vary according to the use of the drug and the clinical setting in which it is used, may be based on payments allowed for lower-cost drugs that are already reimbursed, may be incorporated into existing payments for other products or services, and may reflect budgetary constraints and/or Medicare or Medicaid data used to calculate these rates. Net prices for products also may be reduced by mandatory discounts or rebates required by government health care programs or by any future relaxation of laws that restrict imports of certain medical products from countries where they may be sold at lower prices than in the United States.

The health care industry is experiencing a trend toward containing or reducing costs through various means, including lowering reimbursement rates, limiting therapeutic class coverage and negotiating reduced payment schedules with service providers for drug products. The Medicare Prescription Drug, Improvement and Modernization Act of 2003, or MMA, became law in November 2003 and created a broader prescription drug benefit for Medicare beneficiaries. The MMA also contains provisions intended to reduce or eliminate delays in the introduction of generic drug competition at the end of patent or nonpatent market exclusivity. The impact of the MMA on drug prices and new drug utilization over the next several years is unknown. The MMA also made adjustments to the physician fee schedule and the measure by which prescription drugs are presently paid, changing from Average Wholesale Price to Average Sales Price. The effects of these changes are unknown but may include decreased utilization of new medicines in physician prescribing patterns, and further pressure on drug company sponsors to provide discount programs and reimbursement support programs. There have been, and we expect that there will continue to be, federal and state proposals to constrain expenditures for medical products and services, which may affect reimbursement levels for our future products. In addition, the Centers for Medicare and Medicaid Services frequently change product descriptors, coverage policies, product and service codes, payment methodologies and reimbursement values. Third-party payors often follow Medicare coverage policy and payment limitations in setting their own reimbursement rates and may have sufficient market power to demand significant price reductions.

Foreign governments tend to impose strict price controls, which may adversely affect our future profitability.

In some foreign countries, particularly in the European Union, prescription drug pricing is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take considerable time after the receipt of marketing approval for a product. To obtain reimbursement or pricing approval in some countries, we may be required to conduct a clinical trial that compares the cost-effectiveness of our product candidate to other available therapies. If reimbursement of our products is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, our profitability will be negatively affected.

We may incur significant costs complying with environmental laws and regulations, and failure to comply with these laws and regulations could expose us to significant liabilities.

Our research and development activities use biological and hazardous materials that are dangerous to human health and safety or the environment. We are subject to a variety of federal, state and local laws and regulations governing the use, generation, manufacture, storage, handling and disposal of these materials and wastes

resulting from these materials. We are also subject to regulation by the Occupational Safety and Health Administration, or OSHA, the California and federal environmental protection agencies and to regulation under the Toxic Substances Control Act. OSHA or the California or federal Environmental Protection Agency, or EPA, may adopt regulations that may affect our research and development programs. We are unable to predict whether any agency will adopt any regulations that could have a material adverse effect on our operations. We have incurred, and will continue to incur, capital and operating expenditures and other costs in the ordinary course of our business in complying with these laws and regulations.

Although we believe our safety procedures for handling and disposing of these materials comply with federal, state and local laws and regulations, we cannot entirely eliminate the risk of accidental injury or contamination from the use, storage, handling or disposal of hazardous materials. In the event of contamination or injury, we could be held liable for any resulting damages, and any liability could significantly exceed our insurance coverage.

We may not be able to conduct, or contract with others to conduct, animal testing in the future, which could harm our research and development activities.

Certain laws and regulations relating to drug development require us to test our product candidates on animals before initiating clinical trials involving humans. Animal testing activities have been the subject of controversy and adverse publicity. Animal rights groups and other organizations and individuals have attempted to stop animal testing activities by pressing for legislation and regulation in these areas and by disrupting these activities through protests and other means. To the extent the activities of these groups are successful, our research and development activities may be interrupted or delayed.

RISKS RELATED TO OUR COMMON STOCK

The price of our common stock has been and may continue to be volatile.

The stock markets in general, the markets for biotechnology stocks and, in particular, the stock price of our common stock, have experienced extreme volatility.

Price declines in our common stock could result from general market and economic conditions and a variety of other factors, including:

- adverse results or delays in our clinical trials;
- announcements of FDA non-approval of our product candidates, or delays in the FDA or other foreign regulatory agency review process;
- adverse actions taken by regulatory agencies with respect to our product candidates, clinical trials, manufacturing processes or sales and marketing activities;
- announcements of technological innovations, patents or new products by our competitors;
- regulatory developments in the United States and foreign countries;
- any lawsuit involving us or our product candidates;
- announcements concerning our competitors, or the biotechnology or pharmaceutical industries in general;
- developments concerning any strategic alliances or acquisitions we may enter into;
- actual or anticipated variations in our operating results;
- changes in recommendations by securities analysts or lack of analyst coverage;
- deviations in our operating results from the estimates of analysts;

- sales of our common stock by our executive officers, directors and five percent stockholders or sales of substantial amounts of common stock;
- changes in accounting principles; and
- loss of any of our key scientific or management personnel.

In the past, following periods of volatility in the market price of a particular company's securities, litigation has often been brought against that company. If litigation of this type is brought against us, it could be extremely expensive and divert management's attention and our company's resources.

If our officers, directors and largest stockholders choose to act together, they may be able to control our management and operations, acting in their best interests and not necessarily those of other stockholders.

As of February 28, 2007, our officers, directors and holders of 5% or more of our outstanding common stock beneficially own approximately 50.4% of our common stock. As a result, these stockholders, acting together, will be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions. The interests of this group of stockholders may not always coincide with the interests of other stockholders, and they may act in a manner that advances their best interests and not necessarily those of other stockholders.

Our certificate of incorporation, our bylaws and Delaware law contain provisions that could discourage another company from acquiring us and may prevent attempts by our stockholders to replace or remove our current management.

Provisions of Delaware law, where we are incorporated, our certificate of incorporation and bylaws may discourage, delay or prevent a merger or acquisition that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace or remove our board of directors. These provisions include:

- authorizing the issuance of "blank check" preferred stock without any need for action by stockholders;
- providing for a classified board of directors with staggered terms;
- requiring supermajority stockholder voting to effect certain amendments to our certificate of incorporation and bylaws;
- eliminating the ability of stockholders to call special meetings of stockholders;
- prohibiting stockholder action by written consent; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

In addition, in August 2006, our board of directors adopted a preferred shares rights agreement, the provisions of which could make it more difficult for a potential acquirer to consummate a transaction without the approval of our board of directors.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We sublease approximately 33,700 square feet of laboratory and office space in Redwood City, California under an agreement that terminates in February 2010. We lease an additional 6,489 square feet of laboratory space in Redwood City, California under an agreement that terminates in February 2010. On February 3, 2006, we entered into a lease for additional 34,205 square feet of office space at our Redwood City headquarters that terminates in 2011 and extends our lease on the current space to 2011. We believe these facilities are suitable and adequate for our current needs.

ITEM 3. LEGAL PROCEEDINGS

We are not currently involved in any legal proceedings that could have a material impact on our business or financial condition. We are subject to various routine claims and legal proceedings that arise in the ordinary course of business.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote for our stockholders, through solicitation of proxies or otherwise, in the fourth quarter of our fiscal year ended December 31, 2006.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock has been traded on the NASDAQ Global Market under the symbol "THLD" since February 4, 2005. Prior to that time there was no public market for our stock. The following table lists quarterly information on the price range of our common stock based on the high and low reported sale prices for our common stock as reported by The NASDAQ Global Market for the periods indicated below. These prices do not include retail markups, markdowns or commissions.

	<u>High</u>	<u>Low</u>
Year Ended December 31, 2006:		
First Quarter	\$15.69	\$12.80
Second Quarter	\$16.98	\$ 3.00
Third Quarter	\$ 3.66	\$ 1.42
Fourth Quarter	\$ 4.23	\$ 2.46
Year Ended December 31, 2005:		
First Quarter (from February 4, 2005)	\$ 7.50	\$ 5.37
Second Quarter	\$ 8.50	\$ 5.40
Third Quarter	\$14.09	\$ 7.93
Fourth Quarter	\$15.43	\$ 8.77

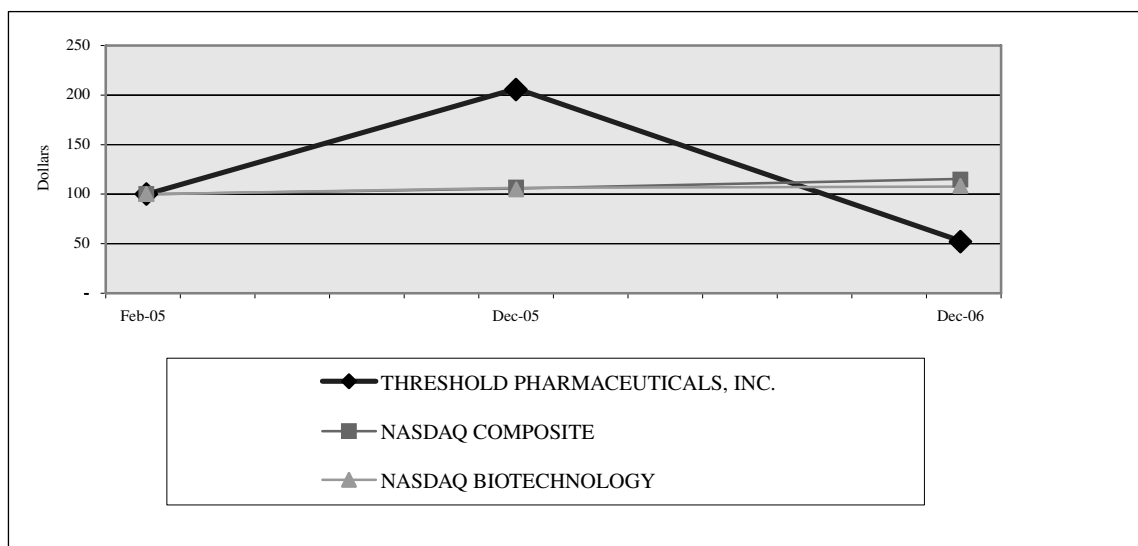
We estimate that there were approximately 92 holders of record of our common stock as of February 28, 2007.

Dividends

We have never declared or paid any dividends on our capital stock. We currently intend to retain any future earnings to fund the development and expansion of our business, and therefore we do not anticipate paying cash dividends on our common stock in the foreseeable future. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our financial condition, results of operations, capital requirements, restrictions contained in future financing instruments and other factors our board of directors deems relevant.

Performance Graph

The following graph compares the cumulative total stockholder return data for the Company's stock since February 4, 2005 (the date on which the Company's stock was first registered under Section 12 of the Securities Exchange Act of 1934, as amended) to the cumulative return over such period of (i) the Nasdaq Composite Index and (ii) the Nasdaq Biotechnology Index. The graph assumes that \$100 was invested on February 4, 2005, the date on which the Company completed the initial public offering of its common stock, in the common stock of the Company and in each of the comparative indexes. The graph further assumes that such amount was initially invested in the common stock of the Company at a per share price of \$7.00, the price to which such stock was first offered to the public by the Company on the date of its initial public offering, and reinvestment of any dividends. The stock price performance on the following graph is not necessarily indicative of future stock price performance.



	<u>02/04/05</u>	<u>12/30/05</u>	<u>12/29/06</u>
Threshold Pharmaceuticals, Inc.	100.00	206.43	52.86
Nasdaq Composite	100.00	105.69	115.75
Nasdaq Biotechnology	100.00	106.54	107.63

Recent Sales of Unregistered Securities

None.

Use of Proceeds From Sale of Registered Securities

(b) In connection with our initial public offering on February 4, 2005, Registration No. 333-114376, we sold 6,112,601 shares of our common stock for net offering proceeds to us after deducting expenses totaling \$38.1 million. As of March 31, 2006, we used approximately \$39.3 million, which included all of the net proceeds of our initial public offering, including approximately \$25.8 million for the clinical development of glufosfamide, TH-070 and 2DG, \$6.2 million for research and development of additional product candidates, and approximately \$7.3 million for working capital, capital expenditures and other general corporate purposes.

(c) Issuer Purchases of Equity Securities

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Period	(a) Total number of shares (or Units) Purchased*	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
10/01/2005 to 10/31/2006 . . .	91,373	\$0.53	—	—
11/01/2006 to 11/30/2006 . . .	—	\$ —	—	—
12/01/2006 to 12/31/2006 . . .	3,480	\$0.53	—	—

* Shares repurchased from former employees upon termination of their employment pursuant to our contractual repurchase rights under the terms of the 2004 Amended and Restated Equity Incentive Plan.

Equity Compensation Plans

The following table provides certain information with respect to all of our equity compensation plans in effect as of December 31, 2006:

	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by stockholders . . .	2,074,801	\$2.60	2,853,712
Equity compensation plans not approved by stockholders	—	—	—
Total	2,074,801	\$2.60	2,853,712(1)(2)

- (1) Includes 922,377 shares of common stock issuable under our 2004 Employee Stock Purchase Plan.
- (2) On January 1, 2006, and annually thereafter, the authorized shares for the 2004 Equity Incentive Plan will automatically be increased by a number of shares equal to the lesser of:
 - 5% of the number of the Company's shares issued and outstanding prior to the preceding December 31;
 - 1,214,402 shares; or
 - an amount determined by the Board of Directors.

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ITEM 6. SELECTED FINANCIAL DATA

We are a development stage company. The following selected statement of operations data for the years ended December 31, 2006, 2005, and 2004 and balance sheet data as of December 31, 2006 and 2005 have been derived from our audited financial statements included elsewhere in this Annual Report on Form 10-K. The following selected statement of operations data for years ended December 31, 2003 and 2002, and balance sheet data as of December 31, 2004, 2003 and 2002 are derived from our audited financial statements not included in this Annual Report on Form 10-K. The selected financial data set forth below have been prepared in accordance with accounting principles generally accepted in the United States of America and should be read together with our financial statements and the related notes to those financial statements, as well as "Management's Discussion and Analysis of Financial Condition and Results of Operations," appearing elsewhere in this Annual Report on Form 10-K. As discussed in Note 9 in Item 8 "Financial Statements and Supplementary Data", on January 1, 2006, the Company began accounting for stock options and stock purchase rights under the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payments" ("SFAS 123(R)"), which requires the recognition of the fair value of stock-based compensation.

