FORM 10-KSB

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

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

For the fiscal year ended December 31, 1996

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 0-28782

_____

NEOTHERAPEUTICS, INC.
(Name of Small Business Issuer in its charter)

COLORADO	93-0979187
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
ONE TECHNOLOGY DRIVE, SUITE I-821 IRVINE, CALIFORNIA (Address of principal executive offices)	92618 (Zip Code)

Issuers telephone number: (714) 788-6700

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: N/A

SECURITIES REGISTERED PURSUANT TO SECTION 12 (g) OF THE ACT:

Common Stock, no par value
Common Stock Purchase Warrants

_____

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

Revenues for the issuer's most recent fiscal year were $0.

The aggregate market value of the voting stock held by non-affiliates as of December 31, 1996 was $16,652,307.

As of March 24, 1997, there were 5,361,807 shares of the issuer's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

TABLE OF CONTENTS

This Annual Report on Form 10-KSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Company's actual results may differ materially from the results projected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in "ITEM 1 - "Description of Business", including the section therein entitled "Risk Factors," and in "ITEM 6 - Discussion and Analysis of Financial Condition and Results of Operations."

PART I

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

The Company was incorporated in Colorado in December 1987. On August 7, 1996, the Company changed its name from Americus Funding Corporation to NeoTherapeutics, Inc. Advanced Immunotherapeutics, Inc. ("AIT"), was incorporated as a California corporation in June 1987. In July 1989, all of the shareholders of AIT exchanged all of their shares of AIT Common Stock for shares of the Company's Common Stock, and AIT became a wholly-owned subsidiary of the Company. Unless the context otherwise requires, all references to the "Company" and "NeoTherapeutics" refer to NeoTherapeutics, Inc., a Colorado corporation, and AIT. The Company's executive offices are located at One Technology Drive, Suite I-821, Irvine, CA 92618, and its telephone number is (714) 788-6700.

The Company is a development stage biopharmaceutical company engaged in the discovery and development of novel therapeutic drugs intended to treat neurodegenerative diseases and conditions, such as memory deficits associated with Alzheimer's disease and aging, stroke, spinal cord injuries and Parkinson's disease. The Company's initial product candidate, AIT-082, and its other compounds under development are based on the Company's patented technology. This technology uses small synthetic molecules to create non-toxic compounds, intended to be administered orally or by injection, that are capable of passing through the blood-brain barrier to rapidly act upon specific target cells in specific locations in the central nervous system, including the brain. Animal and laboratory tests have shown that the Company's AIT-082 compound appears to selectively increase the production of certain neurotrophins, a type of large protein, in the hippocampus and frontal cortex, which are the areas of the brain implicated in memory. These neurotrophins regulate nerve cell growth and function. The Company's technology has been developed to capitalize on the beneficial effects of these proteins, which have been widely acknowledged to be closely involved in the early formation and differentiation of the central nervous system. The Company believes that AIT-082 could have prophylactic, therapeutic and regenerative effects.

The Company's developmental activities to date have benefited from a close association with the National Institutes of Health ("NIH"). The NIH's National Institute on Aging ("NIA") has funded a portion of the pre-clinical

studies on the Company's AIT-082 compound, including toxicity studies. The NIA has committed to fund and conduct two Phase I clinical trials under the auspices of its Alzheimer's Disease Cooperative Study Unit ("ADCSU"), a consortium of approximately 35 highly regarded clinical centers throughout the United States. The NIH's National Institute for Mental Health ("NIMH") has also supported the Company's development efforts by providing funds, along with the NIA, for the production of sufficient quantities of the AIT-082 compound to complete pre-clinical testing and Phase I human clinical trials.

An application has been filed with the Canadian Ministry of Health to test AIT-082 in humans, and Dr. D. W. Molloy of the Geriatric Research Group received authorization from that agency on March 6, 1997 to conduct Phase I/II clinical trials in Alzheimer's patients. These clinical trials commenced on March 24, 1997.

INTRODUCTION TO THE CENTRAL NERVOUS SYSTEM

The human brain contains some 10 billion nerve cells, or neurons, each of which has connections with many other neurons. Sensory, motor and cognitive activities are all governed by this complex network of neurons, each member of which communicates with other neurons across junctions known as "synapses." Communication between neurons involves chemical "messengers" known as neurotransmitters, which are released by the sending neuron, diffuse across a small gap, and bind to corresponding receptors on the receiving neuron. Abnormal neuronal communication has been implicated in a range of psychiatric and neurological disorders, including memory deficits, schizophrenia, depression, anxiety, Parkinson's disease and eating disorders.

The treatment of most diseases is facilitated by cell regeneration, a natural component of human healing. However, in the highly complex realm of neurological diseases, treatment is more difficult because neurons do not naturally regenerate after maturity. Currently available drugs for the treatment of such significant neurological disorders as Alzheimer's and Parkinson's diseases act by increasing or replacing supplies of critical neurotransmitters, but provide time-limited benefits at best. These benefits are limited because the eventual loss of neuronal cells without regeneration means there is eventually nothing for those neurotransmitters to activate.

Much of the early neuroscience-oriented biotechnology research centered on the investigation of certain proteins, known as neurotrophins or neurotrophic factors, which are necessary to the early development of neurons as well as their long-term maintenance and survival. These substances are involved in the fundamental formation and shaping of the nervous system. Given their role in the early neuron development and maintenance, it has been hypothesized that these neurotrophic factors could be used in the treatment of neurodegenerative diseases.

Since neurons do not naturally regenerate following damage or disease, substantial research has been conducted by academic researchers and by the pharmaceutical industry in developing these factors as possible treatments for a variety of neurological disorders. To date, the usefulness of these factors has been limited by their inability to pass the blood-brain barrier, which serves as a "filter" to keep molecules larger than a certain size from leaving the bloodstream and entering the brain and spinal cord. Therefore, neurotrophic factors, which are large molecules, cannot be administered orally or through injection into the bloodstream.

There are currently three alternative approaches to achieving blood-brain barrier access. One approach is to introduce neurotrophic factors by direct injection into the brain through a catheter inserted into a hole drilled into the skull. While this treatment has achieved some success in alleviating some of the symptoms of Alzheimer's disease, the prospect for infection and the inconvenience and expense of the procedure have limited its practical usefulness to date. The second approach is to temporarily break down the blood-brain barrier, which would allow molecules of all sizes (including therapeutic as well as toxic or infectious agents) to enter into the central nervous system. This approach is in the early stage of development, and its utility has not been established.

The third approach, the one taken by the Company, is to find small molecules which can pass through the blood-brain barrier, which can be administered orally or

through injection into the bloodstream. The small-molecule approach taken by the Company, if successful, could lead to the development of compounds which can either mimic the actions of the larger molecule neurotrophic factors or stimulate the production of such factors within the brain, through administration either orally or through injection. The Company believes that such a development could represent a major advance in the treatment of neurological disorders.

Neurotrophic Factors

A number of the Company's compounds modify biological processes that involve neurotrophic factors. In the past, research on neurotrophic factors has been greatly hampered by the fact that such factors naturally exist only in small quantities. However, advances in cloning these factors over the past few years have made them more available for research. The neurotrophic factors of greatest research interest to the Company are:

- NGF (Nerve Growth Factor): NGF has been shown to be essential to the development and maintenance of peripheral sensory and sympathetic system neurons, as well as central cholinergic neurons that are clustered in the hippocampus and cortex areas of the brain. These sites of activity imply possible relevance to Alzheimer's disease degeneration, since it is the loss of cholinergic neurons in those areas which is believed integral to the loss of memory functions characteristic of that disease. Animal studies have shown that NGF can reverse neuronal functional deficits induced by natural aging and by experimental surgical lesions of the brain. Direct administration of NGF into the brain through a catheter inserted into a hole drilled into the skull has led to an improvement in spatial memory in aged rats. Similarly, the direct administration of NGF into the brain of a limited number of Alzheimer's disease patients has been shown to cause an improvement in short-term memory.

- NT-3 (Neurotrophin-3): like NGF , NT-3 stimulates neurite fiber growth. NT-3 appears potentially useful in the treatment of some sensory neuropathies, which are impairments of an individual's subjective awareness of his or her own muscle motion and body positioning, and are encountered in diabetics and in patients receiving chemotherapy for cancer. Infusion of NT-3 directly into the brain has led to improvement in spatial memory in aged rats.

- bFGF (Fibroblast Growth Factor, basic): bFGF is neuroprotective and may promote the proliferation of certain immature neurons. While the exact relevance of bFGF to disease is currently being established, it appears to be the only neurotrophin that causes proliferation of neurons. Based on these observations, the long-held belief that new neurons cannot be generated in adults is being reconsidered. The ability to produce new neurons could have implications in a variety of diseases where neurons have been destroyed, such as Alzheimer's disease, spinal cord injuries and stroke.

THE COMPANY'S DRUG DEVELOPMENT STRATEGY

The Company is engaged in research that has primarily focused on the development of new drugs that act on the nervous system to treat diseases and conditions characterized by a memory impairment, such as Alzheimer's disease, impairment associated with the dementia of aging, stroke, spinal cord injuries, as well as Parkinson's disease.

6

The technical strategy employed by the Company is the synthesis of proprietary chemical molecules that modify specific biological processes in the body. The methods by which the molecules are synthesized are proprietary and specific molecules and their methods of use have been patented by the Company. The Company's drug design methods are based upon the use of hypoxanthine, a natural non-toxic purine compound which is contained in the genetic material of all living matter. Hypoxanthine is chemically linked to a variety of other molecules in order to produce the Company's proprietary AIT series of compounds. The various molecules that are linked to hypoxanthine are selected from known drugs that have established therapeutic activity, producing a bi-functional compound. These compounds exhibit certain functional features of both hypoxanthine (including its ability to facilitate passage through the blood-brain barrier) and the linked therapeutic drugs. Chemical and behavioral studies have given the Company reason to believe that this compound synthesis and selection process increases the probability that the new AIT compounds will retain the efficacy exhibited by their "parent" drugs.

The Company conducts the synthesis and early testing to establish therapeutic potential necessary to obtain patents on new compounds. In that regard, the Company has conducted pre-clinical testing of the safety and efficacy of certain of its compounds and intends to file an Investigational New Drug Application ("IND") for each such compound. With respect to the Company's AIT-082 compound, some Phase I clinical trials will be conducted by the ADCSU, and the Company intends to conduct all other clinical trials necessary to obtain FDA approval. The Company intends to seek out large pharmaceutical companies as partners for the development, manufacture and marketing of certain of its other compounds.

PRODUCTS IN DEVELOPMENT

The Company has discovered, synthesized and tested a series of new compounds. These compounds have been tested in the Company's own former laboratories, at adjunct laboratories at Olive View/UCLA Medical Center, at U.C. Irvine and other independent universities, at other industry research centers and at the NIH. These compounds are all currently in pre-clinical testing. The Company's lead compound, AIT-082, has also begun Phase I/II clinical studies. The following table summarizes the activity and potential use for some of the compounds currently under development. A number of other compounds have been synthesized and are awaiting further biological evaluation. No assurance can be made that any of the Company's compounds will prove to be effective treatments for the indicated diseases or conditions or for any other purposes, or that any such compounds will receive FDA approval.