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
Revenue	\$ 1,461	\$ 690	\$ —	\$ —	\$ —
Operating expenses:					
Research and development (1)	46,267	35,991	16,327	6,252	2,179
General and administrative (1)	14,453	11,235	7,649	2,057	306
Total operating expenses	60,720	47,226	23,976	8,309	2,485
Loss from operations	(59,259)	(46,536)	(23,976)	(8,309)	(2,485)
Interest and other income, net	3,729	2,159	443	65	27
Interest expense	(156)	(31)	(33)	(59)	—
Net loss	(55,686)	(44,408)	(23,566)	(8,303)	(2,458)
Dividend related to beneficial conversion feature of redeemable convertible preferred stock	—	—	—	(40,862)	—
Net loss attributable to common stockholders	<u>(55,686)</u>	<u>\$(44,408)</u>	<u>\$(23,566)</u>	<u>\$(49,165)</u>	<u>\$(2,458)</u>
Net loss per common share:					
Basic and diluted	<u>\$ (1.53)</u>	<u>\$ (1.63)</u>	<u>\$ (20.25)</u>	<u>\$(501.68)</u>	<u>\$(34.62)</u>
Weighted average number of shares used in per common share calculations:					
Basic and diluted	<u>36,337</u>	<u>27,173</u>	<u>1,164</u>	<u>98</u>	<u>71</u>
(1) Includes employee and non-employee non-cash stock-based compensation of:					
Research and development	\$ 5,008	\$ 5,951	\$ 2,960	\$ 313	\$ 21
General and administrative	\$ 5,141	3,470	3,015	753	1

	As of December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Balance Sheet Data:					
Cash, cash equivalents and marketable securities	\$52,810	\$ 99,654	\$ 28,665	\$40,818	\$ 6,260
Working capital	43,698	90,655	21,967	40,177	6,154
Total assets	57,034	102,101	32,213	41,270	6,726
Notes payable, less current portion	1,247	151	382	242	—
Total liabilities	12,796	12,733	8,847	1,126	416
Redeemable convertible preferred stock	—	—	49,839	49,839	8,977
Total stockholders' equity(deficit)	44,238	89,368	(26,473)	(9,695)	(2,667)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties, including those set forth under the heading "Risk Factors" and elsewhere in this Annual Report on Form 10-K. Our actual results and the timing of selected events discussed below could differ materially from those expressed in, or implied by, these forward-looking statements.

Overview

We are a biotechnology company focused on the discovery and development of drugs based on Metabolic Targeting, an approach that targets fundamental differences in metabolism between normal and certain diseased cells. Two of our product candidates were designed to utilize Metabolic Targeting through the potential targeting of the increased uptake of glucose in cancer cells relative to most normal cells. These product candidates, glufosfamide and 2-deoxyglucose ("2DG"), share certain structural characteristics with glucose but act instead as poisons when taken up by a cancer cell. Our other product candidate, TH-302, and the other compounds our scientists are creating and testing in our laboratories, use Metabolic Targeting by targeting the decreased blood supply and oxygenation of most tumor tissues relative to normal tissue. These compounds are relatively non-toxic when oxygen is present, as in healthy tissues, but undergo a chemical conversion in the presence of low levels of oxygen that converts them into toxic compounds that may kill cancer cells. This pipeline of drug candidates is designed to target tumor cells selectively, and we believe that our drugs could be more efficacious and less toxic to healthy tissues than conventional drugs, and thereby provide significant improvement over current therapies.

Our initial clinical focus is on product candidates for the treatment of cancer. We have three product candidates for which we have exclusive worldwide marketing rights:

- Glufosfamide is our lead product candidate for the potential treatment of cancer. We initiated a pivotal Phase 3 clinical trial of glufosfamide for the second-line treatment of pancreatic cancer in September 2004, and completed enrollment in August 2006. In February 2007, we announced that this Phase 3 clinical trial failed to reach its primary endpoint of survival benefit for patients with metastatic pancreatic cancer that have relapsed following chemotherapy with gemcitabine. In July 2006, we completed enrollment in the Phase 2 stage of a study of glufosfamide plus gemcitabine for the first-line treatment of pancreatic cancer. Top line results were announced in December 2006 and, final results are expected in third quarter of 2007. We have initiated Phase 2 trials of glufosfamide in platinum-resistant ovarian and recurrent sensitive small cell lung cancer, and plan to initiate a Phase 2 trial in soft-tissue sarcoma in the first half of 2007. Enrollment in these trials is expected to be completed in 2007, with results reported in 2008.
- 2-deoxyglucose, or 2DG, our second product candidate for the potential treatment of cancer, is being evaluated in a Phase 1 clinical trial alone and in combination with docetaxel as a combination therapy. This trial began in the first quarter of 2004 and we expect to complete enrollment for this trial in the first half of 2007. Top-line results are expected in the third quarter of 2007.
- TH-302 is a hypoxically activated prodrug for the potential treatment of solid tumors, and is in late-stage preclinical testing. TH-302 was discovered by Threshold, is a novel drug candidate that is activated under the metabolic conditions typical of certain cancer cells. If the preclinical tests are supportive we plan to file an IND with the FDA in the first half of 2007.

We also are working to discover novel drug candidates that will specifically target cancer cells and are actively seeking to in-license other promising compounds or programs.

We are a development stage company incorporated in October 2001. We have devoted substantially all of our resources to research and development of our product candidates. We have not generated any revenue from the sale of our product candidates, and, prior to our initial public offering in February 2005, we funded our operations through the private placement of equity securities. In February 2005, we completed our initial public offering that raised net proceeds of \$38.1 million, and in October 2005, we completed an offering of common stock that raised net proceeds of \$62.4 million. As of December 31, 2006 we had cash, cash equivalents, and marketable securities of \$52.8 million. The net loss for 2006 was \$55.7 million and the cumulative net loss since our inception through December 31, 2006 was \$134.7 million.

In July 2006, we announced we were discontinuing development of TH-070 for benign prostatic hyperplasia (“BPH”) based on safety and efficacy results of recently concluded Phase 2 and Phase 3 trials. In August, 2006, we adopted a plan to reduce our operating expenses, which included eliminating 29 full-time employees, or approximately a 35% reduction in staff affecting all areas of the Company. As a result of the staffing reduction we incurred severance benefits of approximately \$1.0 million in the third quarter of 2006. Annual cash savings from the reduction in salary and benefit expenses are estimated to be approximately \$4.0 million. We also expect additional savings in certain non employee-related costs.

We expect to continue to incur losses from operations in the future. We expect that expenses will decrease in 2007 compared to 2006 due to a reduced workforce and smaller clinical trials, and that our cash, cash equivalents and marketable securities will be sufficient to fund our projected operating requirements through at least mid-2008, including completing our current and planned clinical trials and conducting research and discovery efforts toward additional product candidates. Research and development expenses may fluctuate significantly from period to period as a result of the progress and results of our clinical trials.

Revenue

We have not generated any revenue from the sale of our product candidates since our inception and do not expect to generate any revenue from the sale of our product candidates at least within the next couple of years. Through 2006, we recognized \$2.2 million in revenue related to a \$5.0 million upfront payment received in connection with a 2004 agreement with MediBIC Co., Ltd., or MediBIC, for the development of glufosfamide in Japan and several other Asian countries. The payment was contingent upon the finalization of the clinical development plan, which occurred in July 2005. Revenue is being recognized on a straight-line basis over the estimated development period, currently estimated to continue through 2008. We are responsible for all development activities under this agreement.

Research and Development Expenses

Research and development expenses consist primarily of costs of conducting clinical trials, salaries and related costs for personnel including non-cash stock-based compensation, costs of clinical materials, costs for research projects and preclinical studies, costs related to regulatory filings, and facility costs. Contracting and consulting expenses are a significant component of our research and development expenses as we rely on consultants and contractors in many of these areas. We recognize expenses as they are incurred. Our accruals for expenses associated with preclinical and clinical studies and contracts associated with clinical materials are based upon the terms of the service contracts, the amount of services provided and the status of the activities. We expect annual research and development expenses will decrease significantly in the future as we progress with a reduced workforce and smaller clinical trials. From inception through December 31, 2006, we incurred an aggregate of \$107.1 million on research and development expenses, including non-cash stock-based compensation expense.

General and Administrative Expenses

General and administrative expenses consist primarily of salaries and related costs for our personnel in the executive, finance, patent, accounting and other administrative functions, including non-cash stock-based compensation, as well as consulting costs for functions for which we either do not staff or only partially staff, including

public relations, market research and recruiting. Other costs include professional fees for legal and accounting services, insurance and facility costs. From inception through December 31, 2006, we incurred an aggregate of \$35.9 million on general and administrative expenses, including non-cash stock-based compensation expense.

Stock-Based Compensation

Prior to January 1, 2006, we used the intrinsic method of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), in accounting for employee stock options, and present disclosure of pro forma information required under SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123" ("SFAS No. 148"). For stock options granted to employees no compensation expense was recognized unless the exercise price was less than fair market value at the date of grant. Stock-based compensation expense was recognized under APB No. 25 for options granted prior to the Company's initial public offering of its common stock in February 2005 based upon the intrinsic value (the difference between the exercise price at the date of grant and the deemed fair value of the common stock based on the anticipated initial public offering stock price.) In anticipation of our initial public offering which was completed in February 2005, we determined that, for accounting purposes, the deemed fair value of our common stock was greater than the exercise price for certain options. As a result, we have recorded deferred stock-based compensation for these options of \$0.5 million, \$20.4 million and \$2.3 million for the years ended December 31, 2005, 2004 and 2003, respectively. This expense, which is a non-cash charge, has been amortized over the period in which the options vest, which is generally four years. The amortization of this expense recognized for the years ended December 31, 2006, 2005 and 2004 was \$4.4 million, \$5.3 million and \$5.3 million, respectively. Beginning January 1, 2006, we began accounting for stock-based compensation using the fair value method prescribed by SFAS No. 123 "Share-Based Payment.—An Amendment of FASB Statements No. 123 and 95" ("SFAS No. 123R"), issued by the Financial Accounting Standards Board in December 2004. Refer to the discussion of accounting treatment of stock based compensation below under ***Critical Accounting Policies***.

Results of Operations for the Years Ended December 31, 2006 and 2005

Revenue

For the years ended December 31, 2006 and 2005, we recognized \$1.5 million and \$0.7 million in revenue related to a \$5.0 million upfront payment received in connection with a 2004 agreement with MediBIC for the development of glufosfamide in Japan and several other Asian countries. Revenue is being recognized on a straight-line basis over the estimated development period, currently estimated to be through 2008. We are responsible for all development activities under this agreement.

Research and Development

Research and development expenses were \$46.3 million for the year ended December 31, 2006 compared to \$36.0 million for the year ended December 31, 2005. The \$10.3 million increase in expenses is due to a \$6.1 million increase in clinical and development expenses and \$4.6 million in higher staffing and facilities expenses, including \$0.6 million in severance expense related to staff reductions. In addition, stock-based compensation expense decreased by \$0.9 million primarily due to a \$3.4 million decrease in non-employee stock based compensation expense and amortization of our deferred stock compensation charge partially offset by a \$2.5 million increase in employee stock based compensation as result of our adoption of SFAS 123(R) beginning January 1, 2006.

Research and development expenses by project (in thousands)

	<u>Year ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Glufosfamide	\$17,018	\$12,009	\$ 7,522
TH-070	15,647	13,842	3,269
TH-302	2,410	—	—
2DG	1,640	2,498	2,897
Discovery research	9,552	7,642	2,639
Total research and development expenses	<u>\$46,267</u>	<u>\$35,991</u>	<u>\$16,327</u>

Research and development expenses associated with glufosfamide were \$17.0 million for the 2006 and \$12.0 million for 2005. This increase is due to a \$3.3 million increase in clinical and manufacturing expenses and a \$1.5 million increase in staffing expenses. Research and development expenses associated with TH-070 were \$15.6 million for 2006 and \$13.9 million for the 2005. This increase in expenses was due to an increase of \$2.7 million in expenses associated with our Phase 2 United States trial (initiated in June 2005) and our EU Phase 3 trial (initiated in August 2005). These increases were partially offset by \$0.7 million in lower stock based compensation and staffing expenses for the TH-070 project. Research and development expenses associated with our internally discovered compound TH-302 were \$2.4 million in 2006, as the compound progressed through preclinical studies. Research and development expenses associated with 2DG were \$1.6 million for 2006 and \$2.5 million for 2005. This decline was primarily due to lower clinical expenses. Discovery research and development expenses were \$9.6 million for 2006 and \$7.6 million for 2005. The \$2.0 million increase was primarily due to increases in staffing costs to support expansion of our discovery research programs.

We did not track research and development expenses by project prior to 2003, and therefore we cannot provide cumulative project expenses to date. Due to the risks and uncertainties involved in discovering and developing product candidates, such as clinical trial results, regulatory approval requirements, dependence on third parties and market acceptance, all of which are described in "Risk Factors", we cannot reasonably estimate the costs and timing of completion of each project or when any project will result in net cash inflows.

We expect to continue to devote substantial resources to research and development in future periods as we continue our current clinical trials, start additional trials and continue our discovery efforts. Research and development expenses are expected to decrease in 2007 compared to 2006 due to a smaller clinical trials and a reduced workforce.

General and Administrative

General and administrative expenses were \$14.5 million for 2006, compared to \$11.2 million for 2005. The \$3.3 million increase reflects \$1.4 million increase in staffing expenses including \$0.4 million in severance expense related to staff reductions, an increase in stock-based compensation expenses of \$1.7 million primarily due to the adoption of SFAS 123(R) and additional expenses associated with being a public company.

We currently expect our general and administrative expenses to decrease in 2007 due to lower salary and benefit related expenses as a result of 2006 staff reductions and no anticipated material changes in administrative and infrastructure costs.

Interest and Other Income

Interest income for 2006 was \$3.7 million compared to \$2.2 million for 2005. The increase was primarily due to higher invested cash balances and higher average interest rates during 2006 compared to the prior year due to proceeds received from our follow-on offering completed in October 2005.

Interest Expense

Interest expense for the years ended December 31, 2006 and 2005 was \$0.2 million and \$31,000, respectively, reflecting the increase in the balance of our note payable due to \$2.6 million of borrowing in 2006 against our amended loan and security agreement.

Results of Operations for the Years Ended December 31, 2005 and 2004

Revenue

For the year ended December 2005, we recognized \$0.7 million in revenue related to a \$5.0 million upfront payment received in connection with a 2004 agreement with MediBIC for the development of glufosfamide in

Japan and several other Asian countries. The payment was contingent upon the finalization of the clinical development plan, which occurred in July 2005. Revenue is being recognized on a straight-line basis over the estimated development period or through 2008.

Research and Development

Research and development expenses were \$36.0 million for the year ended December 31, 2005 compared to \$16.3 million for the year ended December 31, 2004. The \$19.7 million increase in expenses is due to a \$12.2 million increase in clinical and development expenses, a \$3.4 million increase in expenses associated with higher staffing levels, a \$3.0 million increase in non-cash stock-based compensation expense and a \$1.1 million increase in expenses related to new facilities.

Research and development expenses associated with TH-070 were \$13.9 million for 2005 compared to \$3.3 million for 2004. This \$10.6 million increase in expenses was primarily due to the initiation of our Phase 2 United States and Phase 3 European trials and an increase in staffing and related expenses. Research and development expenses associated with glufosfamide were \$12.0 million and \$7.5 million for 2005 and 2004, respectively. This increase is primarily due to expenses associated with the Phase 3 clinical trial. Research and development expenses associated with 2DG were \$2.5 million and \$2.8 million for 2005 and 2004, respectively. The decrease is primarily attributable to a reduction in 2DG project staffing and related costs. Discovery research and development expenses were \$7.6 million and \$2.7 million for 2005 and 2004, respectively. The increase was primarily due to increases in staffing and related costs to support expansion of our discovery research program.

General and Administrative

General and administrative expenses were \$11.2 million and \$7.6 million for the years ended December 31, 2005 and 2004, respectively. The \$3.6 million increase in general and administrative expenses primarily reflects additional expenses associated with becoming a public company in 2005, including \$1.2 million of higher legal fees, insurance premiums, and consulting services; and \$1.2 million of expenses related to higher staffing levels. Additionally, the increase in general and administrative expenses in 2005 compared to 2004 was due to \$0.7 million of increased patent expenses and a \$0.5 million increase in non-cash stock-based compensation expenses.

Interest and Other Income

Interest income for the year ended December 31, 2005 was \$2.2 million compared to \$0.4 million for the year ended December 31, 2004. The increase was due to greater invested cash balances due to proceeds received from our initial public offering completed in February 2005 and our follow-on offering completed in October 2005, as well as higher average interest rates in 2005.

Interest Expense

Interest expense for the years ended December 31, 2005 and 2004 was \$31,000 and \$33,000, respectively, reflecting the declining balance of our note payable.

Liquidity and Capital Resources

We have incurred net losses since inception through December 31, 2006 of \$134.7 million. We have not generated any product revenues and do not expect to generate revenue from the sale of product candidates at least within the next couple of years. From inception until our initial public offering in February 2005, we funded our operations primarily through the private placement of our preferred stock. In February 2005, we completed our initial public offering of 6,112,601 shares of our common stock, raising net proceeds of \$38.1 million. In October 2005, we completed a public offering of 6,399,222 shares of our common stock for net proceeds of \$62.4 million.

At December 31, 2006, we had cash, cash equivalents and marketable securities of \$52.8 million compared to \$99.7 million and \$28.7 million at December 31, 2005 and 2004, respectively.

Net cash used in operating activities for the years ended December 31, 2006, 2005 and 2004 was \$46.4 million, \$29.9 million and \$10.8 million, respectively. For the year ended December 31, 2006, cash used in operations resulted from the net loss for the year after adding back non-cash charges for stock-based compensation expense, depreciation expenses and deferred revenue. For the year ended December 31, 2005, cash used in operations resulted from the net loss for the year after adding back non-cash charges for stock-based compensation expense, additional accruals for clinical and development expenses and personnel-related expenses, depreciation expense and deferred revenue. For the year ended December 31, 2004 cash used in operations was attributable to our net loss after adjustments for non-cash charges related to the amortization of deferred stock-based compensation, an increase in accrued liabilities for clinical trials and staffing, and the receipt of a research and development contract advance under our development agreement with MediBIC.

Net cash used in investing activities of \$2.4 million, \$11.5 million and \$15.4 million for the years ended December 31, 2006, 2005 and 2004, respectively, was primarily used for purchases of marketable securities of \$42.9 million, \$38.9 million and \$38.2 million in 2006, 2005 and 2004, respectively, capital spending of \$2.4 million, \$1.2 million and \$1.0 million in 2006, 2005 and 2004, respectively, partially offset by sales of marketable securities of \$43.2 million, \$28.4 million and 24.0 million in 2006, 2005 and 2004, respectively.

Net cash provided by financing activities was \$2.3 million for the year ended December 31, 2006, which was primarily attributable to borrowings under a loan and security agreement, net of repayments and to lesser extent cash from stock option exercises and sale stock under the employee stock purchase plan. Net cash provided by financing activities was \$102.0 million for the year ended December 31, 2005, primarily from the two public offerings completed during the year: our initial public offering that was completed in February and raised \$38.1 million of net proceeds, and our follow-on offering that was completed in October and raised \$62.4 million of net proceeds. Net cash used by financing activities was \$0.1 million for the year ended December 31, 2004, primarily for deferred costs related to the initial public offering in February 2005, which were partially offset by borrowings under a loan agreement, net of repayments.

We expect 2007 cash requirements to be in the range of \$30.0 million to \$35.0 million. We believe that our cash, cash equivalents and marketable securities as of December 31, 2006 will be sufficient to fund our projected operating requirements through at least mid-2008, including completing our current and planned trials, conducting research and discovery efforts towards additional product candidates, working capital and general corporate purposes. Additional funds will be required to in-license or otherwise acquire and develop additional products or programs. We intend to seek funds through arrangements with collaborators or others that may require us to relinquish rights to certain product candidates that we might otherwise seek to develop or commercialize independently. Additionally, we may need or choose to raise additional capital or incur indebtedness to continue to fund our operations in the future. Our ability to raise additional funds will depend on our clinical and regulatory events, our ability to identify promising in-licensing opportunities, and factors related to financial, economic, and market conditions, many of which are beyond our control. We cannot be certain that sufficient funds will be available to us when required or on satisfactory terms. If necessary funds are not available, we may have to delay, reduce the scope or eliminate some of our research and development, which could delay the time to market for any of our product candidates.

Obligations and Commitments

In March 2003, we entered into a loan and security agreement with a financial institution to borrow up to \$1.0 million for working capital and equipment purchases. As of December 31, 2004, we had borrowed the full amount under this facility, which is being repaid over a 36-month period from the dates of borrowing. These borrowings bear interest at an average rate of 5.8% per year at December 31, 2006. In April 2006, we amended the existing loan and security agreement to borrow up to an additional \$4.0 million for working capital and equipment purchases. The interest rate for borrowings under this facility will be determined based on the 36-month U.S. Treasury note plus 2.25% on the date of borrowing. We borrowed \$2.6 million under this facility, which will be repaid over a 36-month period from the date of borrowing. The interest rate on these borrowings was approximately 7.2% per annum. At December 31, 2006, the total amount due under this facility was

\$2.5 million. We may borrow up to an additional \$1.4 million for equipment purchases. The amended agreement requires us to maintain the lower of 85% of our total cash and cash equivalents or \$10.0 million at the financial institution. At December 31, 2006, we were in compliance with this covenant.

In August 2004, we entered into a noncancelable facilities sublease agreement that expires on February 28, 2010 for our headquarters in Redwood City, California. On April 1, 2005, we entered into a noncancelable facilities lease agreement that expires on February 28, 2010 for additional laboratory space in Redwood City, California.

In February 2006, we entered into a lease for an additional 34,205 square feet of space and increased the lease term for the existing space located at our headquarters in Redwood City, California to September 30, 2011. The lease is for a period of 66 months, beginning on April 1, 2006 with respect to the additional square footage and will begin on March 1, 2010 with respect to the existing square footage. The lease will expire, unless otherwise terminated under the terms of the lease, on September 30, 2011. The aggregate rent for the term of the lease is approximately \$4.8 million.

In addition, the lease requires us to pay certain taxes, assessments, fees and other costs and expenses associated with the premises as well as a customary management fee. We are also responsible for the costs of certain tenant improvements associated with the leased space. In connection with the lease, we furnished a letter of credit to the landlord for approximately \$0.3 million.

Our major outstanding contractual obligations consist of amounts due under our financing and lease agreements, and purchase commitments. Contractual obligations and related scheduled payments as of December 31, 2006, are as follows (in thousands):

	<u>Within one year</u>	<u>One to three years</u>	<u>Four to five years</u>	<u>After five years</u>	<u>Total</u>
Facilities sublease and lease	\$1,232	\$2,756	\$2,591	\$—	\$ 6,579
Notes payable, principal and interest	1,127	1,313	—	—	2,440
Purchase commitments	1,581	—	—	—	1,581
Total	<u>\$3,940</u>	<u>\$4,069</u>	<u>\$2,591</u>	<u>\$—</u>	<u>\$10,600</u>

In November 2004, we entered into an agreement with MediBIC to develop glufosfamide in Japan and several other Asian countries, and received an upfront payment of \$5.0 million contingent upon the finalization of the clinical development plan. In July 2005, we finalized the development plan with MediBIC and began recognizing revenue from the upfront payment on a straight-line basis over the development period, currently estimated to be through 2008. We are responsible for all development activities under this agreement. We will also be required to make royalty payments upon product commercialization. We may terminate the agreement at any time by making certain payments ranging from \$7.0 million to \$15.0 million, depending on the stage of development of the glufosfamide product in Japan.

In August 2003, we entered into an agreement with Baxter International and Baxter Healthcare S.A., together Baxter, for the licensing and development of glufosfamide. Under this agreement, we paid Baxter an upfront license fee of \$0.1 million and a \$0.1 million development milestone in 2003. We also made a development milestone payment of \$1.3 million in November 2004 and we are obligated to make certain additional development milestone payments, with the next payment due in connection with the filing of a new drug application with the FDA for glufosfamide. We will be required to make a milestone payment of \$1.0 million within 30 days of filing an NDA for glufosfamide with the FDA. Future milestone payments in connection with the development of glufosfamide and United States and foreign regulatory submissions could total up to \$8.0 million, and sales-based milestone payments could total up to \$17.5 million. Following regulatory approval, we will be obligated to pay up to mid-single digit royalties to Baxter based on sales of glufosfamide products. We cannot be certain when, if ever, we will have to make development or sales-based milestone or royalty payments to Baxter.

Under our license agreement with Dr. Theodore J. Lampidis and Dr. Waldemar Priebe for rights under a patent and certain patent applications that generally cover the treatment of cancer with 2DG in combination with certain other cancer drugs, we are obligated to make certain milestone payments, including milestone payments of up to \$0.7 million in connection with the filing and approval of an NDA for the first product covered by the licensed patents, as well as royalties based on sales of such products. We cannot be certain when, if ever, we will have to make these milestone or royalty payments.

Off-Balance Sheet Arrangements

As of December 31, 2006, 2005 and 2004, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. Therefore, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

Income Taxes

We incurred net operating losses for the years ended December 31, 2006, 2005, and 2004 and, accordingly, we did not pay any federal or state income taxes. As of December 31, 2006, we had accumulated approximately \$102.0 million in both federal and state net operating loss carryforwards to reduce future taxable income. If not utilized, our federal and state net operating loss carryforwards begin to expire in 2021 and 2013 for federal and state tax purposes, respectively. Our net operating loss carryforwards are subject to certain limitations on annual utilization in case of changes in ownership, as defined by federal and state tax laws.

At December 31, 2006, we had research credit carryforwards of approximately \$3.3 million and \$2.9 million for federal and California state income tax purposes, respectively. If not utilized, the federal carryforwards will expire in 2021 through 2026. The California state research credit can be carried forward indefinitely.

We have not recorded a benefit from our net operating loss or research credit carryforwards because we believe that it is uncertain that we will have sufficient income from future operations to realize the carryforwards prior to their expiration. Accordingly, we have established a valuation allowance against the deferred tax asset arising from the carryforwards.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and related disclosures. We review our estimates on an ongoing basis. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. While our significant accounting policies are described in more detail in the notes to our consolidated financial statements included in this Annual Report on Form 10-K, we believe the following accounting policies to be critical to the judgments and estimates used in the preparation of our consolidated financial statements.

Stock-Based Compensation

Beginning on January 1, 2006, we began accounting for stock options and stock purchase rights related to our 2004 Employee Stock Purchase Plan under the provisions of SFAS 123(R), which requires the recognition of the fair value of stock-based compensation. The fair value of stock options and ESPP shares was estimated using a Black-Scholes option valuation model. This model requires the input of subjective assumptions in

implementing SFAS 123(R), including expected stock price volatility, expected life and estimated forfeitures of each award. The fair value of equity-based awards is amortized over the vesting period of the award, and we have elected to use the straight-line method of amortization. Due to the limited amount of historical data available to us, particularly with respect to stock-price volatility, employee exercise patterns and forfeitures, actual results could differ from our assumptions.

Prior to the implementation of SFAS 123(R), we accounted for stock options and ESPP shares under the provisions of Accounting Principles Board Opinion No. 25, “*Accounting for Stock Issued to Employees*” and made pro forma footnote disclosures as required by SFAS No. 148, “*Accounting For Stock-Based Compensation—Transition and Disclosure*,” which amended SFAS No. 123, “*Accounting For Stock-Based Compensation*.” Pro forma net loss and pro forma net loss per share disclosed in the footnotes to the consolidated financial statements were estimated using a Black-Scholes option valuation model.

The fair value of our common stock for options granted through the date of the initial public offering in February 2005 was originally estimated by our board of directors, with input from management. We did not obtain contemporaneous valuations by an unrelated valuation specialist. Subsequently, we reassessed the valuations of common stock relating to grants of options during the period from January 1, 2005 through the date of our initial public offering and the years ended December 31, 2004 and 2003. As disclosed more fully in Note 9 of the notes of our consolidated financial statements, we granted stock options and restricted common stock with exercise prices ranging from \$0.16 to \$0.53 per share during the period from January 1, 2005 through the date of our initial public offering and the years ended December 31, 2004 and 2003. In addition, we determined that the fair value of our common stock increased from \$0.16 to \$16.39 per share during that period.

For financial reporting purposes, we have recorded stock-based compensation representing the difference between the estimated fair value of common stock and the option exercise price. Because shares of our common stock were not publicly traded before our initial public offering in February 2005, we determined the estimated fair value based upon several factors, including significant milestones attained, sales of our redeemable convertible preferred stock, changes in valuations of existing comparable publicly-registered biotech companies, trends in the broad market for biotechnology stocks and the expected valuation we would obtain in an initial public offering. Although it was reasonable to expect that the completion of our initial public offering would add value to the shares as a result of increased liquidity and marketability, the amount of additional value could not be measured with precision or certainty. We amortize employee stock-based compensation on a straight-line basis for equity instruments subject to fixed accounting. We amortize employee stock-based compensation in accordance with the provisions of FASB Interpretation No. 28, “*Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*” for equity instruments subject to variable accounting.

We account for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (“EITF”) 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*.” As a result, the non-cash charge to operations for non-employee options with vesting or other performance criteria is affected each reporting period by changes in the estimated fair value of our common stock. The two factors which most affect these changes are the fair value of the common stock underlying stock options for which stock-based compensation is recorded and the volatility of such fair value. If our estimates of the fair value of these equity instruments change, it would have the effect of changing compensation expenses.

Preclinical and Clinical Trial Accruals

Most of our preclinical and clinical trials are performed by third party contract research organizations, or CROs, and clinical supplies are manufactured by contract manufacturing organizations, or CMOs. Invoicing from these third parties may be monthly based upon services performed or based upon milestones achieved. We accrue these expenses based upon our assessment of the status of each study and the work completed, and upon information obtained from the CROs and CMOs. Our estimates are dependent upon the timeliness and accuracy of data provided by the CROs and CMOs regarding the status and cost of the studies, and may not match the

actual services performed by the organizations. This could result in adjustments to our research and development expenses in future periods. To date we have had no significant adjustments.

Marketable Securities

We classify all of our marketable securities as available-for-sale. We carry these investments at fair value, based on quoted market prices, and unrealized gains and losses are included in accumulated other comprehensive income which is reflected as a separate component of stockholders' equity. The amortized cost of securities in this category is adjusted for amortization of premiums and accretions of discounts to maturity. Such amortization is included in interest income. Realized gains and losses are recorded in our statement of operations. If we believe that an other-than-temporary decline exists, it is our policy to record a write-down to reduce the investments to fair value and record the related charge as a reduction of interest income.