COMPOUND	POTENTIAL INDICATIONS	DEVELOPMENT STATUS
AIT-082	Alzheimer's disease, spinal cord injury, amyotrophic lateral sclerosis, memory impairment of aging, stroke	Phase I/II clinical studies began in March 1997; Pre-clinical studies
AIT-097	Parkinson's disease	Pre-clinical studies; toxicity studies expected to begin in 1997
AIT-034	Alzheimer's disease, severe memory impairment	Pre-clinical studies; toxicity studies expected to begin in 1997
AIT-083	Memory impairment, immune impairment, AIDS dementia	Pre-clinical studies
AIT-084	Anti-anxiety and antispasmodic agent	Pre-clinical studies

7

COMPOUND	POTENTIAL INDICATIONS	DEVELOPMENT STATUS
AIT-110	Immune system disorders, angina, arrhythmias	Pre-clinical studies
AIT-111	Hypertension, angina, arrhythmias, altered central nervous system impulse transmission	Pre-clinical studies

AIT-082

The Company's AIT-082 compound is the most extensively studied compound in the AIT series and has been the primary focus of the Company's research efforts. AIT-082 is a small synthetic molecule that incorporates the chemical structural features of hypoxanthine (the only purine which passes the blood-brain barrier) and procainamide, which is a drug marketed for the treatment of cardiac arrhythmias and has been shown to have memory-enhancing activity. AIT-082 has been shown in animal studies to enhance working (or recent) memory, the type of memory which is deficient in patients suffering from Alzheimer's disease. In addition, the Company believes that AIT-082 has potential as a treatment for memory impairments that are seen in children, aged and stroke patients, as well as in patients with nerve damage such as stroke and spinal cord injury.

Pre-clinical testing involving laboratory animals conducted by the Company and independent research institutions has indicated that AIT-082 exhibits the following properties and/or effects:

- Memory: Shown to reduce, delay and prevent memory deficits in aged animals; shown to enhance memory function in young and aged animals.
- Toxicity: Shown to be non-toxic at the highest testable dosage in dogs (1,000 mg/kg) and rats (3,000 mg/kg).
- Dosage: Effective over a wide range of doses, with effectiveness observed at doses as low as 0.5 mg/kg and up to 60 mg/kg; a single dose has been observed to have measurable effects for more than seven days.
- Administration: Active both orally and through injection.
- Tolerance: Tolerance to AIT-082 has not developed even after daily treatment in mice for a period of 11 months.
- Side effects: Has no measured effect in mice on neurological parameters such as learning rate, motivation, performance or ocomotor activity.

Until completion of human clinical trials, there can be no assurance that these properties and/or effects can be replicated in humans.

The Company has shown that when administered to neurons in tissue culture, AIT-082 can induce the same effects as NGF when administered alone. The Company has also shown that AIT-082 causes the production of NGF, NT-3 and bFGF in tissue culture. In addition, the Company has demonstrated that oral administration of AIT-082 increases the levels of NGF, NT-3 and bFGF in the hippocampus and frontal cortex of aged mice. Other researchers have shown that administration of multiple neurotrophins may be more effective as a treatment method than the administration of a single neurotrophin. The Company believes that AIT-082's mechanism of action (after it has passed through the blood-brain barrier) involves activating the genes that lead to the production of a number of different neurotrophins. Neurotrophins themselves are not orally active and do not

pass the blood-brain barrier. Therefore, should oral AIT-082 prove to be an effective treatment for neurological disorders, it could have two distinct practical advantages over NGF, NT-3 or bFGF administered alone directly into the brain as a treatment for such disorders: (i) it can be administered orally; and (ii) it induces the production of multiple neuotrophins in those areas of the brain associated with memory.

The NIA and the NIMH have contracted for production of sufficient quantities of AIT-082 to conduct animal toxicity studies and early human clinical trials and have committed funding for this contract. In addition, the NIA has contracted with an independent laboratory to conduct the toxicology studies required by the FDA for an IND and has committed funding for this contract. The initial production of AIT-082 and the first toxicity studies necessary to prepare and submit an IND have been completed. Additional toxicity studies in animals are expected to commence in the second quarter of 1997. The Company anticipates that the IND for AIT-082 will be submitted to the FDA within the first six months of 1997. There can be no assurance that the Company will be able to file or obtain approval of an IND for AIT-082 during such period, if at all.

The first phase of human clinical evaluation in the United States will begin shortly after approval of the IND. The Company anticipates that these clinical studies should take approximately three to six months to complete; however, there can be no assurance that these studies will not take longer to complete. Two Phase I human clinical studies will be paid for and conducted in the United States by the ADCSU. The ADCSU is a consortium of approximately 35 United States clinical centers funded by the NIA to conduct human Alzheimer's disease research. The ADCSU has reviewed the Company's pre-clinical test data and has approved conducting such clinical trials with AIT-082 after FDA approval of the Company's IND. The Company expects that it will have to fund two Phase II human clinical studies prior to submitting AIT-082 to the FDA for marketing approval. There can be no assurance, however, that clinical trials of AIT-082 will be successful, that the marketing of AIT-082 will be approved by the FDA, or that AIT-082 can be successfully marketed to its targeted population. See "- Drug Approval Process and Government Regulation."

An application has been filed with the Canadian Ministry of Health to test AIT-082 in humans, and Dr. D. W. Molloy of the Geriatric Research Group received authorization from that agency on March 6, 1997 to conduct Phase I/II clinical trials in Alzheimer's patients. These clinical trials commenced on March 24, 1997.

Other Compounds in Development

Due to the historically limited resources available to the Company and the Company's decision to focus those resources on the development of its AIT-082 compound, its other compounds are in an earlier stage of development. These compounds include:

AIT-097. AIT-097 is a chemical derivative of hypoxanthine and dopamine that has been demonstrated in animal studies to improve motor function. The Company believes that AIT-097 has the potential of being developed as a product for the treatment of Parkinson's disease. The Company plans to expand pre-clinical testing and initiate toxicity studies on AIT-097 in 1997.

AIT-034. AIT-034 is a chemical analog of AIT-082 that has been demonstrated in animal studies to enhance memory and to reverse memory deficits in severely impaired animals that do not respond to AIT-082. AIT-034 does not induce the production of NGF, and its mechanism of action is therefore believed to be different than AIT-082. The Company believes that AIT-034 could be a practical complementary product for Alzheimer's disease. The Company expects initial toxicity studies on AIT-034 to commence in 1997.

9

AIT-083. AIT-083 has been demonstrated in animal studies to enhance memory and is a mild stimulant of the central nervous system. AIT-083 has also been shown to be a stimulant of the T-cells of the immune system, making it a candidate for evaluation in the treatment of the dementia associated with HIV infection.

AIT-084. AIT-084 has been shown in animal studies to interact with the brain receptor for gamma-aminobutyric acid (GABA), which is a neurotransmitter, and may have potential as an anti-anxiety and antispasmodic agent.

AIT-110. AIT-110 has been shown to interact with calcium channel proteins in laboratory tests and the Company believes that it has potential use as a treatment of angina and arrhythmias. AIT-110 has also been shown in laboratory tests to have activity as an immunomodulator for the B-cells of the immune system, and the Company believes it has potential for the treatment of a variety of immune system disorders.

AIT-111. AIT-111 has been shown in laboratory tests to interact with calcium channel proteins and protein kinase C, and the Company believes that it has potential for the treatment of hypertension, angina, arrhythmias and a number of conditions associated with altered central nervous system impulse transmissions.

Until extensive further development and testing is completed, which will take many years if undertaken at all, the therapeutic and other effects of these compounds cannot be established.

PRIMARY THERAPEUTIC TARGETS

Alzheimer's Disease. Alzheimer's disease is a neurodegenerative brain disorder that leads to progressive memory loss and dementia. Alzheimer's disease generally follows a course of deterioration over eight years or more, with the earliest symptom being impairment of short- term memory. Alzheimer's disease is now recognized as the most common cause of severe intellectual impairment in persons over the age of 65 in the United States, with approximately four million Americans diagnosed as suffering from Alzheimer's disease. The number of Alzheimer's disease patients is expected to reach 14 million by 2050. Alzheimer's disease is the fourth leading cause of death in the United States with approximately 100,000 deaths per year. The National Alzheimer's Association has estimated that the overall care costs for the treatment and care of the estimated four million United States Alzheimer's disease patients is $100 billion per year.

To date, advanced chronological age appears to be the most significant factor associated with the development of Alzheimer's disease. The incidence of Alzheimer's disease is estimated to be approximately 5-10% in the over-65 age group. Current estimates are that one-third of the entire population in the developed countries will survive to at least 80 years of age, when the risk of contracting Alzheimer's disease increases to approximately 20%. In addition, approximately 50% of the population over 85 years of age has been estimated to be suffering from Alzheimer's disease. The Company is testing two compounds, AIT-082 and AIT-034, which have shown preliminary indications in animals of enhancing or restoring memory, and have potential to be used to treat Alzheimer's disease patients.

Memory Impairment Associated with Aging. Because the populations of developed countries are increasingly becoming older, the costs and social burden of medical care and housing of aged persons suffering from mentally deteriorative diseases is increasing. The availability of a drug to reduce the memory impairments associated with aging would not only have a significant economic impact but would also greatly improve the quality of life for the elderly population. Both AIT-082 and AIT-034 have shown to be effective in ameliorating memory loss associated with aging in mice.

10

Stroke. Among older Americans, stroke ranks as the third leading cause of death. An estimated 500,000 people in the United States suffer strokes each year. The costs associated with the treatment and care of stroke patients are estimated to be approximately $25 billion per year. Most therapeutic approaches to treating strokes are directed towards correcting the circulatory deficit or to blocking the toxic effects of chemicals released in the brain at the time of the stroke. The Company is focusing its emphasis in the treatment of strokes on protecting the cells from injury or degeneration caused by strokes. Since AIT-082 has the potential to enhance nerve regeneration, the Company believes that AIT-082 may prove useful in the treatment of stroke.

Spinal Cord Injury. There are an estimated 200,000 severely disabled survivors of spinal cord trauma in the United States with approximately 10,000 new injuries each year. The cost of care and services for these individuals is estimated to exceed $10 billion per year. Significant research efforts are currently being focused on the neurotrophic factors that can initiate and support new cell development, guide new or damaged nerves to appropriate targets and maintain neuronal function. Animal studies have shown that all these functional restorations are possible with appropriate neurotrophic factors. A major obstacle to the effective use of these neurotrophic factors is the delivery of the appropriate neurotrophin to the site of damage. AIT-082 has been shown in mice to cause the production of several neurotrophic factors in the brain after oral administration, demonstrating that it can effectively penetrate the blood-brain barrier; therefore, the Company believes that AIT-082 could potentially be used to stimulate the regeneration of nerves damaged by spinal cord injury. The Company has committed $100,000 for the establishment of a NeoTherapeutics Fellowship as part of the Reeve-Irvine-Smith Research Center for spinal cord injury.

MARKETING AND SALES STRATEGY

The Company has no experience in the marketing of pharmaceutical products and, with the exception of the marketing of AIT-082 in the United States, the Company does not expect to develop the resources to distribute and market any products it might develop. With respect to any products it may develop (other than AIT-082), the Company intends to license to, or enter into strategic alliances with, larger pharmaceutical companies which could market such products through their already developed distribution networks.