Accounting for Income Taxes

Our income tax policy records the estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in the accompanying balance sheets, as well as operating loss and tax credit carry forwards. We have recorded a full valuation allowance to reduce our deferred tax assets, as based on available objective evidence; it is more likely than not that the deferred tax assets will not be realized. In the event that we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax assets would increase net income in the period such determination was made.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of FIN 48 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (Topic 1N). "*Quantifying Misstatements in Current Year Financial Statements*," ("SAB No. 108"). SAB No. 108 addresses how the effect of prior-year uncorrected misstatements should be considered when quantifying misstatements in current-year financial statements. SAB No. 108 requires SEC registrants (i) to quantify misstatements using a combined approach which considers both the balance-sheet and income-statement approaches, (ii) to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors, and (iii) to adjust their financial statements if the new combined approach results in a conclusion is that an error is material. SAB No. 108 addresses the mechanics of correcting misstatements that include effects from prior years. It indicates that the current-year correction of a material error that includes prior-year effects may result in the need to correct prior-year financial statements even if the misstatement in the prior year or years is considered immaterial. Any prior-year financial statements found to be materially misstated in originating in years subsequent to the issuance of SAB No. 108, prior year financial statements requiring restatement would be restated in accordance with SFAS No. 154, "*Accounting Changes and Error Corrections*." Because the combined approach represents a change in practice, the SEC staff will not require registrants that followed an acceptable approach in the past to restate prior years' historical financial statements. Rather, these registrants can report the cumulative effect of adopting the new approach as an adjustment to the current year's beginning balance of retained earnings. If the new approach is adopted in a quarter other than the first quarter, financial statements for prior interim periods within the year of adoption may need to be restated. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB No. 108 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, “*Fair Value Measures*” (“SFAS No. 157”). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), expands disclosures about fair value measurements, and applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the FASB anticipates that for some entities, the application of SFAS No. 157 will change current practice. We will be required to adopt SFAS No. 157 for financial statements in the first quarter of 2008. We are currently evaluating the impact of SFAS No. 157.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISKS

Interest Rate Risk. Our exposure to market risk for changes in interest rates relates to our cash equivalents on deposit in highly liquid money market funds and investments in short-term marketable securities. The primary objective of our cash investment activities is to preserve principal while at the same time maximizing the income we receive from our invested cash without significantly increasing risk of loss. We invest in high-quality financial instruments, which currently have weighted average maturity of less than one year. We do not use derivative financial instruments in our investment portfolio. Our cash and investments policy emphasizes liquidity and preservation of principal over other portfolio considerations. Our investment portfolio is subject to interest rate risk and will fall in value if market interest rates rise. However, due to the short duration of our investment portfolio we believe an increase in the interest rates of one percentage point, would not be material to our financial condition or results of operations.

In addition, we do not have any material exposure to foreign currency rate fluctuations as we operate primarily in the United States. Although we conduct some clinical and safety studies, and manufacture some active pharmaceutical product with vendors outside the United States, most of our transactions are denominated in U.S. dollars.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**THRESHOLD PHARMACEUTICALS, INC.
(A DEVELOPMENT STAGE ENTERPRISE)
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Threshold Pharmaceuticals, Inc:

We have completed an integrated audit of Threshold Pharmaceutical, Inc.'s (a development stage enterprise) 2006 consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 and audits of its 2005 and 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity (deficit) and of cash flows present fairly, in all material respects, the financial position of Threshold Pharmaceuticals, Inc. (a development stage enterprise) at December 31, 2006 and December 31, 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation for the year ended December 31, 2006.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

San Jose, CA
March 15, 2007

THRESHOLD PHARMACEUTICALS, INC.
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31,	
	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 28,450	\$ 74,947
Marketable securities	24,360	24,707
Prepaid expenses and other current assets	547	563
Total current assets	53,357	100,217
Property and equipment, net	3,169	1,667
Restricted cash	483	192
Other assets	25	25
Total assets	\$ 57,034	\$102,101
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	\$ 619	\$ 1,237
Accrued clinical and development expenses	4,320	4,500
Accrued liabilities	2,286	2,158
Deferred revenue, current portion	1,437	1,437
Notes payable, current portion	997	230
Total current liabilities	9,659	9,562
Deferred revenue, less current portion	1,436	2,873
Notes payable, less current portion	1,247	151
Deferred rent	454	147
Total liabilities	12,796	12,733
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value:		
Authorized: 2,000,000 shares authorized; no shares issued and outstanding.	—	—
Common stock, \$0.001 par value:		
Authorized: 150,000,000 shares; Issued and outstanding: 37,345,890 and 37,231,572 shares at December 31, 2006 and 2005, respectively.	37	37
Additional paid-in capital	182,840	179,634
Deferred stock-based compensation	(3,975)	(11,356)
Accumulated other comprehensive income (loss)	(7)	24
Deficit accumulated during the development stage	(134,657)	(78,971)
Total stockholders' equity	44,238	89,368
Total liabilities and stockholders' equity	\$ 57,034	\$102,101

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

THRESHOLD PHARMACEUTICALS, INC.
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	<u>Years Ended December 31,</u>			Cumulative Period from October 17, 2001 (date of inception) to December 31, 2006
	<u>2006</u>	<u>2005</u>	<u>2004</u>	
Revenue	\$ 1,461	\$ 690	\$ —	\$ 2,151
Operating expenses:				
Research and development	46,267	35,991	16,327	107,051
General and administrative	14,453	11,235	7,649	35,901
Total operating expenses	<u>60,720</u>	<u>47,226</u>	<u>23,976</u>	<u>142,952</u>
Loss from operations	(59,259)	(46,536)	(23,976)	(140,801)
Interest and other income, net	3,729	2,159	443	6,423
Interest expense	(156)	(31)	(33)	(279)
Net loss	<u>(55,686)</u>	<u>(44,408)</u>	<u>(23,566)</u>	<u>(134,657)</u>
Dividend related to beneficial conversion feature of redeemable convertible preferred stock	<u>—</u>	<u>—</u>	<u>—</u>	<u>(40,862)</u>
Net loss attributable to common stockholders	<u>\$(55,686)</u>	<u>\$(44,408)</u>	<u>\$(23,566)</u>	<u>\$(175,519)</u>
Net loss per common share:				
Basic and diluted	<u>\$ (1.53)</u>	<u>\$ (1.63)</u>	<u>\$ (20.25)</u>	
Weighted average number of shares used in per common share calculations:				
Basic and diluted	<u>36,337</u>	<u>27,173</u>	<u>1,164</u>	

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

THRESHOLD PHARMACEUTICALS, INC.
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD
FROM OCTOBER 17, 2001 (DATE OF INCEPTION) TO DECEMBER 31, 2006
(in thousands, except share and per share data)

	Common Stock		Additional Paid-In Capital	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Income (Loss)	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
	Shares	Amount					
Issuance of restricted common stock to a founder and member of the Board of Directors in October 2001 for cash at \$0.02 per share	151,800	\$—	\$ 2	\$ —	\$—	\$ —	\$ 2
Net loss	—	—	—	—	—	(236)	(236)
Balances, December 31, 2001	151,800	—	2	—	—	(236)	(234)
Issuance of restricted common stock to a member of the Board of Directors for cash at \$0.16 per share in January 2002	22,770	—	4	—	—	—	4
Issuance of common stock pursuant to exercise of stock options for cash at \$0.16 per share	2,428	—	—	—	—	—	—
Deferred stock-based compensation	—	—	25	(25)	—	—	—
Amortization of deferred stock-based compensation	—	—	—	1	—	—	1
Non-employee stock-based compensation	—	—	21	—	—	—	21
Components of other comprehensive income (loss):							
Unrealized loss on marketable securities	—	—	—	—	(1)	—	(1)
Net loss	—	—	—	—	—	(2,458)	(2,458)
Comprehensive loss	—	—	—	—	—	—	(2,459)
Balances, December 31, 2002	176,998	—	52	(24)	(1)	(2,694)	(2,667)
Issuance of common stock pursuant to exercise of stock options for cash at \$0.16 per share	7,711	—	1	—	—	—	1
Issuance of a warrant to purchase Series A redeemable convertible preferred stock	—	—	44	—	—	—	44
Beneficial conversion feature related to issuance of Series B redeemable convertible preferred stock	—	—	40,862	—	—	—	40,862
Deemed dividend related to beneficial conversion feature of Series B redeemable convertible preferred stock	—	—	(40,862)	—	—	—	(40,862)
Deferred stock-based compensation, net of cancellations	—	—	2,332	(2,332)	—	—	—
Amortization of deferred stock-based compensation	—	—	—	810	—	—	810
Non-employee stock-based compensation	—	—	256	—	—	—	256
Components of other comprehensive income (loss):							
Change in unrealized gain (loss) on marketable securities	—	—	—	—	164	—	164
Net loss	—	—	—	—	—	(8,303)	(8,303)
Comprehensive loss	—	—	—	—	—	—	(8,139)
Balances, December 31, 2003	184,709	—	2,685	(1,546)	163	(10,997)	(9,695)
Issuance of common stock pursuant to exercise of stock options for cash	3,518,304	4	874	—	—	—	878
Deferred stock-based compensation, net of cancellations	—	—	20,385	(20,385)	—	—	—
Amortization of deferred stock-based compensation	—	—	—	5,294	—	—	5,294
Non-employee stock-based compensation	—	—	681	—	—	—	681
Repurchase of unvested common stock	(12,446)	—	(6)	—	—	—	(6)

THRESHOLD PHARMACEUTICALS, INC.
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)—(Continued)
FOR THE PERIOD
FROM OCTOBER 17, 2001 (DATE OF INCEPTION) TO DECEMBER 31, 2006
(in thousands, except share and per share data)

	Common Stock		Additional Paid-In Capital	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Income (Loss)	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
	Shares	Amount					
Components of other comprehensive income (loss):							
Change in unrealized gain (loss) on marketable securities	—	—	—	—	(59)	—	(59)
Net loss	—	—	—	—	—	(23,566)	(23,566)
Comprehensive loss							(23,625)
Balances, December 31, 2004	3,690,567	4	24,619	(16,637)	104	(34,563)	(26,473)
Issuance of common stock in an initial public offering for cash of \$7.00, per share, net of issuance costs of \$4.6 million	6,112,601	6	38,129	—	—	—	38,135
Issuance of common stock for cash of \$10.46 per share, net of issuance costs of \$4.5 million	6,399,222	6	62,389	—	—	—	62,395
Issuance of common stock pursuant to exercise of warrants	19,269	—	—	—	—	—	—
Conversion of convertible preferred stock upon initial public offering	20,552,812	21	49,818	—	—	—	49,839
Issuance of common stock pursuant to stock plans	508,626	—	557	—	—	—	557
Deferred stock-based compensation, net of cancellations	—	—	3,321	(3,321)	—	—	—
Reversal of deferred stock-based compensation related to employee terminations	—	—	(2,862)	2,862	—	—	—
Amortization of deferred stock-based compensation	—	—	(416)	5,740	—	—	5,324
Non-employee stock-based compensation	—	—	4,097	—	—	—	4,097
Repurchase of unvested common stock	(51,525)	—	(18)	—	—	—	(18)
Components of other comprehensive income (loss):							
Change in unrealized gain (loss) on marketable securities	—	—	—	—	(80)	—	(80)
Net loss	—	—	—	—	—	(44,408)	(44,408)
Comprehensive loss							(44,488)
Balances, December 31, 2005	37,231,572	37	179,634	(11,356)	24	(78,971)	89,368
Issuance of common stock pursuant to stock plans	276,772	—	518	—	—	—	518
Reversal of deferred stock-based compensation related to employee terminations	—	—	(2,970)	2,970	—	—	—
Amortization of deferred stock-based compensation	—	—	—	4,411	—	—	4,411
Stock-based compensation	—	—	5,738	—	—	—	5,738
Repurchase of unvested common stock	(162,454)	—	(80)	—	—	—	(80)
Components of other comprehensive income (loss):							
Change in unrealized gain (loss) on marketable securities	—	—	—	—	(31)	—	(31)
Net loss	—	—	—	—	—	(55,686)	(55,686)
Comprehensive loss							(55,717)
Balances, December 31, 2006	37,345,890	\$ 37	\$182,840	\$ (3,975)	\$ (7)	\$(134,657)	\$ 44,238

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

THRESHOLD PHARMACEUTICALS, INC.
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31,			Cumulative Period from October 17, 2001 (date of inception) to December 31, 2006
	2006	2005	2004	
Cash flows from operating activities:				
Net loss	\$(55,686)	\$(44,408)	\$(23,566)	\$(134,657)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	938	573	143	1,755
Stock-based compensation expense	10,149	9,421	5,975	26,633
Amortization of debt issuance costs	—	—	10	44
Gain on sale of investments, property and equipment	(41)	—	—	(36)
Changes in operating assets and liabilities:				
Prepaid expenses and other current assets	16	(272)	(189)	(573)
Accounts payable	(618)	257	699	619
Accrued clinical and development expenses	(180)	4,057	227	4,320
Accrued liabilities	128	1,114	823	2,286
Deferred rent	307	69	78	454
Deferred revenue	(1,437)	(690)	5,000	2,873
Net cash used in operating activities	<u>(46,424)</u>	<u>(29,879)</u>	<u>(10,800)</u>	<u>(96,282)</u>
Cash flows from investing activities:				
Acquisition of property and equipment	(2,405)	(1,162)	(1,022)	(4,894)
Acquisition of marketable securities	(42,915)	(38,874)	(38,199)	(114,284)
Proceeds from sales and maturities of marketable securities	43,238	28,413	24,023	89,924
Restricted cash	(291)	85	(162)	(483)
Net cash used in investing activities	<u>(2,373)</u>	<u>(11,538)</u>	<u>(15,360)</u>	<u>(29,737)</u>
Cash flows from financing activities:				
Proceeds from redeemable convertible preferred stock, net	—	—	—	49,839
Proceeds from issuance of common stock, net of offering expenses	438	102,357	(415)	102,387
Proceeds from issuance of notes payable	2,616	—	490	3,616
Repayment of notes payable	(754)	(332)	(185)	(1,373)
Net cash provided by (used in) financing activities	<u>2,300</u>	<u>102,025</u>	<u>(110)</u>	<u>154,469</u>
Net increase (decrease) in cash and cash equivalents	(46,497)	60,608	(26,270)	28,450
Cash and cash equivalents, beginning of period	74,947	14,339	40,609	—
Cash and cash equivalents, end of period	<u>\$ 28,450</u>	<u>\$ 74,947</u>	<u>\$ 14,339</u>	<u>\$ 28,450</u>
Supplemental disclosures:				
Cash paid for interest	<u>\$ 156</u>	<u>\$ 31</u>	<u>\$ 33</u>	<u>\$ 234</u>
Non-cash investing and financing activities:				
Deferred stock-based compensation	<u>\$ (2,970)</u>	<u>\$ 459</u>	<u>\$ 20,385</u>	<u>\$ 20,231</u>
Conversion of redeemable convertible preferred stock	<u>\$ —</u>	<u>\$ 49,839</u>	<u>\$ —</u>	<u>\$ 49,839</u>
Deferred offering expenses in connection with IPO	<u>\$ —</u>	<u>\$ (1,287)</u>	<u>\$ 1,287</u>	<u>\$ —</u>
Change in unrealized gain in marketable securities	<u>\$ (31)</u>	<u>\$ (80)</u>	<u>\$ (59)</u>	<u>\$ (7)</u>
Fair value of redeemable convertible preferred stock warrant	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 44</u>
Dividend related to beneficial conversion feature of redeemable convertible preferred stock	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 40,862</u>
Accrued cost of acquisition of property and equipment	<u>\$ —</u>	<u>\$ (589)</u>	<u>\$ 589</u>	<u>\$ —</u>

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

THRESHOLD PHARMACEUTICALS, INC.
(A DEVELOPMENT STAGE ENTERPRISE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Operations and Basis of Presentation

Threshold Pharmaceuticals, Inc. (the “Company”) was incorporated in the State of Delaware on October 17, 2001. The Company is a biotechnology company focused on the discovery and development of small molecule therapeutics for the potential treatment of cancer. The Company has product candidates in various stages of development as well as discovery and, since inception, has devoted substantially all of its time and efforts to performing research and development, raising capital and recruiting personnel.