The Company's marketing strategy for AIT-082 differs from its marketing strategy for its other future products because the Company believes the development history (i.e. the technical and financial support provided by the NIA, NIMH and ADCSU) and potential market (i.e. Alzheimer's disease, for which there currently are only limited treatment options) for AIT-082 present certain marketing advantages that its other proposed products do not have at this time. The Company intends to market AIT-082 in the United States by developing its own internal marketing organization. The Company believes this approach for the United States sales is feasible since the Company expects to market AIT-082 to a focused niche market primarily composed of psychiatrists and neurologists at major Alzheimer's disease treatment centers. Furthermore, the Company believes that, should AIT-082 ultimately be approved for marketing by the FDA, the involvement by members of the ADCSU in conducting human clinical trials of AIT-082 could provide the Company with an advantage in marketing AIT-082. The Company believes the technical and financial support provided to the Company by the NIA, NIMH and ADCSU for the development of AIT-082 will also make the marketing of AIT-082 in the United States more feasible for the Company. The Company expects to begin to build a marketing organization in the Unites States after it makes a determination as to whether the clinical results are sufficient to satisfy FDA requirements for marketing approval. If, in the judgment of the Company, such approval is likely, then the Company

will begin to implement a marketing plan for AIT-082. The Company may consider granting a co-marketing license to a larger pharmaceutical company in the United States.

The Company currently intends to conduct its own synthesis and early testing of new compounds to establish therapeutic potential necessary to obtain patents. Thereafter, the Company may decide to enter into strategic alliances or licensing arrangements with larger pharmaceutical companies that could then provide for the continued development of certain of its compounds, including obtaining all necessary FDA approvals for the marketing of drugs derived from these compounds. The Company may decide to enter into strategic alliances at various steps in the drug approval process, depending upon its evaluation of various factors pertaining to the development and marketing of its compounds. These factors may include the expense of obtaining FDA approval of the compound, the size of the target market for drugs derived from a compound, the potential difficulties in marketing drugs derived from a compound and the possibility of obtaining assistance from scientific and government entities in developing a compound.

As part of the Company's overall marketing strategy, it intends to enter into strategic alliances or licensing arrangements with respect to overseas distribution of all of the products it develops, including AIT-082. The Company believes that the complexities of the various regulatory and marketing procedures in foreign countries make it inadvisable for the Company to undertake any such regulatory or marketing efforts by itself. With respect to AIT-082, the Company may wait until Phase I clinical trials are successfully completed in the United States before licensing AIT-082 in Europe and Japan as well as granting a co-marketing license in the United States.

If the Company enters into strategic alliances or licensing arrangements with respect to any of its compounds, it may retain the rights to co-market certain of these products in the United States.

DRUG APPROVAL PROCESS AND OTHER GOVERNMENT REGULATION

The production and marketing of the Company's products and its research and development activities are subject to regulation for safety, efficacy and quality by numerous governmental authorities in the United States and other countries. In the United States, drugs are subject to rigorous regulation. The Federal Food, Drug and Cosmetics Act, as amended, and the regulations promulgated thereunder, as well as other federal and state statutes and regulations, govern, among other things, the testing, manufacture, safety, efficacy, labeling, storage, record keeping, approval, advertising and promotion of the Company's proposed products. Product development and approval within this regulatory framework take a number of years and involve the expenditure of substantial resources. In addition to obtaining FDA approval for each product, each drug manufacturing establishment must be registered with, and approved by, the FDA. Domestic manufacturing establishments are subject to regular inspections by the FDA and must comply with Good Manufacturing Practices ("GMP"). To supply products for use in the United States, foreign manufacturing establishments must also comply with GMP and are subject to periodic inspection by the FDA or by regulatory authorities in certain of such countries under reciprocal agreements with the FDA. Drug product and drug substance manufacturing establishments located in California also must be licensed by the State of California in compliance with local regulatory requirements.

New Drug Development and Approval. The United States system of new drug approval is one of the most rigorous in the world. According to a February 1993 report by the Congressional Office of Technology Assessment, it costs an average of $359 million and takes an average of 15 years from discovery of a compound to bring a single new pharmaceutical product to market. Approximately one in 1,000 compounds that enter the pre-clinical testing stage eventually makes it to human testing and only one-fifth of those are ultimately approved for commercialization. In recent years, societal and

governmental pressures have created the expectation that drug discovery and development costs can be reduced without sacrificing safety, efficacy and innovation. The need to significantly improve or provide alternative strategies for successful pharmaceutical discovery, research and development remains a major health care industry challenge.

Drug Discovery. In the initial stages of drug discovery before a compound reaches the laboratory, typically tens of thousands of potential compounds are randomly screened for activity in an assay assumed to be predictive of a particular disease process. This drug discovery process can take several years. Once a "screening lead" or starting point for drug development is found, isolation and structural determination is initiated. Numerous chemical modifications are made to the screening lead (called "rational synthesis") in an attempt to improve the drug properties of the lead. After a compound emerges from the above process, it is subjected to further studies on the mechanism of action, further in vitro screening against particular disease targets and finally, in vivo animal screening. If the compound passes these evaluation points, animal toxicology is performed to begin to analyze the potential toxic effects of the compound, and if the results indicate acceptable toxicity findings, the compound emerges from the basic research mode and moves into the pre-clinical phase.

Pre-clinical Testing. During the pre-clinical testing stage, laboratory and animal studies are conducted to show biological activity of the compound against the targeted disease, and that the compound is evaluated for safety. These tests can take up to three years or more to complete.

Investigational New Drug Application (IND). After pre-clinical testing, an IND is submitted to the FDA to begin human testing of the drug. The IND becomes effective if the FDA does not reject it within 30 days. The IND must indicate the results of previous experiments, how, where and by whom the new studies will be conducted, how the chemical compound is manufactured, the method by which it is believed to work in the human body, and any toxic effects of the compound found in the animal studies. In addition, the IND must be reviewed and approved by an Institutional Review Board comprised of physicians at the hospital or clinic where the proposed studies will be conducted. Progress reports detailing the results of the clinical trials must be submitted at least annually to the FDA.

Phase I Clinical Trials. After an IND becomes effective, Phase I human clinical trials can begin. These studies, involving usually between 20 and 80 healthy volunteers, can take up to one year or more to complete. The studies determine a drug's safety profile, including the safe dosage range. The Phase I clinical studies also determine how a drug is absorbed, distributed, metabolized and excreted by the body, as well as the duration of its action.

Phase II Clinical Trials. In Phase II clinical trials, controlled studies of approximately 100 to 300 volunteer patients with the targeted disease assess the drug's effectiveness. These studies are designed primarily to evaluate the effectiveness of the drug on the volunteer patients as well as to determine if there are any side effects on these patients. These studies can take up to two years or more. In addition, PhaseI/II clinical trials may be conducted that evaluate not only the efficacy but also the safety of the drug on the targeted patient population.

Phase III Clinical Trials. This phase typically lasts up to three years or more and usually involves 1,000 to 3,000 patients with the targeted disease. During the Phase III clinical trials, physicians monitor the patients to determine efficacy and to observe and report any adverse reactions that may result from long-term use of the drug.

New Drug Application (NDA). After completion of all three clinical trial phases, the data is analyzed and, if the data indicates that the drug is safe and effective, a NDA is filed with the FDA. The NDA must contain all of the information on the drug that has been gathered to date, including data from the clinical trials. NDAs are often over 100,000 pages in length. The average NDA review time for new pharmaceuticals approved in 1995 was 19.2 months.

Fast Track Review. In December 1992, the FDA formalized procedures for accelerating the approval of drugs to be marketed for the treatment of certain serious diseases for which no satisfactory alternative treatment exists, such as Alzheimer's disease and AIDS. If it is demonstrated that the drug has a positive effect on survival or irreversible morbidity during Phase

II clinical trials, then the FDA may approve the drug for marketing without completion of Phase III testing. At the present time, the Company believes that AIT-082 may be able to qualify for "fast-track" FDA review; however, no assurance can be made that AIT-082 will ultimately be demonstrated to meet the requirements for such "fast-track" review.

Approval. If the FDA approves the NDA, the drug becomes available for physicians to prescribe. The Company must continue to submit periodic reports to the FDA, including descriptions of any adverse reactions reported. For certain drugs which are administered on a long-term basis, the FDA may request additional clinical studies (Phase IV) after the drug has begun to be marketed to evaluate long-term effects.

In addition to regulations enforced by the FDA, the Company is also subject to regulation under the Occupational Safety and Health Act, the Environmental Protection Act, the Toxic Substances Control Act, the Resource Conservation and Recovery Act and other present and future federal, state or local regulations. The Company's research and development activities involves the controlled use of hazardous materials, chemicals, viruses and various radioactive compounds. Although the Company believes that its safety procedures for handling and disposing of such materials comply with the standard prescribed by state and federal regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, the Company could be held liable for any damages that result, and any such liability could exceed the resources of the Company.

For marketing outside the United States, the Company or its prospective licensees will be subject to foreign regulatory requirements governing human clinical trials and marketing approval for drugs and devices. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary widely from country to country. The Company does not currently have any facilities or employees outside of the United States.

MANUFACTURING

The Company has only limited capability at present to chemically synthesize compounds for its research, testing and development programs for AIT-082 or any of its other compounds. The NIMH and NIA have agreed to fund the production of AIT-082 by an FDA-certified drug manufacturer in quantities sufficient to conduct toxicity testing and early human clinical trials. The Company believes that the quantities of AIT-082 being produced under this funding should be sufficient to conduct these Phase I human clinical trials. The Company will need to ensure the production of additional amounts of AIT-082 if, and when, additional clinical programs for AIT-082 are initiated. Therefore, the Company plans to establish a pilot plant or to establish a contractual relationship with an FDA-certified drug manufacturer for the production of AIT-082 and its other compounds under development.

PATENTS AND PROPRIETARY RIGHTS

Patents and other proprietary rights are vital to the Company's business. The Company's policy is to seek patent protection for its proprietary compounds and technology, and it intends to protect its technology, inventions and improvements to inventions that are commercially important to the development of its business. The Company also intends to rely on trade secrets, know-how, continuing technology innovations and licensing arrangements to develop and maintain its competitive position.

On February 25, 1992, Dr. Alvin Glasky was issued a United States patent (No. 5,091,432) which establishes proprietary rights for a series of compounds whose chemistry is based upon a purine, hypoxanthine, and for the use of these compounds in the treatment of neuroimmunologic disorders. This patent expires on March 28, 2010. These compounds are bi-functional drugs that combine the ability of hypoxanthine to be absorbed rapidly into the body with the pharmacological activity of a second molecular component. These second components were selected to provide a wide variety of potential therapeutic

applications including the treatment of schizophrenia, Parkinson's disease and memory deficits. On September 5, 1995, Dr. Glasky was issued a second United States patent (No. 5,447,939) which covers the treatment of neurological and neurodegenerative diseases through modification of certain biochemical processes in cells. This patent expires on July 25, 2014. This second patent incorporates certain technology developed under the auspices of, and belonging to, McMaster University in Ontario, Canada.

Both patents have been assigned to the Company by Dr. Glasky. In connection with these assignments, Dr. Glasky has been granted a royalty of two percent of all revenues derived by the Company from the use and sale by the Company of any products which are covered by either of the aforementioned patents or any subsequent derivative patents, in each case for the life of the patent. However, Dr. Glasky will not receive any royalties with respect to sales of products which utilize patent rights licensed to the Company by McMaster University. In the event the Company terminates Dr. Glasky's employment without cause, the royalty rate shall be increased to five percent, and in the event Dr. Glasky dies, his estate or family shall be entitled to continue to receive royalties at the rate of two percent.