In June 2005, the Company formed a wholly-owned subsidiary, THLD Enterprises (UK), Limited in the United Kingdom in connection with conducting clinical trials in Europe. As of December 31, 2006, there has been no financial activity related to this entity.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly owned subsidiary, and reflect the elimination of intercompany accounts and transactions.

The Company believes that its cash, cash equivalents and marketable securities as of December 31, 2006 will be sufficient to fund its projected operating requirements through at least mid-2008, including completing its current and planned trials, conducting research and discovery efforts towards additional product candidates, working capital and general corporate purposes. Additional funds will be required to in-license or otherwise acquire and develop additional products or programs. The Company intends to seek funds through arrangements with collaborators or others that may require the Company to relinquish rights to certain product candidates that it might otherwise seek to develop or commercialize independently. Additionally, the Company may need or choose to raise additional capital or incur indebtedness to continue to fund its operations in the future. The Company’s ability to raise additional funds will depend on the Company’s clinical and regulatory events and factors related to financial, economic, and market conditions, many of which are beyond its control. The Company cannot be certain that sufficient funds will be available when required or on satisfactory terms. If necessary funds are not available, the Company may have to delay, reduce the scope or eliminate some of its research and development, which could delay the time to market for any of its product candidates.

Use of Estimates

The preparation of consolidated 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 consolidated financial statements and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. All cash and cash equivalents are held in the United States of America in financial institutions or money market funds, which are unrestricted as to withdrawal or use.

Restricted Cash

Restricted cash represents two certificates of deposit held at a financial institution that serve as collateral for the Company’s facility lease and sublease agreement.

Marketable Securities

The Company classifies its marketable securities as “available-for-sale.” Such marketable securities are recorded at fair value and unrealized gains and losses are recorded as a separate component of stockholders’ equity until realized. Realized gains and losses on sale of all such securities will be reported in net loss, computed using the specific identification cost method. The Company places its marketable securities primarily in U.S. government securities, money market funds, corporate bonds and commercial paper.

Fair value of financial instruments

The carrying amounts of certain of the Company’s financial instruments, including cash and cash equivalents, accounts payable and accrued liabilities approximate fair value due to their relatively short maturities. Based on borrowing rates currently available to the Company for loans with similar terms, the carrying value of the notes payable at December 31, 2006 and 2005 approximates fair value. Estimated fair values for marketable securities, which are separately disclosed elsewhere, are based on quoted market prices for the same or similar instruments.

Concentration of credit risk and other risks and uncertainties

Financial instruments which potentially subject the Company to concentrations of risk consist principally of cash and cash equivalents. The Company’s cash and cash equivalents are invested in deposits with two major financial institutions in the United States of America that management believes are creditworthy. The Company is exposed to credit risk in the event of default by the financial institutions for amounts in excess of Federal Deposit Insurance Corporation insured limits. The Company performs periodic evaluations of the relative credit standings of these financial institutions and limits the amount of credit exposure with any institution.

Any products developed by the Company will require approval from the U.S. Food and Drug Administration (“FDA”) or foreign regulatory agencies prior to commercial sales. There can be no assurance that the Company’s products will receive the necessary approvals. If the Company is denied such approvals or such approvals are delayed, it could have a material adverse effect on the Company.

The Company has three drug candidates in development, none of which have received regulatory approval. To achieve profitable operations, the Company must successfully develop, test, manufacture and market its products. There can be no assurance that any such products can be developed successfully or manufactured at an acceptable cost and with appropriate performance characteristics, or that such products will be successfully marketed. These factors could have a material adverse effect on the Company’s future financial results.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets, generally three years. Leasehold improvements are amortized using the straight-line method over the estimated useful life of the improvement, or the lease term, if shorter. Accordingly, leasehold improvements are being amortized over lease terms of approximately 4-5 years. Maintenance and repairs are charged to operations as incurred. Upon sale or retirement of assets, the cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operations.

Impairment of long-lived assets

In accordance with the provisions of Statement of Financial Accounting Standards Board (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-lived Assets,” (“SFAS No. 144”) the Company reviews long-lived assets, including property and equipment, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Under SFAS No. 144, an impairment loss would be recognized when estimated undiscounted future cash flows expected to

result from the use of the asset and its eventual disposition is less than its carrying amount. Impairment, if any, is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. The Company considers various valuation factors, principally discounted cash flows, to assess the fair values of long-lived assets. As of December 31, 2006, the Company has not incurred any such impairment losses.

Comprehensive income (loss)

Comprehensive income (loss) generally represents all changes in stockholders' equity (deficit) except those resulting from investments or contributions by stockholders. The Company's net loss and unrealized gain (loss) on available-for-sale marketable securities represent the only components of other comprehensive loss.

Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 101 (SAB 104,) "Revenue Recognition in Financial Statements" and Emerging Issues Task Force (EITF) Issue 00-21 "Revenue Arrangements with Multiple Deliverables" (EITF 00-21). In connection with the Company's agreement with MediBIC, the Company recognizes revenue from the non-refundable, upfront payment ratably over the term of its performance under the agreements. The upfront payment received, pending recognition as revenue, is recorded as deferred revenue and classified as a short-term or long-term liability on the balance sheet to be amortized over the period of deferral.

Research and development expenses

Research and development expenses are charged to research and development expense as incurred. Research and development expenses consist of salaries and benefits, laboratory supplies, consulting fees and fees paid to third party contract research and manufacturing organizations.

Preclinical and Clinical Trial Accruals

Most of the Company's preclinical and clinical trials are performed by third party contract research organizations (CROs), and clinical supplies are manufactured by contract manufacturing organizations (CMOs). Invoicing from these third parties may be monthly based upon services performed or based upon milestones achieved. The Company accrues these expenses based upon its assessment the status of each study and the work completed, and upon information obtained from the CROs and CMOs. The Company's estimates are dependent upon the timeliness and accuracy of data provided by the CROs and CMOs regarding the status and cost of the studies, and may not match the actual services performed by the organizations. This could result in adjustments to the Company's research and development expenses in future periods. To date the Company has had no significant adjustments.

Income taxes

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

Segments

The Company has one reportable segment and uses one measurement of profitability to manage its business. All long-lived assets are maintained in the United States of America.

Stock-based compensation

Prior to January 1, 2006, the Company used the intrinsic method of Accounting Principles Board Opinion No. 25, “*Accounting for Stock Issued to Employees*” (“APB No. 25”), in accounting for employee stock options, and present disclosure of pro forma information required under SFAS No. 123, “*Accounting for Stock-Based Compensation*” (“SFAS No. 123”) as amended by SFAS No. 148, “*Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123*” (“SFAS No. 148”). For stock options granted to employees no compensation expense was recognized unless the exercise price was less than fair market value at the date of grant. Stock-based compensation expense was recognized under APB No. 25 for options granted prior to the Company’s initial public offering of its common stock in February 2005 based upon the intrinsic value (the difference between the exercise price at the date of grant and the deemed fair value of the common stock based on the anticipated initial public offering stock price.) In anticipation of the Company’s initial public offering, which was completed in February 2005, the Company determined that, for accounting purposes, the deemed fair value of our common stock was greater than the exercise price for certain options. As a result, the Company recorded deferred stock-based compensation for these options of \$0.5 million, \$20.4 million and \$2.3 million for the years ended December 31, 2005, 2004 and 2003, respectively. This expense, which is a non-cash charge, has been amortized over the period in which the options vest, which is generally four years. The amortization of this expense recognized for the years ended December 31, 2006, 2005 and 2004 was \$4.4 million, \$5.3 million and \$5.3 million, respectively.

Beginning January 1, 2006, the Company began accounting for stock-based compensation using the modified prospective transition method prescribed by SFAS No. 123 “*Share-Based Payment.—An Amendment of FASB Statements No. 123 and 95*” (“SFAS No. 123R”), issued by the Financial Accounting Standards Board in December 2004. SFAS No.123R requires measurement of all employee stock-based compensation awards using a fair-value method and recording of such expense in the consolidated financial statements over the requisite service period. See Note 9 “Equity Incentive Plans” for further discussion.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (“EITF”) 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”, which require that such equity instruments are recorded at their fair value on the measurement date. The measurement of stock-based compensation is subject to periodic adjustment as the underlying equity instruments vest.

Recent accounting pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109” (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 16, 2006, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of FIN 48 is not expected to have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (Topic 1N). “*Quantifying Misstatements in Current Year Financial Statements,*” (“SAB No. 108”). SAB No. 108 addresses how the effect of prior-year uncorrected misstatements should be considered when quantifying misstatements in current-year financial statements. SAB No. 108 requires SEC registrants (i) to quantify misstatements using a combined approach which considers both the balance-sheet and income-statement approaches, (ii) to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors, and (iii) to adjust their financial statements if the new combined approach results in a conclusion is that an error is material. SAB No. 108 addresses the mechanics of correcting misstatements that include effects from prior years. It indicates that the current-year correction of a material error that includes prior-year effects may result in the need to correct prior-year financial statements even if the misstatement in the prior year or years is

considered immaterial. Any prior-year financial statements found to be materially misstated in originating in years subsequent to the issuance of SAB No. 108, prior year financial statements requiring restatement would be restated in accordance with SFAS No. 154, "Accounting Changes and Error Corrections." Because the combined approach represents a change in practice, the SEC staff will not require registrants that followed an acceptable approach in the past to restate prior years' historical financial statements. Rather, these registrants can report the cumulative effect of adopting the new approach as an adjustment to the current year's beginning balance of retained earnings. If the new approach is adopted in a quarter other than the first quarter, financial statements for prior interim periods within the year of adoption may need to be restated. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB No. 108 did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measures" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), expands disclosures about fair value measurements, and applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the FASB anticipates that for some entities, the application of SFAS No. 157 will change current practice. The Company will be required to adopt SFAS No. 157 for financial statements in the first quarter of 2008. The Company is currently evaluating the impact of SFAS No. 157.

NOTE 2—NET LOSS PER COMMON SHARE:

Basic net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of vested common shares outstanding during the period. Diluted net loss per common share is computed by giving effect to all potential dilutive common shares, including outstanding options, common stock subject to repurchase, warrants and redeemable convertible preferred stock. A reconciliation of the numerator and denominator used in the calculation of basic and diluted net loss per common share follows (in thousands):

	Years Ended December 31,		
	2006	2005	2004
Numerator:			
Net loss attributable to common stockholders	<u>\$(55,686)</u>	<u>\$(44,408)</u>	<u>\$(23,566)</u>
Denominator:			
Weighted-average number of common shares outstanding . . .	37,394	29,098	2,335
Less: Weighted-average shares subject to repurchase	<u>(1,058)</u>	<u>(1,925)</u>	<u>(1,171)</u>
Weighted-average number of common shares outstanding used in computing basic and diluted net loss per common share	<u>36,337</u>	<u>27,173</u>	<u>1,164</u>
Basic and diluted net loss per common share	<u>\$ (1.53)</u>	<u>\$ (1.63)</u>	<u>\$ (20.25)</u>

The following outstanding options, common stock subject to repurchase, redeemable convertible preferred stock and warrants were excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an antidilutive effect (in thousands):

	December 31,		
	2006	2005	2004
Redeemable convertible preferred stock	—	—	20,553
Options to purchase common stock	2,075	926	447
Common stock subject to repurchase	615	1,475	2,069
Shares issuable related to the ESPP	69	40	—
Warrants to purchase redeemable convertible preferred stock	—	—	38

NOTE 3—MARKETABLE SECURITIES

The Company invests in highly-liquid, investment-grade securities. The following is a summary of the Company's available-for-sale securities at December 31, 2006 and 2005:

As of December 31, 2006 (in thousands):	Cost Basis	Unrealized Gain	Unrealized Loss	Fair Value
Money market funds	\$ 2,952	\$—	\$—	\$ 2,952
Corporate bonds	6,078	2	(2)	6,078
Government securities	13,223	2	(9)	13,216
Commercial paper	29,181	4	—	29,185
Asset-backed securities	900	—	—	900
	<u>52,334</u>	<u>8</u>	<u>(11)</u>	<u>52,331</u>
Less cash equivalents	<u>(27,967)</u>	<u>(4)</u>	<u>—</u>	<u>27,971</u>
Total marketable securities	<u>\$ 24,367</u>	<u>\$ 4</u>	<u>\$ (11)</u>	<u>\$ 24,360</u>

As of December 31, 2005 (in thousands):	Cost Basis	Unrealized Gain	Unrealized Loss	Fair Value
Common stock in a public company	\$ 28	\$ 36	\$—	\$ 64
Money market funds	3,719	—	—	3,719
Certificates of Deposit	3,325	—	—	3,325
Corporate bonds	7,159	—	(6)	7,153
Government securities	7,485	1	(9)	7,477
Commercial paper	71,785	10	(3)	71,792
Asset-backed securities	4,863	—	(5)	4,858
	<u>98,364</u>	<u>47</u>	<u>(23)</u>	<u>98,388</u>
Less cash equivalents	<u>(73,670)</u>	<u>—</u>	<u>—</u>	<u>(73,670)</u>
Total marketable securities	<u>\$ 24,694</u>	<u>\$ 47</u>	<u>\$ (23)</u>	<u>\$ 24,707</u>

Gross realized gains on sales of marketable securities in 2006 and 2005 were \$41,000 and \$34,000, respectively. There were no realized gains or losses on the sales of marketable securities in 2004.

As of December 31, 2006, weighted average days to maturity for the Company's available for sale securities was 79 days, with the longest maturity being November 2007.

The following table provides the breakdown of the marketable securities with unrealized losses at December 31, 2006 (in thousands):

As of December 31, 2006 (in thousands):	In loss position for less than twelve months	
	Fair Value	Unrealized Loss
Corporate bonds	\$ 5,087	\$ (2)
Government securities	8,490	(9)
	<u>\$13,577</u>	<u>\$(11)</u>

The gross unrealized losses related to marketable securities are primarily due to a decrease in the fair value of debt securities as a result of an increase in interest rates during the year ended December 31, 2006. The Company has determined that the gross unrealized losses on its marketable securities at December 31, 2006 are temporary in nature. The Company reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is temporary include

the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, credit quality and the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

NOTE 4—PROPERTY AND EQUIPMENT

Property and equipment comprise the following (in thousands):

	December 31,	
	2006	2005
Computer and office equipment	\$ 901	\$ 330
Laboratory equipment	1,202	728
Leasehold improvements	2,787	1,426
	4,890	2,484
Less: Accumulated depreciation	(1,721)	(817)
Total property and equipment, net	<u>\$ 3,169</u>	<u>\$ 1,667</u>

Depreciation expense was \$0.9 million, \$0.6 million, \$0.1 million and \$1.7 million for the years ended December 31, 2006, 2005 and 2004, and, cumulatively, for the period from October 17, 2001 (date of inception) to December 31, 2006, respectively.