With respect to the second United States patent, the Company and McMaster University have entered into a license agreement whereby McMaster University has licensed to the Company all patent rights belonging to McMaster University contained in such patent. This agreement calls for minimum payments by the Company of $25,000 per year to McMaster University, with the first payment due in July of 1997, and for the Company to pay to McMaster University a royalty of five percent of the net sales of all products sold by the Company which incorporate the patent rights licensed to the Company by McMaster University.

The Company also currently has two United States and a number of corresponding foreign patent applications on file. There can be no assurance, however, that the scope of the coverage claimed in the Company's patent applications will not be significantly reduced prior to a patent being issued. Corresponding foreign patent applications with respect to the Company's issued patents have been filed in numerous foreign countries.

The patent positions of pharmaceutical and drug development companies are generally uncertain and involve complex legal and factual issues. There can be no assurance that third parties will not assert patent or other intellectual property infringement claims against the Company with respect to its products or technology or other matters. There may be third-party patents and other intellectual property relevant to the Company's products and technology which are not known to the Company. Patent

litigation is becoming more common in the biopharmaceutical industry. Litigation may be necessary to defend against or assert claims of infringement, to enforce patents issued to the Company, to protect trade secrets owned by the Company or to determine the scope and validity of proprietary rights of third parties. Although no third party has asserted that the Company is infringing such third party's patent rights or other intellectual property, there can be no assurance that litigation asserting such claims will not be initiated, that the Company would prevail in any such litigation or that the Company would be able to obtain any necessary licenses on reasonable terms, if at all. Any such claims against the Company, whether meritorious or not, as well as claims initiated by the Company against third parties, can be time consuming and expensive to defend or prosecute and to resolve. If competitors of the Company prepare and file patent applications in the United States that claim technology also claimed by the Company, the Company may have to participate in interference proceedings declared by the Patent and Trademark Office to determine priority of invention, which could result in substantial cost to the Company, even if the outcome were to ultimately be favorable to the Company. The results of such proceedings are highly unpredictable and, as a result of such proceedings, the Company may have to obtain licenses in order to continue to conduct clinical trials, manufacture or market certain of its products. No assurance can be made that the Company will be able to obtain any such licenses on favorable terms, if at all.

The Company also relies upon unpatented trade secrets and improvements, unpatented know-how and continuing technological innovation to develop and maintain its competitive position, which it seeks to protect in part, by confidentiality agreements with its employees and consultants and with corporate partners and/or collaborators as such relationships are formed in the future. The agreements provide that all confidential information developed or made known to an individual during the course of the employment or consulting relationship shall be kept confidential and not disclosed to third parties except in specified circumstances. In the case of employees, the agreements provide that all inventions conceived by the individual while employed by the Company shall be the exclusive property of the Company. There can be no assurance that these agreements will not be breached, that the Company would have adequate remedies for breach, or that the Company's trade secrets will not otherwise become known or be independently discovered by competitors.

COMPETITION

The pharmaceutical industry is characterized by rapidly evolving technology and intense competition. Many companies of all sizes, including a number of large pharmaceutical companies as well as several specialized biotechnology companies, are engaged in activities similar to that of the Company. The Company's larger competitors include Amgen, Inc., Chiron Corp., Bristol-Myers Squibb Company, Glaxo Wellcome PLC, Regeneron Pharmaceuticals, Inc., Cephalon, Inc., Warner-Lambert Co., Hoechst Marion Roussel Ltd. and Pfizer, Inc., among others. In addition, colleges, universities, governmental agencies and other public and private research institutions will continue to conduct research and are becoming more active in seeking patent protection and licensing arrangements to collect license fees, milestone payments and royalties in exchange for license rights to technologies that they have developed, some of which will be directly competitive with that of the Company. These companies and institutions also compete with the Company in recruiting highly qualified scientific personnel. Most of the Company's competitors have substantially greater financial, research and development, human and other resources than the Company. Furthermore, large pharmaceutical companies have significantly more experience than the Company in pre-clinical testing, human clinical trials and regulatory approval procedures.

Although the Company has just begun to conduct clinical trials with respect to AIT-082, the Company has not conducted clinical trials with respect to any of its other

compounds under development nor has it sought the approval of the FDA for any product based on such compounds. Furthermore, if the Company is permitted to commence commercial sales of products based on compounds it develops, including AIT-082, and decides to manufacture such products itself, then the Company will also be competing with respect to manufacturing efficiency and marketing capabilities, which are areas in which the Company has no prior experience.

Any product for which the Company obtains FDA approval must also compete for market acceptance and market share. A number of drugs intended for the treatment of Alzheimer's disease, memory loss associated with aging, stroke and other neurodegenerative diseases and disorders are on the market or in the later stages of clinical testing. Two drugs have been approved the FDA for marketing in the United States as treatments for memory impairment associated with Alzheimer's disease. One is currently being marketed by Warner-Lambert Co. under the name Cognex(R). The other drug, which has recently been approved by the FDA for Alzheimer's disease, is being marketed by Pfizer, Inc. under the name of Aricept(R). Certain technologies under development by other pharmaceutical companies could result in treatments for Alzheimer's disease and other diseases and disorders for which the Company is developing its own treatments. Several other companies are engaged in research and development of compounds which use neurotrophic factors in a manner similar to that of the Company's compounds. In the event that one or more of these programs were successful, the market for the Company's products could be reduced or eliminated.

The Company expects technological developments in the neuropharmacology field to continue to occur at a rapid rate and expects

competition will remain intense as advances continue to be made. Although the Company believes, based on the preliminary pre-clinical test results involving certain of its compounds, that it will be able to continue to compete in the discovery and early clinical development of compounds for neurological disorders, there can be no assurance that the Company will be able to do so, and the Company does not presently have sufficient resources to compete with major pharmaceutical companies in the areas of later-stage clinical testing, manufacturing and marketing.

EMPLOYEES

As of December 31, 1996, the Company had nine full-time employees of which four hold Ph.D. degrees, one part-time employee, four part- time research assistants and three consultants. There can be no assurance that the Company will be able to attract and retain qualified personnel in sufficient numbers to meet its needs. The Company's employees are not subject to any collective bargaining agreements, and the Company regards its relations with its employees to be good.

RISK FACTORS

This Annual Report on Form 10-KSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1993 and Section 21E of the Securities Exchange Act of 1934. The Company's actual results may differ materially from the results projected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, the following:

History of Operating Losses: Future Profitability Uncertain

The Company is a development stage biopharmaceutical company. From its inception in 1987 through December 31, 1996, the Company incurred losses of approximately $6.1 million, substantially all of which consisted of research and development and general and administrative expenses. The Company has not generated any revenues from product sales to date, and there can by no assurance that revenues

from product sales will ever be achieved. Moreover, even if the Company eventually generates revenues from product sales, the Company nevertheless expects to incur significant operating losses over the next several years. The Company's ability to achieve profitable operations in the future will depend in large part on completing development of its products, obtaining regulatory approvals for such products and bringing several of these products to market. The likelihood of the long-term success of the Company must be considered in light of the expenses, difficulties and delays frequently encountered in the development and commercialization of new pharmaceutical products, competitive factors in the marketplace as well as the burdensome regulatory environment in which the Company operates. There can be no assurance that the Company will ever achieve significant revenues or profitable operations.

Technological Uncertainty; Early Stage of Product Development; No Assurance of Regulatory Approvals

The Company's proposed products are in the pre-clinical stage of development and will require significant further research, development, clinical testing and regulatory clearances. The Company has no products available for sale and does not expect to have any products resulting from its research efforts commercially available for at least several years. As of March 24, 1997, one of the Company's proposed products, AIT-082, has started clinical studies in Alzheimer's patients in Canada. The Company has not filed an Investigational New Drug Application ("IND") with the United States Food and Drug Administration ("FDA") on any of its products currently under research and development. Although the Company plans to file an IND in the United States with respect to its AIT-082 compound for the treatment of Alzheimer's disease by mid-1997, there can be no assurance that the Company will be successful in achieving the IND filing by this date, if at all. Moreover, the Company's AIT-082 compound is the only product for which the Company expects to file an IND in the foreseeable future. The Company's proposed products are subject to

the risks of failure inherent in the development of products based on innovative technologies. These risks include the possibilities that some or all of the proposed products could be found to be ineffective or toxic, or otherwise fail to receive necessary regulatory clearances, that the proposed products, although effective, will be uneconomical to manufacture or market, that third parties may now or in the future hold proprietary rights that preclude the Company from marketing them, or that third parties will market a superior or equivalent product. Accordingly, the Company is unable to predict whether its research and development activities will result in any commercially viable products or applications. Furthermore, due to the extended testing and regulatory review process required before marketing clearance can be obtained, the Company does not expect to be able to commercialize any therapeutic drug for a least several year, either directly or through any potential corporate partners or licensees. There can be no assurance that the Company's proposed products will prove to be safe or effective in humans or will receive regulatory approval that are required for commercial sale. The Company's primary area of therapeutic focus, disorders of the central nervous system ("CNS"), is not thoroughly understood and there can be no assurance that the products the Company is seeking to develop will prove to be safe and effective in treating CNS disorders or any other diseases.

Need for Additional Funding; Uncertainty of Access to Capital

The Company will require substantial funds for further development of its potential products and to commercialize any products that may be developed. The Company's capital requirements depend on numerous factors, including the progress of its research and development programs, the progress of pre-clinical and clinical testing, the time and cost involved in obtaining regulatory approvals, the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights, competing technological and market developments and the ability of the Company to establish collaborative arrangements. The Company has no current anticipated sources of

additional funding. The Company believes that its existing capital resources will be sufficient to satisfy its current and projected funding requirements for at least the next 12 months. The Company anticipates that after the next 12 months, it may require substantial additional capital. Moreover, if the Company experiences unanticipated cash requirements during the next 12 months, the Company could require additional capital to fund its operations, continue research and development programs as well as to continue the pre-clinical and clinical testing of its potential products and to commercialize any products that may be developed. The Company may seek such additional funding through public or private financings or collaborative or other arrangements with third parties. There can be no assurance that additional funds will be available on acceptable terms, if at all. The Company may receive additional funds upon the exercise from time to time of its Common Stock Purchase Warrants (the "Warrants") and other outstanding warrants and stock options, but there can be no assurance that any such warrants or stock options will be exercised or that the amounts received will be sufficient for the Company's purposes. If additional funds are raised by issuing equity securities, further substantial dilution to existing shareholders may result. If adequate funds are not available, the Company may be required to delay, scale back or eliminate one or more of its development programs, or to obtain funds by entering into arrangements with collaborative partners or others that may require the Company to relinquish rights to certain of its products or technologies that the Company would not otherwise relinquish.

Dependence on Third Parties for Clinical Testing, Manufacturing and Marketing

The Company does not have the resources and, except with respect to its AIT-082 compound, does not presently intend to conduct later- stage human clinical trials itself or to manufacture any of its proposed products for commercial sale. The Company therefore presently intends to seek larger pharmaceutical company partners to conduct such activities for most or all of its proposed products. In connection with its efforts to secure corporate partners, the Company will seek to retain certain co-marketing rights to certain of its proposed products, so that it may promote such products to selected medical specialists while its corporate partner promotes these

products to the general medical market. There can be no assurance that the Company will be able to enter into any such partnering arrangements on this or any other basis. In addition, there can be no assurance that either the Company or its prospective corporate partners can successfully introduce its proposed products, that they will achieve acceptance by patients, health care providers and insurance companies, or that they can be manufactured and marketed at prices that would permit the Company to operate profitably.

The National Institute on Aging ("NIA") and the National Institute for Mental Health ("NIMH") have agreed to fund the production of the Company's AIT-082 compound for animal toxicity studies and early human clinical trials, and the Alzheimer's Disease Cooperative Study Unit ("ADCSU"), a consortium of approximately 35 United States clinical centers which receives funding from the NIA, has agreed to fund and conduct two Phase I human clinical trials of AIT-082. Should any of the NIA, NIMH or the ADCSU withdraw such support, the Company would be forced to use a portion of its capital to fund such clinical trials.

Lack of Operating Experience

To date, the Company has engaged exclusively in the development of pharmaceutical technology and products. Although members of the Company's management have substantial experience in pharmaceutical company operations, the Company has no experience in manufacturing or procuring products in commercial quantities or marketing pharmaceutical products and has only limited experience in negotiating, setting up and maintaining strategic relationships, conducting clinical trials and other later-stage phases of the regulatory approval process. There can be no assurance that the Company will successfully engage in any of these activities with

respect to AIT-082 or any other products which it may choose to distribute. In the event the Company decides to establish a commercial-scale manufacturing facility for AIT-082, the Company will require substantial additional funds and personnel and will be required to comply with extensive regulations applicable to such a facility. The Company presently intends to establish its own sales and marketing capabilities to market its AIT-082 compound in the United States once it is certain of obtaining FDA approval of AIT-082. There can be no assurance that the Company will be able to develop adequate manufacturing or marketing capabilities either on its own or through third parties.

Need to Comply with Governmental Regulation and to Obtain Product Approvals

The testing, manufacturing, labeling, distribution, marketing and advertising of products such as the Company's proposed products and its ongoing research and development activities are subject to extensive regulation by governmental regulatory authorities in the United States and other countries. The FDA and comparable agencies in foreign countries impose substantial requirements on the introduction of new pharmaceutical products through lengthy and detailed clinical testing procedures, sampling activities and other costly and time consuming compliance procedures. The Company's proprietary compounds require substantial clinical trials and FDA review as new drugs. The Company cannot predict with certainty when it might submit many of its proprietary products currently under development for regulatory review. Once the Company submits its potential products for review, there can be no assurance that FDA or other regulatory approvals for any pharmaceutical products developed by the Company will be granted on a timely basis or at all. A delay in obtaining or failure to obtain such approvals would have a material adverse effect on the Company's business and results of operations. Failure to comply with regulatory requirements could subject the Company to regulatory or judicial enforcement actions, including, but not limited to, product recalls or seizures, injunctions, civil penalties, criminal prosecution, refusals to approve new products and withdrawal of existing approvals, as well as potentially enhanced product liability exposure. Sales of the Company's products outside the United States will be subject to regulatory requirements governing clinical trials and marketing approval. These requirements vary widely from country to country and could delay introduction of the Company's products in those countries.

Dependence on Key Personnel

The Company's success is dependent on its key management and scientific personnel, especially Dr. Alvin Glasky, the loss of whose services could significantly delay the achievement of the Company's planned development objectives. Although the Company has obtained key man life insurance on Dr. Glasky in the face amount of $2 million, there can be no assurance that the proceeds of such policy will be sufficient to compensate the Company for any disruptions resulting from the loss of Dr. Glasky's services. Achievement of the Company's business objectives will require substantial additional expertise in such areas as finance, manufacturing and marketing, among others. Competition for qualified personnel among pharmaceutical companies is intense, and the loss of key personnel, or the inability to attract and retain the additional, highly skilled personnel required for the expansion of the Company's activities, could have a material adverse effect on the Company's business and results of operations.

Uncertainty Regarding Patents and Proprietary Rights

The Company actively pursues a policy of seeking patent protection for its proprietary products and technologies. The Company owns two United States patents and currently has two United States patent applications on file. In addition, corresponding patent applications with respect to the Company's United States patents and pending United States applications have been filed in a number of foreign jurisdictions. However, there can be no assurance that the Company's patents will

provide it with significant protection against competitors. Litigation could be necessary to protect the Company's patents, and there can be no assurance that the Company will have the financial or personnel resources necessary to pursue such litigation or otherwise to protect its patent rights. In addition to pursuing patent protection in appropriate cases, the Company also relies on trade secret protection for its unpatented proprietary technology. However, trade secrets are difficult to protect. There can be no assurance that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to the Company's trade secrets, that such trade secrets will not be disclosed or that the Company can effectively protect its rights to unpatented trade secrets. The Company pursues a policy of having its employees and consultants execute proprietary information agreements upon commencement of employment or consulting relationships with the Company, which agreements provide that all confidential information developed or made known to the individual during the course of the relationship shall be kept confidential except in specified circumstances. There can be no assurance, however, that these agreements will provide meaningful protection for the Company's trade secrets or other proprietary information.

Furthermore, there can be no assurance that claims against the Company will not be raised in the future based on patents held by others or that, if raised, such claims will not be successful. Such claims, if brought, could seek damages as well as an injunction prohibiting clinical testing, manufacturing and marketing of the affected product. If any such actions are successful, in addition to any potential liability for damages, the Company could be required to obtain a license in order to continue to manufacture or market the affected product. There can be no assurance that the Company would prevail in any such action or that any license required under any such patent would be made available under acceptable terms, if at all. There has been, and the Company believes that there will continue to be, significant litigation in the pharmaceutical industry regarding patent and other intellectual property rights. If the Company becomes involved in any litigation, it could consume a substantial portion of the Company's financial and personnel resources regardless of the outcome of such litigation.

Competition

Competition in the area of pharmaceutical products is intense. There are many companies, both public and private, including well-known pharmaceutical companies, that are engaged in the development of products for certain of the applications being pursued by the Company. The Company's

probable larger competitors include Amgen, Inc., Chiron Corp., Bristol-Myers Squibb Company, Glaxo Wellcome PLC, Regeneron Pharmaceuticals, Inc., Cephalon, Inc., Hoechst Marion Roussel Ltd. and Pfizer, Inc., among others. In addition, Warner-Lambert Co. is currently marketing a drug, tacrine, which has been approved by the FDA for treatment of Alzheimer's disease, under the name Cognex(R). Another drug, which has recently been approved by the FDA for treatment of Alzheimer's disease, is being marketed by Pfizer, Inc. under the name of Aricept(R). Most of these companies have substantially greater financial, research and development, manufacturing and marketing experience and resources than the Company and represent substantial long-term competition for the Company. In addition, there are numerous other companies that are also in the process of developing products for the treatment of diseases and disorders for which the Company is developing products. Such companies may succeed in developing pharmaceutical products that are more effective or less costly than any products that may be developed by the Company.

Factors affecting competition in the pharmaceutical industry vary depending on the extent to which the competitor is able to achieve a competitive advantage based on proprietary technology. If the Company is able to establish and maintain a significant proprietary position with respect to its products, competition will likely depend primarily

on the effectiveness of the product and the number, gravity and severity of its unwanted side effects as compared to alternative products.

The industry in which the Company competes is characterized by extensive research and development efforts and rapid technological progress. Although the Company believes that its proprietary position may give it a competitive advantage with respect to its proposed drugs, new developments are expected to continue and there can be no assurance that discoveries by others will not render the Company's potential products noncompetitive. The Company's competitive position also depends on its ability to attract and retain qualified scientific and other personnel, develop effective proprietary products, implement development and marketing plans, obtain patent protection and secure adequate capital resources. There can be no assurance that the Company will be able to successfully attract or retain such personnel.

Risk of Product Liability

Although the Company currently carries product liability insurance, there can be no assurance that the amounts of such coverage will be sufficient to protect the Company, nor that there can by any assurance that the Company will be able to obtain or maintain additional insurance on acceptable terms for its clinical and commercial activities or that such additional insurance would be sufficient to cover any potential product liability claim or recall. Failure to maintain sufficient coverage could have a material adverse effect on the Company's business and results of operations.

Use of Hazardous Materials

The Company's research and development efforts involve the use of hazardous materials. The Company is subject to federal, state and local laws and regulations governing the storage, use and disposal of such materials and certain waste products. Although the Company believes that its safety procedures for handling and disposing of such materials comply with the standards prescribed by federal, state and local regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of an accident, the Company could be held liable for any damages that result and any such liability could exceed the resources of the Company. The Company may incur substantial costs to comply with environmental regulations if the Company develops its own commercial manufacturing facility.

Possible Volatility of Stock Price

The stock market from time to time experiences significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the

market price of the Company's Common Stock and/or Warrants. In addition, the market price of the Common Stock and/or Warrants is likely to be highly volatile. Factors such as fluctuations in the Company's results of operations, timing and announcements of technological innovations or new products by the Company or its competitors, FDA and foreign regulatory actions, developments with respect to patents and proprietary rights, public concern as to the safety of products developed by the Company or others, changes in health care policy in the United States and in foreign countries, changes in stock market analyst recommendations regarding the Company, the pharmaceutical industry generally and general market conditions each may have a significant adverse effect on the market price of the Common Stock and/or Warrants. In addition, it is likely that during at least some future quarterly periods, the Company's results of operations will fail to meet the expectations of stock market analysts and investors and, in such event, the market price of the Company's Common Stock and/or Warrants could be materially and adversely affected.

Control by Directors and Executive Officers

The Company's directors and executive officers beneficially own in the aggregate approximately 26.4% of the Company's outstanding Common Stock. These shareholders, if acting together, would be able to control substantially all matters requiring approval by the shareholders of the Company, including the election of directors and the approval of mergers or other business combination transactions. Such concentration of ownership could discourage or prevent a change of control of the Company.

Effect of Certain Charter and Bylaws Provisions

Certain provisions of the Company's Articles of Incorporation and Bylaws may have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of the Company. Such provisions could limit the price that certain investors might be willing to pay in the future for shares of Common Stock. These provisions may make it more difficult for shareholders to take certain corporate actions and could have the effect of delaying or preventing a change in control of the Company

ITEM 2. DESCRIPTION OF PROPERTY

The Company currently maintains its principal administrative offices in Irvine, California which are leased on a month-to-month basis. The monthly rent for this facility is $8,424. The Company's research is conducted at laboratories located at the Olive View/UCLA Medical Center in Sylmar, California and at the University of California at Irvine, California. The Company has entered into a 7-year lease with two 5-year renewal options for a new 34,000 square foot facility which will serve to consolidate the Company's research and development, operations and administrative functions under one roof. This building is expected to be completed in June 1997 and will be leased by the Company.

ITEM 3. LEGAL PROCEEDINGS

The Company is not currently involved in any litigation or legal proceedings and is not aware of any litigation or proceeding threatened against it.

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

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 1996.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

COMMON STOCK

As December 31, 1996, there were 5,361,807 shares of Common Stock outstanding held of record by 259 shareholders.