Certain laboratory, computer and office equipment with a cost basis of approximately \$1.3 million is collateral for borrowings under the loan and security agreement with Silicon Valley Bank.

NOTE 5—ACCRUED LIABILITIES:

Accrued liabilities comprise the following (in thousands):

	December 31,	
	2006	2005
Payroll and employee related expenses	\$1,610	\$1,265
Professional services	384	369
Other accrued expenses	292	524
Total Accrued liabilities	<u>\$2,286</u>	<u>\$2,158</u>

In August 2006, the Company adopted a plan to reduce its operating expenses, following its decision to discontinue development of TH-070 for benign prostatic hyperplasia. The plan included a reduction of 29 full-time employees in both research and development and general and administrative areas of the Company. As a result of the staffing reduction, the Company incurred severance benefits of approximately \$1.0 million during the quarter ended September 30, 2006. The payout of the accrued severance benefits was completed in the fourth quarter of 2006.

The following table sets forth an analysis of the restructuring accrual during the year ended December 31, 2006 (in thousands):

	<u>Balance at January 1, 2006</u>	<u>Charges</u>	<u>Cash paid</u>	<u>Balance at December 31, 2006</u>
Severance and benefits	\$—	\$1,035	\$(1,035)	\$—

NOTE 6—NOTES PAYABLE:

On March 27, 2003, the Company entered into a loan and security agreement with Silicon Valley Bank to borrow up to \$1.0 million for working capital and equipment purchases. The Company borrowed the full amount

under this facility as of December 2004, which will be repaid over a 36-month period from the date of borrowing, at an average interest rate of 5.8% per annum. In connection with the agreement, the Company issued Silicon Valley Bank a warrant to purchase 38,000 shares of Series A redeemable convertible preferred stock, which was fully exercised in 2005.

In April 2006, the Company amended the existing loan and security agreement to borrow up to an additional \$4.0 million for working capital and equipment purchases. The interest rate for borrowings under this facility will be determined based on the 36-month U.S. Treasury note plus 2.25% on the date of borrowing. The Company borrowed \$2.6 million under this facility, which will be repaid over a 36-month period from the date of borrowing. The interest rate on these borrowings was approximately 7.2% per annum.

At December 31, 2006, future principal payments under the amended loan and security agreement are as follows (in thousands):

Year Ending December 31,		
2007	\$ 997
2008	910
2009	<u>337</u>
Total	<u><u>\$2,244</u></u>

Under the amended loan and security agreement, the Company is required to maintain the lower of 85% of its total cash and cash equivalents or \$10.0 million with the financial institution. Borrowings under the equipment line of credit are collateralized by the related equipment. At December 31, 2006, the Company was in compliance with all covenants in the agreement.

NOTE 7—COMMITMENTS AND CONTINGENCIES:

The Company leases certain of its facilities under noncancelable leases, which qualify for operating lease accounting treatment under SFAS No. 13, “*Accounting for Leases*,” and, as such, these facilities are not included on its consolidated balance sheets. On August 31, 2004, the Company entered into a noncancelable facility sublease agreement for 33,700 square feet of laboratory and office space. The lease was effective October 1, 2004 and expires February 2010. On April 1, 2005 the Company entered into a noncancelable facility operating lease for approximately 6,489 square feet of laboratory space, which expires in February 2010. In connection with the execution of the lease, the Company paid a security deposit of approximately \$25,000.

In February 2006, the Company entered into a new lease for an additional 34,205 square feet of space and an increase in the lease term for the existing space located at the Company’s headquarters in Redwood City, California to September 30, 2011. The lease is for a period of 66 months, beginning on April 1, 2006 with respect to the additional square footage and will begin on March 1, 2010 with respect to the existing square footage. The lease will expire, unless otherwise terminated under the terms of the lease, on September 30, 2011. The aggregate rent for the term of the lease is approximately \$4.8 million. In addition, the lease requires the Company to pay certain taxes, assessments, fees and other costs and expenses associated with the premises in amounts yet to be determined as well as a customary management fee. The Company will also be responsible for the costs of certain tenant improvements associated with the leased space. In connection with the lease, the Company furnished a letter of credit to the landlord for approximately \$0.3 million.



The future rental payments required by the Company for all of its facilities under noncancelable operating leases are as follows (in thousands):

Years Ended December 31,	
2007	\$1,232
2008	1,358
2009	1,398
2010	1,462
2011	<u>1,129</u>
Future minimum rental payments	<u>\$6,579</u>

Rent expense for the years ended December 31, 2006, 2005, 2004, and, cumulatively, for the period from October 17, 2001 (date of inception) to December 31, 2006 was \$1.1 million, \$0.6 million, \$0.7 million and \$3.0 million, respectively.

The Company's purchase commitments at December 31, 2006 were \$1.6 million, which are primarily for the manufacture and testing of active pharmaceutical ingredient (API) or drug product for clinical testing.

License agreements

In November 2002, the Company entered into an exclusive license agreement with certain individuals for rights to certain patent applications. Under the terms of the agreement, the Company was required to make aggregate upfront payments of approximately \$15,000. Based on the early stage of development and the uncertainty of the feasibility of the licensed technology, the upfront fees were expensed immediately as incurred. The Company is also required to make various milestone payments up to \$700,000 in connection with regulatory filings and approvals and additional royalty payments upon product commercialization. No milestone or royalty payments have been made as of December 31, 2006.

In August 2003, the Company entered into an exclusive worldwide license and development agreement with Baxter International and Baxter Healthcare S.A., together Baxter for certain patent rights and technology associated with glufosfamide and its drug candidates in development. Under the terms of the agreement, the Company made an initial upfront payment of \$100,000 and in December 2003, another milestone payment of \$100,000. In November 2004, the Company made an additional milestone payment of \$1.3 million. The Company will be required to make a milestone payment of \$1.0 million within 30 days of filing a NDA for glufosfamide with the FDA. Total additional milestone payments in connection with the development of glufosfamide and United States of America and foreign regulatory submissions and approvals could total \$8.0 million. In addition, based on the attainment of specified sales thresholds the Company could be required to make payments totaling \$17.5 million. The Company will also be required to make royalty payments upon product commercialization. No royalty payments have been made as of December 31, 2006.

In November 2004, the Company entered into an agreement with MediBIC Co. Ltd. (MediBIC) to develop glufosfamide in Japan and several other Asian countries, and received an upfront payment of \$5.0 million contingent upon the finalization of the clinical development plan. In July 2005, the Company finalized the development plan with MediBIC and began recognizing revenue from the upfront payment on a straight-line basis over the development period, currently estimated to be through 2008. The Company is responsible for all development activities under this agreement. The Company will also be required to make royalty payments upon product commercialization. The Company may terminate the agreement at any time by making certain payments ranging from \$7.0 million to \$15.0 million, depending on the stage of development.

The unamortized portion of the upfront payment has been classified as deferred revenue on the Company's consolidated balance sheet at December 31, 2006 and 2005.

Indemnification

The Company enters into indemnification provisions under its agreements with other companies in the ordinary course of business, including business partners, contractors and parties performing its clinical trials. Pursuant to these arrangements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified parties for losses suffered or incurred by the indemnified party as a result of the Company's activities. The terms of these indemnification agreements are generally perpetual. The maximum potential amount of future payments the Company could be required to make under these agreements is not determinable. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. The Company maintains commercial general liability insurance and products liability insurance to offset certain of its potential liabilities under these indemnification provisions.

The Company's bylaws provide that it is required to indemnify its directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct of a culpable nature, to the fullest extent permissible by applicable law; and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified.

NOTE 8—STOCKHOLDERS' EQUITY

Common stock

On February 4, 2005, the Company completed its initial public offering of 6.1 million shares of common stock for net proceeds totaling \$38.1 million. On October 14, 2005, the Company completed a public offering of 6.4 million shares of its common stock for net proceeds totaling \$62.4 million. Each share of common stock has the right to one vote. The holders of common stock are also entitled to receive dividends whenever funds are legally available and when declared by the Board of Directors, subject to the prior rights of holders of all classes of stock outstanding having priority rights as to dividends. No dividends have been declared or paid as of December 31, 2006.

On October 24, 2001, shares of restricted stock were issued to the Company's founder and member of the Board of Directors under a restricted stock purchase agreement. In August 2005, the founder resigned from the Company and entered into a consulting and stock vesting agreement. Under the terms of this agreement, the vesting of his restricted stock accelerated at December 31, 2005, and compensation expense associated with the accelerated vesting of these options was recorded for his services as a consultant through December 31, 2005. On January 29, 2002, shares of restricted common stock were issued to a member of the Board of Directors under a restricted stock purchase agreement. The shares vest over a six-year period. The unvested shares of common stock are subject to repurchase by the Company in the event of termination of the consulting relationship. Included in common stock as of December 31, 2005 and 2004 for both awards are 4,849 and 55,168 shares subject to the Company's right of repurchase, respectively. As of December 31, 2006, there were no restricted awards subject to the Company's right of repurchase.

Reverse Stock Split

On January 10, 2005, the Company's Board of Directors and stockholders approved a 1 for 1.6469 reverse stock split of the Company's common shares. The stock split was affected on January 26, 2005. All common share and per share amounts and the conversion ratios of the redeemable convertible preferred stock contained in the accompanying consolidated financial statements were retroactively adjusted to reflect the stock split.

Preferred Share Rights Agreement

On August 8, 2006, the board of directors adopted a Preferred Shares Rights Agreement. As part of this agreement, preferred stock purchase rights ("the rights") were distributed to stockholders of record as of August 23, 2006, at the rate of one right for each share of common stock held. The rights become exercisable

only upon the acquisition, or the acquisition of the right to acquire, by a person or group of affiliated or associated persons, 15% or more of the outstanding shares of the Company's common stock. Once exercisable, each right entitles the holder to purchase, at a price of \$25.00, one one-thousandth of a share of Series A Participating Preferred Stock. For a limited period of time following the announcement of any such acquisition or offer, the rights are redeemable by the Company at a price of \$0.01 per right. If the rights are not redeemed or exchanged, each right will then entitle the holder to receive, upon exercise of such right, a number of shares of the Company's common stock having a then current value equal to two times the purchase price of such right. Similarly, if the rights are not redeemed or exchanged and following the acquisition of 15% or more of the outstanding shares of the Company's common stock by a person or group of affiliated or associated persons, (i) the Company consolidates with or merges into another entity, (ii) another entity consolidates with or merges into the Company or (iii) the Company sells or otherwise transfers 50% or more of its consolidated assets or earning power, each right will then entitle the holder to receive, upon exercise of such right, a number of shares of common stock of the acquiring company having a then current value equal to two times the purchase price. For a limited period of time after the exercisability of the rights, each right, at the discretion of the board of directors, may be exchanged for one share of common stock per right. The Company has initially reserved 200,000 shares of preferred stock pursuant to the exercise of these rights. These rights expire on August 8, 2016.

NOTE 9—EQUITY INCENTIVE PLANS AND STOCK BASED COMPENSATION

2004 Equity Incentive Plan

On April 7, 2004, the Board of Directors adopted the 2004 Equity Incentive Plan (the "2004 Plan"), and received stockholder approval on January 10, 2005. The 2004 Plan became effective upon the completion of the Company's initial public offering and provides for the granting of incentive stock options, nonstatutory stock options, stock appreciation rights, stock awards and cash awards to employees and consultants. In 2005, 2,428,805 shares of common stock were authorized for issuance pursuant to the 2004 Plan, plus any shares which had been reserved but not issued under the 2001 Equity Incentive Plan (the "2001 Plan") or issued and forfeited after the date of the initial public offering, plus any shares repurchased at or below the original purchase price and any options which expire or become unexercisable after the initial public offering, thereafter plus all shares of common stock restored by the Board of Directors pursuant to the provision of the 2004 Plan that permits options to be settled on a net appreciation basis. The Company will not grant any options under the 2001 Plan after the effectiveness of the 2004 Plan. On January 1, 2006, and annually thereafter, the authorized shares will automatically be increased by a number of shares equal to the lesser of:

- 5% of the number of the Company's shares issued and outstanding prior to the preceding December 31;
- 1,214,402 shares;
- an amount determined by the Board of Directors.

On December 20, 2005, the Board of Directors approved an addition of 1,214,402 shares for issuance under the 2004 Plan effective January 1, 2006.

Activity under the 2001 Plan and 2004 Plan is set forth below:

	Shares Available for Grant	Outstanding Options		Weighted Average Exercise Price
		Number of Shares	Exercise Price	
Shares reserved at Plan inception	1,214,402	—	\$ —	\$ —
Balances, December 31, 2001	1,214,402	—	—	—
Options granted	(1,080,024)	1,080,024	0.16	0.16
Options exercised	—	(2,428)	0.16	0.16
Balances, December 31, 2002	134,378	1,077,596	0.16	0.16
Additional shares reserved	3,036,007	—	—	—
Options granted	(726,564)	726,564	0.16–0.26	0.16
Options exercised	—	(7,711)	0.16	0.16
Options canceled	5,568	(5,568)	0.16	0.16
Balances, December 31, 2003	2,449,389	1,790,881	0.16–0.26	0.16
Options granted	(2,222,333)	2,222,333	0.26–0.53	0.36
Options exercised	—	(3,518,304)	0.16–0.53	0.25
Options canceled	47,573	(47,573)	0.16–0.53	0.28
Balances, December 31, 2004	274,629	447,337	0.16–0.53	0.45
Additional shares reserved	2,428,805	—	—	—
Options granted	(947,187)	947,187	0.53–14.98	8.22
Options exercised	—	(453,317)	0.16–0.53	0.49
Options canceled	14,850	(14,850)	5.80–12.45	6.62
Options repurchased	63,969	—	0.16–0.53	0.41
Balances, December 31, 2005	1,835,066	926,357	0.16–14.98	8.29
Additional shares reserved	1,214,402	—	—	—
Options granted (1)	(4,466,000)	4,466,000	1.55–16.52	6.99
Options exercised	—	(132,143)	0.26–6.26	0.92
Options canceled (1)	3,185,413	(3,185,413)	0.53–16.52	10.48
Options repurchased	162,454	—	0.16–0.53	0.49
Balances, December 31, 2006	<u>1,931,335</u>	<u>2,074,801</u>		2.60

- (1) Includes 2,172,000 options that had a weighted average exercise price of \$12.37, which were cancelled and re-granted at an exercise price of \$2.57 in September 2006.