MARKET FOR SECURITIES

The Company's Common Stock (NEOT) and Warrant (NEOTW) are currently listed on the Nasdaq National Market. For each quarter since trading commenced, on September 26, 1996, the high and low bid quotations of the Company's Common Stock and Warrant, as reported by Nasdaq, were as follows:

	Common Stock		Warrant	
	Bid Price		Bid Price	
Quarter Ended	High	Low	High	Low
September 30, 1996	$6-1/4	$5-1/4	$2-1/4	$1-3/4
December 31, 1996	$6	$3-3/4	$2-3/8	$1

The foregoing bid quotations reflect inter-dealer prices, without retail mark-ups, mark-downs or commissions, and may not represent actual transactions.

DIVIDENDS

The Company has never paid cash dividends on its Common Stock and does not intend to pay dividends in the foreseeable future.

RECENT SALES OF UNREGISTERED SECURITIES

The following is a summary of transactions by the Company during the year ended December 31, 1996 involving sales of the Company's securities that were not registered under the Securities Act of 1933 (the "Securities Act").

1. In January 1996, the Company sold 4,000 shares of Common Stock to one investor for consideration of $10,000. The Company paid commissions of $500 in conjunction with such sale.

2. In March 1996, the Company sold 2,000 shares of Common Stock to one investor for consideration of $5,000. The Company paid commissions of $100 in conjunction with such sale.

3. In April 1996, the Company sold 2,000 shares of Common Stock to one investor for consideration of $5,000. The Company paid commissions of $250 in conjunction with such sale.

4. In May 1996, the Company sold 178,800 shares of Common Stock to twenty-seven investors for aggregate consideration of $447,000. The Company paid commissions of $22,350 in conjunction with such sale.

5. In May 1996, the Company granted an option to purchase 30,000 shares of Common Stock, at an exercise price of $0.025 per share, to a financial consultant in exchange for certain investment banking services.

6. In June 1996, the Company sold 80,000 shares of Common Stock to two investors for consideration of $200,000. The Company paid commissions of $10,000 in conjunction with such sale.

7. In July 1996, the Company granted options to purchase 95,000 shares of Common Stock, at exercise prices ranging from $3.75 to $4.13 per share, to five employees and one consultant pursuant to its 1991 Stock Incentive Plan.

24

8. In July 1996, the Company granted options to purchase a total of 12,000 shares of Common Stock, at an exercise price of $0.025 per share, to two technical consultants in exchange for consulting services.

9. In July 1996, the Company issued 300,000 shares of Common Stock to seven security holders upon the conversion of 75 Revenue Participation Units ("RPUs").

10. In September 1996, the Company granted options to purchase 70,000 shares of Common Stock, at an exercise price of $4.50 per share, to four non-employee directors, one employee and two consultants pursuant to its 1991 Stock Incentive Plan.

In the transactions described in paragraphs 1 through 6, exemption from the registration requirements of the Securities Act was claimed under Rule 504 and/or Rule 506 and/or Section 4(2) of the Securities Act. In the transactions described in paragraphs 7, 8 and 10, exemption from the registration requirements of the Securities Act was claimed under Rule 701 and/or Section 4(2) of the Securities Act. The foregoing transactions did not involve any public offering and the recipients either received adequate information about the Company or had access, through employment or other relationships, to such information. In each of the foregoing transactions, the Company reasonably believed that each of the recipients was "sophisticated" within the meaning of Section 4(2) of the Securities Act.

In the transaction described in paragraph 9, exemption from the registration requirements of the Securities Act was claimed under Section 3(a)(9) of the Securities Act on the basis that the Company exchanged securities with existing security holders where no commissions were paid.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

PRELIMINARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-KSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Company's actual results may differ materially from the results projected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in Item 1. "Description of Business", including the section therein entitled "Risk Factors", and this Item 6.

RESULTS OF OPERATIONS

Overview

From the inception of the Company in June 1987 through December 31, 1996, the Company devoted its resources primarily to fund its research and development efforts, and incurred a cumulative net loss of approximately $6.1 million. During this period, the Company had only limited revenues from grants, and had no revenues from the sale of products or other sources. The Company expects its operating expenses to increase over the next several years as it expands its research and development and commercialization activities and operations. The Company expects to incur significant additional operating losses for at least the next several years unless such operating losses are offset, if at all, by licensing revenues under strategic alliances with larger pharmaceutical companies which the Company is currently seeking.

Year ended December 31, 1996 compared to Year ended December 31, 1995

There were no revenues for the twelve month period ended December 31, 1996, whereas during the same period in 1995 the Company received the final portion of its Small Business Innovative Research grant revenues of $125,431 from the National Institute on Aging ("NIA"), an agency of the U.S. Government.

25

Research and development expenses for the twelve months ended December 31, 1996 increased by approximately $310,000 or 101% over the previous year. This increase was due primarily to personnel additions, salary increases, consulting fees, license fees and insurance costs as the Company commenced utilization of the proceeds from the recent public sale of Common Stock. Research and development expenses are expected to continue to increase as the Company continues to expand its product development and clinical trial activities.

General and administrative expenses decreased approximately $7,300 or 1% for the year ended December 31, 1996 over the year ended December 31, 1995. General and administrative expenses for 1996 reflect increased expenses related to additional personnel, salary increases, insurance, professional and consulting fees, commissions, facilities rent, travel, regulatory agency and other fees associated with being a public company which were all either significantly higher in 1996 than in 1995, or were initially incurred in 1996. Although such expenses were lower or did not exist in 1995, general and administrative expenses for 1995 include compensation expense for shares of Common Stock which were forfeited pursuant to an agreement with certain stockholders. These shares were reissued, triggering compensation expense for the difference between the original price per share when such shares were issued and the fair market value of the stock on the date of reissuance. Also, in the 1995 period, the Company operated from the Chief Executive Officer's residence on a rent-free basis with very limited administrative and technical staff. The Company expects general and administrative expenses to continue to increase in future periods in support of the expected increases in both research and development activities as well as sales and marketing activities should the Company successfully bring one or more of its products to market.

LIQUIDITY AND CAPITAL RESOURCES

From inception through December 1996, the Company financed its operations primarily through grants, sales of securities, borrowings and deferred payment of salaries and other expenses from related parties.

At December 31, 1996, included in the Company's working capital of approximately $14.7 million, were cash and cash equivalents of approximately $10 million and short-term investments of approximately $5.7 million. In comparison, at December 31, 1995, the Company had a working capital deficiency of approximately $704,000 and a nominal cash balance. The increases resulted from the private placement sale of Common Stock during the first six months of 1996 aggregating approximately $633,700, and the September 26, 1996 public sale of 2,500,000 "Units", with each Unit consisting of one share of the Company's Common Stock and one Common Stock purchase Warrant. The closing took place on October 1, 1996 and, on that date, the Company realized net cash proceeds of approximately $17,363,000 from the sale. On October 11, 1996, the underwriter of the public offering of the Units exercised an option to purchase an additional 200,000 Units resulting in net cash proceeds of $1,389,000 to the Company. Expenses directly related to the public offering of Units were approximately $576,000 at December 31, 1996.

In January 1997, the Company entered into a long-term operating lease with a major developer, whereby the developer has commenced the construction of the Company's future administrative and research and development facility. The Company expects to occupy the facility in late June 1997 and, in addition to the rental, has committed to pay the developer in March 1997 approximately $1.4 million for construction of tenant improvements, primarily relating to specialized research and development laboratory facilities. The lease runs for seven years and contains two renewal options for five years each at the then fair market value rate. Minimum rental commitments for the seven year period from July 1997 (assuming occupancy occurs as

scheduled) through June 2002 are approximately $283,300 (1997), $465,600 (1998), $483,100 (1999), $500,500 (2000 and 2001) $538,100 (2002) $554,200 (2003) and $285,400 (2004).

The Company has committed an aggregate of $276,000 to several Universities to conduct general sceintific research programs and to provide for a two year Fellowship Grant.

Since its inception, the Company has been in the development stage and therefore devotes substantially all of its efforts to research and development. The Company has incurred cumulative losses of approximately $6.1 million through December 31, 1996, and expects to incur substantial losses over the next several years. The Company's future capital requirements and availability of capital will depend upon many factors, including continued scientific progress in research and development programs, the scope and results of preclinical studies and clinical trials, the time and costs involved in obtaining regulatory approvals, the cost involved in filing, prosecuting and enforcing patent claims, competing technological developments, the cost of manufacturing scale-up, the cost of commercialization activities and other factors which may not be within the Company's control. While the Company believes that its existing capital resources will be adequate to fund its capital needs for at least 12 months of operations, the Company also believes that ultimately it will require substantial additional funds in order to complete the research and development activities currently contemplated and to commercialize its proposed products.

Without additional funding, the Company may be required to delay, reduce the scope or eliminate one or more of its research and development projects, or obtain funds through arrangements with collaborative partners or others which may require the Company to relinquish rights to certain technologies, product candidates or products that the Company would otherwise seek to develop or commercialize on its own. Other factors impacting the future success of the Company are the ability to develop products which will be safe and effective in treating neurological and immunological diseases, ability to obtain government approval as well as dependency on key personnel.

ITEM 7. FINANCIAL STATEMENTS.

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors
of NeoTherapeutics, Inc.:

We have audited the accompanying consolidated balance sheets of NeoTherapeutics, Inc. (a Colorado corporation in the development stage) and subsidiary as of December 31, 1995 and 1996, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 1996 and the related consolidated statements of operations from inception (June 15, 1987) to December 31, 1996. 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 in accordance with generally accepted auditing standards. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NeoTherapeutics, Inc. and subsidiary as of December 31, 1995 and 1996, and the results of their operations and their cash flows for each of the three years ended December 31, 1996 and the related consolidated statements of operations from inception (June 15, 1987) to December 31, 1996 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Orange County, California
February 14, 1997

NEOTHERAPEUTICS, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	1995	1996
CURRENT ASSETS:		
Cash and cash equivalents	$ 859	$ 9,995,062
Marketable securities and short-term investments	-	5,702,114
Other receivables, principally investment interest	-	163,988
Prepaid expenses and refundable deposits	984	239,171
Total current assets	1,843	16,100,335
PROPERTY AND EQUIPMENT, at cost:		
Equipment	59,872	158,396
Property	-	33,076
Accumulated depreciation	(51,065)	(58,963)
Property and equipment, net	8,807	132,509

OTHER ASSETS:		
Marketable securities	-	1,746,432
	$ 10,650	$ 17,979,276

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 249,864	$ 262,604
Accrued payroll and related taxes	227,787	331,175
Employee expense reimbursement	84,179	82,717
Accrued interest to related parties	121,417	122,396
Notes payable to related parties	22,500	558,304
Total current liabilities	705,747	1,357,196
LONG TERM LIABILITIES:		
Notes payable to related party	558,304	-
STOCKHOLDERS' EQUITY (DEFICIT):		
Revenue participation units, 75 and no units outstanding, respectively	676,000	-
Common Stock, no par value, 25,000,000 shares authorized:		
Issued and outstanding, 2,095,019 and 5,361,807 shares, respectively	3,086,407	23,125,763
Deficit accumulated during the development stage	(5,015,808)	(6,503,683)
Total stockholder's equity (deficit)	(1,253,401)	16,622,080
	$ 10,650	$ 17,979,276

The accompanying notes are an integral part of these consolidated balance sheets.