At December 31, 2006, stock options outstanding and exercisable by exercise price were as follows:

December 31, 2006					
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 0.16 – 2.29	240,132	8.50	\$ 1.23	76,731	\$ 0.36
\$ 2.55 – 2.55	5,000	9.72	2.55	312	2.55
\$ 2.57 – 2.57	1,556,732	9.10	2.57	198,093	2.57
\$ 2.61 – 3.33	209,000	9.75	2.87	11,457	2.86
\$ 3.45 – 3.45	35,000	9.79	3.45	1,874	3.45
\$ 3.54 – 3.54	3,000	9.81	3.54	—	—
\$ 6.26 – 6.26	5,000	8.38	6.26	5,000	6.26
\$14.04 – 14.04	937	9.19	14.04	937	14.04
\$14.98 – 14.98	20,000	9.16	14.98	7,500	14.98
	<u>2,074,801</u>	9.11	2.60	<u>301,904</u>	2.43

The aggregate intrinsic value of options outstanding and options exercisable as of December 31, 2006 was \$2.5 million and \$0.5 million, respectively. As of December 31, 2006, the ending vested and expected to vest was 2,047,584 and the aggregate intrinsic value of these options was \$2.5 million. The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company's common stock for options that were in-the-money at December 31, 2006.

The total intrinsic value of stock options exercised during the year ended December 31, 2006 was \$0.5 million determined at the date of the option exercise. Cash received from stock option exercises was \$0.1 million for the year ended December 31, 2006. The Company issues new shares of common stock upon exercise of options. In connection with these exercises, there was no tax benefit realized by the Company due to its current loss position.

On September 26, 2006, the Company cancelled 2,172,000 options of 70 eligible employees, consultants and directors that had a weighted average exercise price of \$12.37 and re-granted 2,172,000 options at an exercise price of \$2.57, which was the Company's closing price on September 29, 2006. As a result of the repricing of options of eligible employees and directors, the Company will incur an incremental stock-based compensation expense of approximately \$1.5 million over the weighted average vesting period of the repriced options of 3.0 years. The incremental expense related to the repricing recorded during the year ended December 31, 2006 was not material.

Before the initial public offering in February 2005, the 2001 Plan allowed options to be exercised prior to vesting. Included in common stock at December 31, 2006 are 615,129 shares subject to repurchase related to options exercised prior to vesting.

2004 Employee Stock Purchase Plan

Effective with the initial public offering, the Board of Directors approved the 2004 Employee Stock Purchase Plan (the "Purchase Plan"). The Purchase Plan contains consecutive, overlapping 24 month offering periods. Each offering period includes four six-month purchase periods. The price of the common stock purchased will be the lower of 85% of the fair market value of the common stock at the beginning of an offering period or at the end of the purchase period. For the year ended December 31, 2006, employees had purchased 144,229 shares of common stock under the Purchase Plan at an average price of \$3.14. For the year ended December 31, 2005, employees had purchased 55,309 shares of common stock under the Purchase Plan at an average price of \$5.95 per share. At December 31, 2006, plan participants had \$0.2 million withheld to purchase stock on February 15, 2007, which is included in accrued liabilities on the accompanying balance sheet. At December 31, 2006, 922,377 shares were authorized and available for issuance under the ESPP.

Directors Compensation Program

In December 2005, the Board of Directors approved revised compensation arrangements for non-employee directors of the Company. Effective January 1, 2006, non-employee directors receive an annual retainer \$30,000, and, in addition, chairpersons of the Audit, Compensation and Nominating and Corporate Governance Committees receive annual retainers of \$16,000, \$14,000, and \$10,000, respectively. In May 2005, each non-employee director was granted an option to purchase 15,000 shares of the Company's common stock under the Company's 2004 Equity Incentive Plan. In addition, at each annual meeting of stockholders of the Company, each non-employee director who has served as director at least six months prior to such meeting will receive an automatic grant of an option to purchase 15,000 shares of the Company's common stock. Pursuant to the provisions of the plan, in June 2006, the five non-employee directors received an automatic grant of 15,000 shares of the Company's common stock.

Stock based Compensation

Prior to January 1, 2006 the Company accounted for stock-based employee compensation arrangements in accordance with the recognition and measurement provisions of Accounting Principles Board Opinion No. 25,

“Accounting for Stock Issued to Employees” (“APB 25”) and complied with the disclosure provisions of Statement of Financial Accounting Standards No. 123, “Accounting for Stock-Based Compensation” (“SFAS 123”), as amended by SFAS No. 148, “Accounting for Stock-Based Compensation, Transition and Disclosure.” Under APB 25, unearned stock compensation is based on the difference, if any, on the date of grant, between the fair value of the Company’s common stock and the exercise price. Stock-based compensation expense was recognized under APB 25 for options granted prior to the Company’s initial public offering of its common stock in February 2005 based upon the intrinsic value (the difference between the exercise price at the date of grant and the deemed fair value of the common stock based on the anticipated initial public offering stock price.) The Company did not recognize stock-based compensation cost in its statement of operations for periods prior to January 1, 2006, for option grants that had an exercise price equal to the market value of the underlying common stock on the date of grant.

On January 1, 2006, the Company adopted the fair value provisions of SFAS No.123(R) Share-Based Payment “SFAS 123(R)” using the modified prospective transition method, except for options granted prior to the Company’s initial public offering in February 2005, for which the fair value was determined for disclosure purposes using the minimum value method. Under this transition method, stock-based compensation cost recognized for the year ended December 31, 2006 includes:

- compensation cost for all unvested stock-based awards as of January 1, 2006 that were granted subsequent to the Company’s initial public offering in February 2005, and prior to January 1, 2006, that were earned during the year ended December 31, 2006 based on the recognition of the grant date fair value estimated in accordance with the original provisions of SFAS 123 over the service period, which is generally the vesting period;
- compensation cost for all stock-based awards granted or modified subsequent to January 1, 2006, that were earned during the year ended December 31, 2006 based on the recognition of the grant date fair value estimated in accordance with the provisions of SFAS 123(R) over the service period, which is generally the vesting period; and
- compensation cost for options granted prior to the Company’s initial public offering in February 2005 that were earned during the year ended December 31, 2006, based on the grant date intrinsic value over the service period, which is generally the vesting period.

In addition, SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Prior to the adoption of SFAS 123(R), the Company accounted for forfeitures upon occurrence. Under the modified prospective transition method, results for prior periods have not been restated.

Stock-based compensation expense recognized under SFAS 123(R) and APB 25 in the Company’s consolidated statement of operations for the year ended December 31, 2006 related to stock options and ESPP was \$10.1 million. The stock-based compensation expense for the year ended December 31, 2006, included \$4.4 million related to options granted prior to the initial public offering that were valued using the intrinsic value method in accordance with the provisions of APB 25. As a result of adopting SFAS 123(R) on January 1, 2006, the Company’s loss from operations and net loss for the year ended December 31, 2006 was \$4.6 million, higher than if it had continued to account for stock-based compensation under APB 25. Basic and diluted net loss per share for the year ended December 31, 2006 would have been \$1.40 if the Company had not adopted SFAS 123(R). The implementation did not have an impact on cash flows during year ended December 31, 2006.

Valuation Assumptions

The Company estimated the fair value of stock options granted using the Black-Scholes option-pricing formula and a single option award approach. This fair value is being amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. The fair value of employee stock

options and employee purchase rights under the Company's ESPP was estimated using the following weighted-average assumptions for the years ended December 31, 2006, 2005 and 2004:

	Year ended December 31,		
	2006	2005	2004
Employee Stock Options			
Risk-free interest rate	4.59%	3.66%	2.77%
Expected life (in years)	5.73	4.0	4.0
Dividend yield	—	—	—
Volatility	77%	68%	—
Weighted-average fair value of stock options granted	\$4.49	\$7.35	\$9.01
Employee Stock Purchase Plan			
Risk-free interest rate	5.0	3.11%	—
Expected life (in years)	1.25	1.25	—
Dividend yield	—	—	—
Volatility	67%	67%	—
Weighed-average fair value of ESPP purchase rights	\$1.13	\$3.24	—

To determine the expected term of the Company's employee stock options granted during the year ended December 31, 2006, the Company utilized the simplified approach as defined by SEC Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107"). To determine the risk-free interest rate, the Company utilized an average interest rate based on U.S. Treasury instruments with a term consistent with the expected term of the Company's awards. To determine the expected stock price volatility for the Company's stock options for the year ended December 31, 2006, the Company examined historical volatilities for industry peers as the Company did not have sufficient trading history for its common stock and utilized a median of the historical volatilities of the Company's industry peers. The Company will continue to analyze the expected stock price volatility and expected term assumption as more historical data for the Company's common stock becomes available. The expected stock price volatility for the Company's ESPP for the year ended December 31, 2006 was based on expected stock price volatilities of the Company's industry peers, as well as the historical volatility of the Company's common stock as the Company had trading history for its common stock in excess of the expected term of the stock purchase rights under the ESPP. The fair value of all the Company's stock based award assumes no dividends as the Company does not anticipate paying cash dividends on its common stock.

Employee Stock-based Compensation Expense

Deferred stock-based compensation There were no below-market grants subsequent to the initial public offering in February 2005. Prior to the initial public offering, the Company issued options to certain employees under the 2001 Plan with exercise prices below the fair market value of the Company's common stock at the date of grant, determined with hindsight. In accordance with the requirements of APB No. 25, the Company has recorded deferred stock-based compensation for the difference between the exercise price of the stock option and the fair market value of the Company's stock at the date of grant. This deferred stock-based compensation is amortized to expense on a straight-line basis over the period during which the Company's right to repurchase the stock lapses or the options vest, generally four years. In accordance with the requirements of APB 25, the Company recorded deferred stock-based compensation aggregating \$19.8 million, net of forfeitures (including \$(3.0) million, \$0.5 million and \$20.4 million in 2006, 2005 and 2004, respectively.) Through December 31, 2006, the Company amortized approximately \$15.8 million of such compensation expense, net of forfeitures, with approximately \$4.4 million, \$5.3 million and \$5.3 million being amortized for the years ended December 31, 2006, 2005 and 2004, respectively.

In May 2004, the Company granted 386,778 options to employees to purchase shares of common stock at \$0.53 per share. These options contained a call feature that allowed the Company to cancel the options by

January 31, 2005 if the Company did not complete an initial public offering by December 31, 2004. If the Company had elected to exercise this call feature, the outstanding options would have been cancelled and any shares purchased pursuant to exercise of the options would be immediately repurchasable by the Company at the original purchase price. Stock compensation expense was amortized in accordance with the provisions of FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" for these awards subject to variable accounting. On December 14, 2004 the Company's Board of Directors eliminated the call feature. Prior to the elimination of the call feature the Company applied variable accounting to these options, resulting in deferred stock-based compensation of \$6.0 million and stock compensation expense of \$2.4 million during the year ended December 31, 2004. Beginning in 2005, the remaining deferred stock-based compensation related to these options is being amortized on a straight-line basis over the remaining option vesting period.

Stock-based compensation expense As required by SFAS 123(R) the Company recognized \$4.4 million of stock-based compensation expense related to stock options granted subsequent to the Company's initial public offering in February 2005, under the Company's stock option plans, for the year ended December 31, 2006, in addition to the amortization of deferred compensation above. As of December 31, 2006, the total unrecognized compensation cost related to unvested stock-based awards granted to employees under the Company's stock option plans was approximately \$9.0 million after forfeitures. This cost will be recorded as compensation expense on a straight-line basis over the remaining weighted average requisite service period of approximately 3.1 years.

Stock-based compensation expense in connection with the Purchase Plan for the year ended December 31, 2006 was \$0.3 million.

Non-employee Stock-based Compensation Expense

Stock-based compensation expense related to stock options granted to non-employees is recognized on a straight-line basis, as the stock options are earned. During the years ended December 31, 2006, 2005 and 2004, the Company issued options to non-employees. The options generally vest ratably over the time period the Company expects to receive services from the non-employee. The values attributable to these options are amortized over the service period and the unvested portion of these options was remeasured at each vesting date. The Company believes that the fair value of the stock options is more reliably measurable than the fair value of the services received. The fair value of the stock options granted were revalued at each reporting date using the Black-Scholes valuation model as prescribed by SFAS No. 123 using the following assumptions:

	Years Ended December 31,		
	2006	2005	2004
Risk-free interest rate	4.63%	4.25%	4.38%
Expected life (in years)	6.12	10	10
Dividend yield	—	—	—
Expected volatility	77%	80%	70%

The stock-based compensation expense will fluctuate as the fair market value of the common stock fluctuates. In connection with the grant of stock options to non-employees, the Company recorded stock-based compensation of approximately \$1.1 million, \$4.1 million and \$0.7 million for the years ended December 31, 2006, 2005 and 2004, respectively. In August 2005, the president and founder of the Company resigned as president and entered into a consulting and stock vesting agreement. Under the terms of this agreement, the vesting of certain of his options accelerated at December 31, 2005, subject to certain conditions. Due to the change in status from that of an employee to a consultant, compensation expense associated with the accelerated vesting of these options was recorded for his services as a consultant through December 31, 2005.

Stock-based compensation expense was allocated to research and development and general and administrative as follows (in thousands):

	Year Ended December 31,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Stock-based compensation expense:			
Research and development	\$ 5,008	\$5,951	\$2,960
General and administrative	<u>5,141</u>	<u>3,470</u>	<u>3,015</u>
	<u>\$10,149</u>	<u>\$9,421</u>	<u>\$5,975</u>

Pro forma Disclosure

The modified prospective transition method of SFAS 123(R) requires the presentation of pro forma information for periods presented prior to the adoption of SFAS 123(R) regarding net loss and net loss per share as if the Company had accounted for its stock options under the fair value method of SFAS 123. If compensation expense had been determined based upon the fair value at the grant date for employee compensation arrangements, consistent with the methodology prescribed under SFAS 123, the Company's pro forma net loss and pro forma net loss per share under SFAS 123 would have been as shown in the following table. For the purpose of this pro forma disclosure, the estimated value of the stock awards is recognized on a straight-line basis over the service period, which is generally the vesting periods of the awards (in thousands, except per share data):

	Year Ended December 31, 2005
Net loss attributable to common stockholders, as reported	\$(44,408)
Deduct: Employee total stock-based compensation determined under fair value method	<u>(1,060)</u>
Pro-forma net loss attributable to common stockholders	<u>\$(45,468)</u>
Net loss attributable to common stockholders per common share, basic and diluted:	
As reported	<u>\$ (1.63)</u>
Pro-forma	<u>\$ (1.67)</u>

Disclosures for the year ended December 31, 2006 was not presented because stock-based employee compensation was accounted for under SFAS 123(R)'s fair-value method during this period. Additionally, the stock-based employee compensation determined under the fair-value method for the years ended December 31, 2005 has been adjusted to exclude the effect of the options granted prior to the Company's initial public offering in February 2005, as those options were valued for pro forma disclosure purposes using the minimum value method. Pro forma disclosure for the year end December 31, 2004 is not presented as all options granted during 2004 and preceding years were valued using the minimum value method. The total intrinsic value of stock options exercised during the years ended December 31, 2005 and 2004 were \$0.4 million and \$0.2 million, respectively, determined at the date of the option exercise. Cash received from stock option exercises was \$0.2 million and \$0.9 million for the years ended December 31, 2005 and 2004, respectively.

NOTE 10—INCOME TAXES

A reconciliation of income taxes at the statutory federal income tax rate to net income taxes included in the accompanying statements of operations is as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
U.S. federal taxes (benefit) at statutory rate	\$(18,933)	\$(15,099)	\$(8,013)
State federal income tax benefit	(3,642)	(2,428)	(1,374)
Unutilized (utilized) net operating losses	20,316	16,944	6,075
Stock-based compensation	1,068	200	1,919
Research and development credits	(1,702)	(738)	(554)
Tax assets not benefited	2,884	1,112	1,947
Other	9	9	—
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

The tax effects of temporary differences that give rise to significant components of the net deferred tax assets are as follows (in thousands):

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Capitalized start-up costs	\$ 408	\$ 408	\$ 1,014
Net operating loss carryforwards	40,729	24,043	9,482
Research and development credits	5,250	2,112	874
Deferred stock compensation	6,620	3,829	—
Other (accruals, reserves, depreciation)	1,983	674	852
Total deferred tax assets	<u>54,990</u>	<u>31,066</u>	<u>12,222</u>
Less: Valuation allowance	<u>(54,990)</u>	<u>(31,066)</u>	<u>(12,222)</u>
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

At December 31, 2006, the Company had federal and state net operating loss carryforwards of approximately \$102.0 million available to offset future taxable income. The Company's federal and state net operating loss carryforwards will begin to expire in 2021 and 2013, respectively, if not used before such time to offset future taxable income or tax liabilities. For federal and state income tax purposes, a portion of the Company's net operating loss carryforward is subject to certain limitations on annual utilization in case of changes in ownership, as defined by federal and state tax laws. The annual limitation may result in the expiration of the net operating loss before utilization.

At December 31, 2006, the Company had federal research and development tax credits of approximately \$3.3 million, which will expire in years 2021 through 2026, and state research and development tax credits of approximately \$2.9 million, which will have no expiration date.

The Company has established a valuation allowance against its deferred tax assets due to the uncertainty surrounding the realization of such assets. The valuation allowance increased by \$23.9 million, \$18.8 million and \$7.8 million for the years ended December 31, 2006, 2005 and 2004.

NOTE 11—EMPLOYEE BENEFIT PLAN

In November 2002, the Company implemented a 401(k) Plan to provide a retirement savings program for the employees of the Company. The 401(k) Plan is maintained for the exclusive purpose of benefiting the 401(k) Plan participants. The 401(k) Plan is intended to operate in accordance with all applicable state and federal laws and regulations and, to the extent applicable, the provisions of Department of Labor regulations issued pursuant to ERISA Section 404(c). As of December 31, 2006, the Company has not made any contributions to the 401(k) Plan.

NOTE 12—QUARTERLY FINANCIAL DATA (UNAUDITED):

The following table presents certain unaudited quarterly financial information for the eight quarters ended December 31, 2006. This information has been prepared on the same basis as the audited consolidated financial statements and includes all adjustments necessary to state fairly the unaudited quarterly results of operations.

<u>2006</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
(in thousands, except per share data)				
Revenue	\$ 359	\$ 359	\$ 359	\$ 384
Net loss attributable to common stockholders	\$(13,826)	\$(15,527)	\$(16,713)	\$ (9,620)
Basic and diluted net loss per share attributable to common stockholders	\$ (0.38)	\$ (0.43)	\$ (0.46)	\$ (0.26)
Shares used in computation of basic and diluted net loss per share	35,949	36,178	36,502	36,711
 <u>2005</u>				
(in thousands, except per share data)				
Revenue	\$ —	\$ —	\$ 331	\$ 359
(in thousands, except per share data) Net loss attributable to common stockholders	\$ (7,540)	\$(10,186)	\$(11,526)	\$(15,156)
Basic and diluted net loss per share attributable to common stockholders	\$ (0.46)	\$ (0.36)	\$ (0.40)	\$ (0.44)
Shares used in computation of basic and diluted net loss per share	16,340	28,679	28,961	34,452

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation as of December 31, 2006, under the supervision and with the participation of our management, including our Chief Executive Officer and Vice President, Finance and Controller, of the effectiveness of the design and operation of our disclosure controls and procedures, which are defined under SEC rules as controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized and reported within required time periods and that the information accumulated and communicated to our management, including our Chief Executive Officer and Vice President, Finance and Controller as appropriate, to allow timely decisions, regarding required disclosure. Based upon that evaluation, our Chief Executive Officer and Vice President, Finance and Controller concluded that, as of such date, our disclosure controls and procedures were effective.

Management's report on internal control over financial reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Vice President, Finance and Controller, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on criteria established in the *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and our overall control environment. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2006.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, as an independent registered accounting firm, as stated in their report appearing herein, which expresses unqualified opinions on management's assessment on the effectiveness of the Company's internal control over financial reporting as of December 31, 2006.

Limitations on the Effectiveness of Controls

Our management, including our Chief Executive Officer and Vice President, Finance and Controller, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a

control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Threshold Pharmaceuticals, Inc. have been detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in internal controls over financial reporting

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the fourth quarter of the year ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item will be contained in our Proxy Statement for the 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006 and is hereby incorporated by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item will be contained in our Proxy Statement for the 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006 and is hereby incorporated by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item will be contained in our Proxy Statement for the 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006 and is hereby incorporated by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

The information required by this item will be contained in our Proxy Statement for the 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006 and is hereby incorporated by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item will be contained in our Proxy Statement for the 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after December 31, 2006 and is hereby incorporated by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are being filed as part of this report:

- (1) The following financial statements of the Company and the report of PricewaterhouseCoopers LLP are included in Part II, Item 8:
 - Report of Independent Registered Public Accounting Firm
 - Consolidated Balance Sheets
 - Consolidated Statements of Operations
 - Consolidated Statements of Stockholders' Deficit
 - Consolidated Statements of Cash Flows
 - Notes to Consolidated Financial Statements
- (2) All financial statement supporting schedules are omitted because the information is inapplicable or presented in the Notes to Consolidated Financial Statements.

EXHIBIT NUMBER	DESCRIPTION
3.1(1)	Amended and Restated Certificate of Incorporation of the Registrant
3.2(2)	Amended and Restated Bylaws of the Registration
3.3(10)	Certificate of Designations of Rights, Powers and Preferences of Series A Participating Preferred Stock of Registrant
4.1(3)	Specimen Certificate evidencing shares of common stock
4.3(3)	Amended and Restated Investor Rights Agreement dated as of November 17, 2003 among the Registrant and the parties listed therein
4.4(3)	Form of Amendment No. 1 to Amended and Restated Investor Rights Agreement among the Registrant and certain parties to the Amended and Restated Investor Rights Agreement
4.5(10)	Preferred Shares Rights Agreement, dated as of August 8, 2006, by and between Registrant and Mellon Investor Services LLC
4.6(10)	Form of Rights Certificate
10.1(3)+	2001 Equity Incentive Plan
10.3(3)+	2004 Employee Stock Purchase Plan
10.6†(3)	Agreement between the Registrant, Baxter International Inc., a Delaware corporation, and Baxter Oncology GmbH, a German corporation, dated as of August 5, 2003
10.7†(3)	Exclusive License Agreement by and between the Registrant, Dr. Theodore Lampidis and Dr. Waldemar Priebe, dated as of November 11, 2002
10.8(3)	Loan and Security Agreement by and between the Registrant and Silicon Valley Bank, dated March 27, 2003
10.9(3)+	Form of Indemnification Agreement by and between the Registrant and its officers and directors
10.10(11)†	Agreement by and between the Registrant and Aziende Chimiche Riunite Angelini Francesco - Acraf S.p.a. dated as of June 24, 2004
10.11(3)	Sublease by and between the Registrant and ArQule, Inc. dated as of August 31, 2004
10.12(3)	Offer Letter by and between the Registrant and William A. Halter dated as of September 3, 2004
10.13(3)	Offer Letter by and between the Registrant and George G.C. Parker dated as of September 3, 2004

EXHIBIT NUMBER	DESCRIPTION
10.14†(3)	Development Agreement by and between the Registrant and MediBIC Co. Ltd., dated as of November 30, 2004
10.15(3)+	Form of Change of Control Severance Agreement by and between the Registrant and each of Harold E. Selick, Janet I. Swearson, Mark G. Matteucci and Alan Colowick
10.18(3)	Letter Agreement amending Development Agreement by and between the Registrant and MediBIC Co. Ltd.
10.19(4)+	Employment Letter Agreement by and between the Registrant and Alan B. Colowick dated October 25, 2004
10.20(5)+	Amended and Restated 2004 Equity Incentive Plan
10.22(7)+	Offer Letter by and between the Registrant and Michael S. Ostrach dated as of September 2, 2005
10.24(8)	Triple Net Space Lease by and between the Registrant and Pacific Shores Investors, LLC, dated January 31, 2006
10.25(9)	Form of Notice of Grant of Stock Options and Stock Option Agreement
10.26(12)	Amendment to Loan and Security Agreement by and between the Registrant and Silicon Valley Bank, dated April 7, 2006
10.27(13)+	Agreement and Release by and between the Registrant and Janet I. Swearson dated August 9, 2006
10.28(10)	Offer Letter by and between the Registrant and Cathleen P. Davis, dated August 8, 2006
10.29+	Advisory Board Agreement by and between the Registrant and Alan B. Colowick dated October 13, 2006
10.30(14)+	Change of Control Severance Agreement by and between the Registrant and Michael S. Ostrach
10.31+	Change of Control and Severance Agreement by and between the Registrant and Michael K. Brawer dated November 3, 2007
23.1	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
31.1	Certification Pursuant to Rule 15d-14 of the Securities and Exchange Act of 1934, as amended, as Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification Pursuant to Rule 15d-14 of the Securities and Exchange Act of 1934, as amended, as Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- (1) Filed as exhibit 3.2 to our Registration Statement on Form S-1, as amended (File No. 333-114376), filed on April 9, 2004, and incorporated herein by reference.
- (2) Filed as exhibit 3.4 to our Registration Statement on Form S-1, as amended (File No. 333-114376), filed on April 9, 2004, and incorporated herein by reference.
- (3) Filed as the like number exhibit to our Registration Statement on Form S-1, as amended (File No. 333-114376), filed on April 9, 2004, and incorporated herein by reference.
- (4) Filed as the like number exhibit to our Quarterly Report on Form 10-Q filed on May 13, 2005, and incorporated herein by reference.

- (5) Filed as the like number exhibit to our Current Report on Form 8-K filed on May 24, 2005, and incorporated herein by reference.
 - (6) Filed as exhibit 10.20 to our Current Report on Form 8-K filed on August 19, 2005, and incorporated herein by reference.
 - (7) Filed as the like number exhibit to our Current Report on Form 8-K filed on September 16, 2005, and incorporated herein by reference.
 - (8) Filed as the like number exhibit to our Current Report on Form 8-K filed on February 9, 2006, and incorporated herein by reference.
 - (9) Filed as the like number exhibit to our Current Report on Form 8-K filed on March 17, 2006, and incorporated herein by reference.
 - (10) Filed as the like number exhibit to our Current Report on Form 8-K filed on August 9, 2006, and incorporated herein by reference.
 - (11) Filed as the like number exhibit to our Annual Report on Form 10-K filed on March 28, 2006, and incorporated herein by reference.
 - (12) Filed as the like number exhibit to our Quarterly Report on Form 10-Q filed on May 15, 2006, and incorporated herein by reference.
 - (13) Filed as the like number exhibit to our Quarterly Report on Form 10-Q filed on November 9, 2006, and incorporated herein by reference.
 - (14) Filed as exhibit 10.27 to our Current Report on Form 8-K filed on August 9, 2006, and incorporated herein by reference.
- † Confidential treatment granted as to certain portions, which portions have been omitted and filed separately with the Securities and Exchange Commission.
- + Indicates a management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

THRESHOLD PHARMACEUTICALS, INC.

March 15, 2007

By: /s/ HAROLD E. SELICK
Harold E. Selick, Ph.D.
Chief Executive Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ HAROLD E. SELICK, PH.D.</u> Harold E. Selick, Ph.D.	Chief Executive Officer (principal executive officer)	March 15, 2007
<u>/s/ CATHLEEN P. DAVIS</u> Cathleen P. Davis	Vice President, Finance and Contoller (principal financial and accounting officer)	March 15, 2007
<u>/s/ BRUCE C. COZADD</u> Bruce C. Cozadd	Director	March 15, 2007
<u>/s/ PATRICK G. ENRIGHT</u> Patrick G. Enright	Director	March 15, 2007
<u>/s/ WILLIAM A. HALTER</u> William A. Halter	Director	March 15, 2007
<u>/s/ WILFRED E. JAEGER, M.D.</u> Wilfred E. Jaeger, M.D.	Director	March 15, 2007
<u>/s/ GEORGE G. C. PARKER, PH.D.</u> George G. C. Parker, Ph.D.	Director	March 15, 2007
<u>/s/ MICHAEL F. POWELL, PH.D.</u> Michael F. Powell, Ph.D.	Director	March 15, 2007

10-K

CORPORATE INFORMATION

MANAGEMENT TEAM

Harold E. Selick, Ph.D.
Chief Executive Officer

Michael K. Brawer, M.D.
Chief Medical Officer

Cathleen P. Davis
Vice President,
Finance and Controller

Kevin R. Kaster, J.D.
Senior Vice President,
Corporate Development

Stewart M. Kroll
Vice President, Biostatistics
and Clinical Operations

Mark G. Matteucci, Ph.D.
Senior Vice President,
Discovery Research

BOARD OF DIRECTORS

Bruce C. Cozadd
Executive Chairman,
Jazz Pharmaceuticals

William A. Halter
Lieutenant Governor of Arkansas

David R. Hoffmann
Independent Director

Wilfred E. Jaeger, M.D.
Partner, Three Arch Partners

George G. C. Parker, Ph.D.
Dean Witter Distinguished Professor
of Finance and Management,
Graduate School of Business,
Stanford University

Michael F. Powell, Ph.D.
Managing Director,
Sofinnova Ventures, Inc.

Harold E. Selick, Ph.D.
Chief Executive Officer

CORPORATE INFORMATION

CORPORATE HEADQUARTERS
Threshold Pharmaceuticals
1300 Seaport Boulevard, 5th Floor
Redwood City, CA 94063
650.474.8200 telephone
650.474.2529 fax

STOCKHOLDER INFORMATION

ANNUAL MEETING
The Annual Meeting of Stockholders will
be held May 16, 2006 at 12:00 p.m. at:
Threshold Pharmaceuticals
1300 Seaport Boulevard, 5th Floor
Redwood City, CA 94063

TRANSFER AGENT
Mellon Investor Services LLC
85 Challenger Road
Ridgefield Park, NJ 07660
800.356.2017

SHAREHOLDER INFORMATION
Symbol: THLD
Exchange: NASDAQ

LEGAL COUNSEL
Heller Ehrman White & McAuliffe LLP
Menlo Park, CA

INDEPENDENT AUDITORS
PricewaterhouseCoopers LLP
San Jose, CA



THRESHOLD PHARMACEUTICALS, INC.

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