NEOTHERAPEUTICS, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31,			PERIOD FROM JUNE 15, 1987 (INCEPTION) THROUGH DECEMBER 31,
	1994	1995	1996	1996
REVENUES, from grants	$ 235,790	$ 125,431	$ -	$ 497,128
OPERATING EXPENSES:				
Research and development	286,831	305,932	615,485	2,966,812
General and administrative	221,478	667,218	659,895	3,429,106
	508,309	973,150	1,275,380	6,395,918
LOSS FROM OPERATIONS	(272,519)	(847,719)	(1,275,380)	(5,898,790)
OTHER INCOME (EXPENSE):				
Interest income	78	131	268,231	275,944
Interest expense	(39,901)	(46,816)	(51,769)	(480,136)
Other income (expense)	-	(974)	20,043	48,299

Total other income (expense) . . .	(39,823)	(47,659)	236,505	(155,893)
NET LOSS	$(312,342)	$(895,378)	$(1,038,875)	$(6,054,683)
NET LOSS PER SHARE	$(0.13)	$(0.36)	$(0.31)	
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING	2,447,727	2,466,234	3,374,549	

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

NEOTHERAPEUTICS, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

	REVENUE PARTICIPATION UNITS	COMMON STOCK SHARES	COMMON STOCK AMOUNT	DEFICIT ACCUMULATED DURING THE DEVELOPMENT STAGE	DEFERRED COMPENSATION	TOTAL
BALANCE, Inception (June 15, 1987) . .	$ -	-	$ -	$ -	$ -	$ -
Common stock issued	-	465,902	2,100	-	-	2,100
Net loss	-	-	-	(31,875)	-	(31,875)
BALANCE, December 31,1987	-	465,902	2,100	(31,875)	-	(29,775)
Common stock issued	-	499,173	2,250	-	-	2,250
Revenue Participation Units issuance	594,000	-	-	-	-	594,000
Net loss	-	-	-	(556,484)	-	(556,484)
BALANCE, December 31, 1988	594,000	965,075	4,350	(588,359)	-	9,991
Revenue Participation Units issuance	82,000	-	-	-	-	82,000
Net effect of acquisition	-	145,000	354,316	-	-	354,316
Net loss	-	-	-	(934,563)	-	(934,563)
BALANCE, December 31, 1989	676,000	1,110,075	358,666	(1,522,922)	-	(488,256)
Exercise of warrants	-	31,108	136,402	-	-	136,402
Common stock issued in exchange for accrued salaries on June 30 at $1.25	-	402,518	503,144	-	-	503,144
Net loss	-	-	-	(859,172)	-	(859,172)
BALANCE, December 31, 1990	676,000	1,543,701	998,212	(2,382,094)	-	(707,882)
Net Loss	-	-	-	(764,488)	-	(764,488)
BALANCE, December 31, 1991	676,000	1,543,701	998,212	(3,146,582)	-	(1,472,370)
Net loss	-	-	-	(423,691)	-	(423,691)
BALANCE, December 31, 1992	676,000	1,543,701	998,212	(3,570,273)	-	(1,896,061)
Common stock issued in exchange for investment banking services on March 18 at $1.35	-	40,000	54,000	-	-	54,000
Common stock issued in exchange for accrued salaries on December 30 at $2.50	-	255,476	638,694	-	-	638,694
Common stock issued in exchange for note payable to President on December 30 at $2.50	-	200,000	500,000	-	-	500,000
Common stock issued in exchange for accrued expenses on December 30 at $2.50	-	20,842	52,104	-	-	52,104
Stock options issued in exchange for accrued professional fees on December 31 at $1.35	-	-	108,000	-	-	108,000
Stock options issued in exchange for future services on December 31 at $1.35	-	-	39,750	-	-	39,750
Stock options issued for services	-	-	-	-	(93,749)	(93,749)
Net loss	-	-	-	(237,815)	-	(237,815)
BALANCE, December 31, 1993	676,000	2,060,019	2,390,760	(3,808,088)	(93,749)	(835,077)

32

NEOTHERAPEUTICS, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) - (CONTINUED)

	REVENUE PARTICIPATION UNITS	COMMON STOCK SHARES	COMMON STOCK AMOUNT	DEFICIT ACCUMULATED DURING THE DEVELOPMENT STAGE	DEFERRED COMPENSATION	TOTAL
Common stock issued for cash at $2.50 .	$ -	13,000	$ 32,500	$ -	$ -	$ 32,500
Amortization deferred compensation	-	-	-	-	93,749	93,749
Net loss	-	-	-	(312,342)	-	(312,342)
BALANCE, December 31, 1994	676,000	2,073,019	2,423,260	(4,120,430)	-	(1,021,170)
Common stock issued for cash at $2.50	-	22,000	55,000	-	-	55,000
Common stock forfeiture	-	(678,836)	(1,193,943)	-	-	(1,193,943)
Common stock reissued at $2.50 . .	-	678,836	1,697,090	-	-	1,697,090
Stock options issued for services at $2.50	-	-	105,000	-	-	105,000
Net loss	-	-	-	(895,378)		(895,378)
BALANCE, December 31, 1995	676,000	2,095,019	3,086,407	(5,015,808)	-	(1,253,401)
Common stock issued for cash at $2.50 (net of commission) . .	-	266,800	633,650	-	-	633,650
Stock options issued for services at $2.50	-	-	103,950	-	-	103,950
Cash paid out for fractional shares	-	(12)	(25)	-	-	(25)
Conversion of Revenue Participation units into common stock	(676,000)	300,000	1,125,000	(449,000)	-	-
Common stock and warrants issued for cash at $7.60, less commissions and costs of public offering	-	2,700,000	18,176,781	-	-	18,176,781
Net loss	-	-	-	(1,038,875)	-	(1,038,875)
BALANCE, December 31, 1996	$ -	5,361,807	$23,125,763	$(6,503,683)	$ -	$16,622,080

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

33

NEOTHERAPEUTICS, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31, 1994	1995	1996	PERIOD FROM JUNE 15, 1987 (INCEPTION) THROUGH DECEMBER 31, 1996
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$(312,342)	$(895,378)	$(1,038,875)	$(6,054,683)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization . . .	3,387	4,336	7,898	184,452

Issuance of common stock options for services	-	105,000	103,950	208,950
Amortization of deferred compensation	93,749	-	-	93,749
Compensation expense for extension of Debt Conversion Agreements, net		503,147	-	503,147
Gain on sale of assets	-	-	-	(5,299)
Increase in other receivables	-	-	(163,988)	(163,742)
(Increase) decrease in prepaid expenses and refundable deposits	(200)	92	(238,187)	(189,168)
Increase (decrease) in accounts payable and accrued expenses	26,070	46,679	12,740	422,704
Increase in accrued payroll and related taxes	106,120	121,667	103,388	969,869
Increase (decrease) in employee expense reimbursement	5,400	(301)	(1,462)	82,717
Increase in accrued interest to related parties	39,901	46,816	979	422,800
Net cash used in operating activities	(37,915)	(67,942)	(1,213,557)	(3,524,504)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of equipment	(4,380)	(2,461)	(131,600)	(271,775)
Purchases of marketable securities and short-term investments			(7,448,546)	(7,448,546)
Payment of organization costs	-	-	-	(66,093)
Proceeds from sale of equipment	-	-	-	29,665
Issuance of note receivable	-	-	-	100,000
Net cash used in investing activities	(4,380)	(2,461)	(7,580,146)	(7,656,749)

NEOTHERAPEUTICS, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONSOLIDATED STATEMENTS OF CASH FLOWS - (CONTINUED)

	YEARS ENDED DECEMBER 31,			PERIOD FROM JUNE 15, 1987 (INCEPTION) THROUGH DECEMBER 31,
	1994	1995	1996	1996
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from notes payable to related parties, net	$ 9,000	$ 10,000	$ (22,500)	$ 757,900
Proceeds from issuance of common stock and warrants net of related offering costs and expenses	32,500	55,000	18,810,431	19,541,828
Proceeds from Revenue Participation Units	-	-	-	676,000
Cash paid out for fractional shares	-	-	(25)	(25)
Cash at acquisition	-	-	-	200,612
Net cash provided by financing activities	41,500	65,000	18,787,906	21,176,315
Net increase (decrease) in cash	(795)	(5,403)	9,994,203	9,995,062
Cash, beginning of period	7,057	6,262	859	-
Cash, end of period	$ 6,262	$ 859	$ 9,995,062	$ 9,995,062
SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:				
Conversion of accrued payroll into shares of no par value common stock	$ -	$ -	$ -	$ 1,141,838
Conversion of notes payable to related parties into shares of no par value common stock	$ -	$ -	$ -	$ 500,000
Conversion of accrued interest into notes payable to related parties	$ -	$ -	$ -	$ 300,404

Conversion of Revenue Participation Units into shares of no par value common stock	$ -	$ -	$ 676,000	$ 676,000
Issuance of stock options for services	$ -	$105,000	$ 103,950	$ 208,950
Conversion of other accrued liabilities to shares of no par value common stock	$ -	$ -	$ -	$ 52,104

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

NEOTHERAPEUTICS, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1996

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Business

NeoTherapeutics, Inc. (the "Company") was incorporated in Colorado as Americus Funding Corporation ("AFC") in December 1987. In August 1996, AFC changed its name to to NeoTherapeutics, Inc. The Company's wholly-owned subsidiary, Advanced ImmunoTherapeutics, Inc. ("AIT") was incorporated in California in June 1987. In July 1989, AIT completed an agreement with the Company which provided for AIT to become a wholly- owned subsidiary of AFC in a transaction accounted for as a reverse acquisition. All references to the "Company" hereinafter refer to NeoTherapeutics, Inc. and AIT as a consolidated entity.

The Company is a development stage biopharmaceutical enterprise engaged in the discovery and development of novel therapeutic drugs intended to treat neurodegenerative diseases and conditions, such as memory deficits associated with Alzheimer's disease and aging, stroke, spinal cord injuries and Parkinson's disease. The accompanying consolidated financial statements include the results of operations of the subsidiary, AIT, from June 15, 1987 (inception), through July 18, 1989 (date of acquisition of AFC), and the consolidated results of operations of the Company thereafter.

Development Stage Enterprise

The Company is in the development stage and, therefore, devotes substantially all of its efforts to research and development activities. Since its inception, the Company has incurred cumulative losses of approximately $6.1 million through December 31, 1996, and expects to incur substantial losses over the next several years. While the Company believes that its existing capital resources, including the net proceeds of its recently completed public offering of Common Stock and Warrants will be adequate to fund its capital needs for at least 12 months of operations, the Company also believes that, ultimately, it will require substantial additional funds in order to complete the research and development activities currently contemplated and to commercialize its proposed products. The Company's future capital requirements and availability of capital will depend upon many factors including, but not limited to, continued scientific progress in research and development programs, the scope and results of preclinical studies and clinical trials, the time and costs involved in obtaining regulatory approvals, the cost involved in filing, prosecuting and enforcing patent claims, competing technological developments, the cost of manufacturing scale-up, the cost of commercialization activities and other factors which may not be within the Company's control.

Principles of Consolidation

The consolidated financial statements include accounts of the Company and its subsidiary. All significant intercompany accounts and transactions have been eliminated.

Cash and Cash Equivalents

Cash and cash equivalents consists of cash and highly liquid investments of commercial paper and demand notes with original maturities of less than 90 days.

Marketable Securities

The Company accounts for investments in marketable securities under Statements of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The statement requires investments in debt and equity securities to be classified among three categories as follows: Held-to-maturity, trading and available-for-sale. As of December 31, 1996, all securities held by the Company were considered held-to-maturity. Securities held-to-maturity are stated at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income on investment securities. A valuation allowance is not established to recognize temporary market value fluctuations as the Company has the intent and ability to hold these investments until maturity. Short-term investments consist of commercial paper and equivalent corporate obligations and are stated at amortized cost.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed using principally the straight- line method over the following estimated useful lives:

Equipment	5 to 7 Years
Leasehold Improvements	Term of Lease

Research and development

All costs related to research and development activities are treated as expenses in the period incurred.

Grant Revenue

Revenue consists of amounts earned from grants which are recognized in accordance with the terms of the related agreements.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." This statement, among other things, requires that income taxes be accounted for using the liability method.

Net Loss Per Share

Net loss per share is calculated using the weighted average number of shares outstanding. Common equivalent shares are excluded from the computation as their effect is antidilutive, except that, pursuant to the Securities and Exchange Commission ("SEC") Staff Accounting Bulletins, common and common equivalent shares (stock options, warrants and RPU's converted to common stock in July 1996) issued during the period commencing 12 months prior to the public offering at prices below the public offering price have been included in the calculation as if they were outstanding for all periods presented (using the treasury stock method for stock options warrants at the estimated initial public offering price).

Reclassifications

Certain amounts in the accompanying 1994 and 1995 financial statements have been reclassified to conform with the 1996 presentation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Pronouncements

Effective January 1, 1996, the Company adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." The statement requires that impairment losses for long-lived assets and identifiable intangibles to be held and used be based on the fair market value of the asset. The statement also requires that these assets be reported at the lower of carrying amount or fair market value less cost to sell. The adoption of this statement did not have a material effect on the Company's financial position.

Effective January 1, 1996, the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation." The statement requires, at a minimum, new disclosures regarding employee and non-employee stock-based compensation plans. The Company has continued using the measurement prescribed by the former standard, and accordingly, this pronouncement did not have a material effect on the Company's financial position or results of operations.

2. RELATED PARTY TRANSACTIONS

During 1987 and 1988, the Company's President, who is also a major stockholder of the Company, loaned a total of $270,650 to the Company for working capital purposes, of which $250,000 plus $2,000 of accrued interest was canceled in December 1988 in exchange for the issuance of 28 RPU's which, in turn, were converted into 112,000 shares of common stock (see Note 8). The Company borrowed an additional

$737,250 from the President during 1989 through 1993. On December 31, 1993, balances on the outstanding notes and accrued interest due to the President were $757,900 and $300,404, respectively. On December 31, 1993, the Company

issued 200,000 shares of common stock to the President in exchange for cancellation of $500,000 of loans made to the Company. The remaining $257,900 in principal and accrued interest of $300,404 were converted to a $558,304 secured promissory note currently bearing interest at 9% per annum (increased by amendment from 7% on January 1, 1996). The note is due on December 31, 1997, or, pursuant to a second amendment effective January 1, 1997, at the time the Company enters into a distribution license agreement with another company, whichever occurs first. Under the second amendment, the President has released all collateral held as security (all assets of the Company) on the note and has agreed to subordinate the note to institutional debt, if required.

In September 1990, the Company issued a warrant to the President to purchase up to 88,173 shares of Common Stock of the Company at any time between September 1, 1990 and August 31, 1995 for $3.75 per share. Effective August 31, 1995, the expiration date of the warrant was extended to August 31, 2000.

In June 1990, certain founders and key employees of the Company converted $503,148 of accrued salaries due them to 402,518 shares of common stock at the price of $1.25 per share, the estimated fair market value as determined by the Board of Directors. On December 31, 1993, certain key employees agreed to accept 276,318 shares of common stock, in exchange for cancellation of $690,798 of indebtedness for unpaid compensation and unreimbursed expenses. The exchange, which was at the price of $2.50 per share, was in excess of estimated fair market value on the issuance date as determined by the Board of Directors. All of the aforementioned shares had a risk of forfeiture whereby, if the Company did not generate a minimum of $500,000 in total operating revenues from inception through December 31, 1995, all shares were to be returned to the Company and the holders would forfeit all rights to the shares and any claim to the previously accrued but unpaid compensation and expenses. Effective December 31, 1995, five of the parties, who were present or past employees, entered into agreements with the Company whereby the forfeiture date for the Debt Conversion Agreements of 1990 and 1993 was extended from December 31, 1995 to December 31, 1997, in exchange for increasing the minimum total operating revenues from $500,000 to $1,000,000 to be achieved by December 31, 1997. The compensation expense previously recorded which related to the shares forfeited on December 31, 1995, was reversed in the 1995 statement of operations. Accordingly, a new measurement date exists for new shares issued subject to forfeiture on December 31, 1997. The value used to record compensation expense is the estimated fair market value as determined by the board of directors on December 31, 1995. One party to the Debt Conversion Agreements of 1990 and 1993 has claimed that his 88,848 shares are vested and that there was no need for him to enter into a new agreement, and therefore he has not entered into an agreement under the new terms. Although the Company believes that such shares were forfeited under the terms of the Debt Conversion Agreements of 1990 and 1993, the Company has accounted for the stock as issued and outstanding until such time as the Company can obtain the surrender of these shares.

Assignment of Patents by President

The President of the Company has assigned two patents to the Company:

a) On June 6, 1991, the President assigned to the Company all rights to the inventions covered by U.S. Patent No. 5,091,432 (a composition of matter patent covering the "AIT" series of chemical compounds) and any corresponding foreign applications and patents, including all continuations, divisions, reissues and renewals of said applications and any patents issued out of or based upon said applications;

b) On June 30, 1996, the President assigned to the Company all rights to the inventions covered by U.S. Patent No. 5,447,939, covering certain inventions in carbon monoxide dependent guanylyl cyclase and methods

of use.

Under both patent assignment agreements, which expire concurently with the expiration of the underlying patent and any patents derived therefrom, the Company was obligated to pay the President a royalty of four percent (4%) of all revenues derived by the Company from the use and sale by the Company of any products or methods included in the patents. Further, in the event that the President's employment is terminated, the royalty rate was to be increased to six percent (6%). Finally, in the event of the President's death, the family or estate is entitled to continue to receive royalties at a rate of two percent (2%) for the duration of the respective agreement. The President has the right to terminate the patent assignment upon the filing of a petition of bankruptcy or insolvency with respect to the Company.

On July 26, 1996, the Company and its President amended both the June 6, 1991 and June 30, 1996 patent assignment agreements. Under these amendments, (i) the royalty rate contained in both agreements has been reduced to two percent (2%), or five percent (5%) in the event the President's employment is terminated by the Company without cause, and (ii) the President no longer has the right to terminate either patent assignment should a petition of bankruptcy or insolvency be filed with respect to the Company.

McMaster University Agreement

On July 10, 1996 the Company entered into an "Exclusive License Agreement" with McMaster University (University) which allows the Company use of certain chemical compounds developed by the University covered in a patent filed jointly by the Company and the University. Under the Agreement the Company paid a one time licensing fee of $15,000 and is obligated to pay an annual five percent (5%) royalty on net sales of products containing compounds developed by the University. The agreement calls for minimum annual royalty payments of $25,000 payable beginning July 1997.

Employment Agreement

Effective July 1, 1996, the Company entered into an employment agreement with the President. The agreement, among other things, provides for the grant of incentive stock options, an annual base salary with annual increases and an annual bonus based on the Company's attainment of certain performance objectives. The agreement terminates on June 30, 1999. The agreement also provides for guaranteed severance payments upon the President's termination of employment without cause, or upon a change of control of the Company. In connection with entering into this Agreement, the President was granted an incentive option to purchase 75,000 shares of Common Stock at 110 percent of fair market value at the date of grant ($4.13 per share). This option vests in three equal increments over the life of the agreement.

3. COMPENSATION AND EXPENSES DUE TO FOUNDERS AND KEY EMPLOYEES

At December 31, 1995 and 1996, accrued payroll and related taxes includes $218,000 and $315,000, respectively, of unpaid compensation due to founders and key employees of the Company. At December 31, 1995 and 1996, $84,179 and $82,717, respectively, was due to founders and key employees as expense reimbursements and $121,417 and $122,396, respectively, of accrued interest relating to notes payable was also owed to such related parties. All of the aforementioned amounts owing at December 31, 1996 were paid in January 1997.

4. MARKETABLE SECURITIES

The Company accounts for marketable securities under Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain

Investments in Debt and Equity Securities. At December 31, 1996, the Company classified all of its marketable securities as held-to-maturity.

A summary of securities held to maturity at December 31, 1996 is as follows:

Type of Investment	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Market Value
Commercial Paper	$1,553,759	$ -	$(10,769)	$1,542,990
Corporate Bonds	4,148,355	1,391	(468)	4,149,278
	5,702,114	1,391	(11,237)	5,692,268
U.S. Government Agencies	1,746,432	1,468	-	1,747,900
Total Securities Held to Maturity	$7,448,546	$2,859	$(11,237)	$7,440,168

The above securities which have maturities ranging from ninety days to twenty four months are shown in the consolidated balance sheet at December 31, 1996, as follows:

	Cost	Market Value
Due in one year or less	$5,702,114	$5,692,268
Due after one year through two years	$1,746,432	$1,747,900

There were no sales of securities for the year ended December 31, 1996.

5. REVENUE FROM GRANTS

In July 1995, the Small Business Innovative Research Grant (the SBIR Grant) from the National Institute of Health was completed and no additional funds were due or collected. The Company has received an aggregate of $497,128 from the SBIR Grant. During 1995, the National Institute on Aging (NIA) and the National Institute for Mental Health (NIMH) issued contracts to an independent subcontractor of theirs to manufacture AIT-082 for animal and human testing programs. The NIA also issued an additional contract to one of its subcontractors to conduct the subchronic animal toxicity studies required by the U.S. Food and Drug Administration as a part of any Investigational New Drug (IND) application for AIT-082. The entire cost of these two contracts will be paid by the NIA and NIMH directly to the subcontractors.

6. PROVISION FOR INCOME TAXES

No provision for federal and state income taxes has been recorded as the Company incurred net operating losses through December, 31, 1996. At December 31, 1996, the Company had approximately $2,100,000 of federal net operating loss carryforwards available to offset future taxable income, if any; and approximately $6,055,000 of net operating loss carryforwards available for financial reporting purposes. Such carryforwards expire from 2009 through 2011. The primary differences between tax and financial reporting is the

capitalization of certain start-up expenses for income tax reporting purposes which are expensed for financial reporting purposes. Under the Tax Reform Act of 1986, the amounts of and benefits from net operating losses carried forward may be impaired or limited in certain circumstances. Events which may cause limitations in the amount of net operating losses that the Company may utilize in any one year include but are not limited to, a cumulative ownership change of more than 50 percent over a three year period. At December 31, 1996, the effect of such limitation, if imposed, has not been determined.

7. COMMITMENTS AND CONTINGENCIES

Facility leases

The Company leases its present facilities from a property developer under a non-cancelable operating lease which expires the earlier of August 1997 or upon occupancy of the Company's new primary research and development and administrative facility which is presently under construction by such developer and expected to be completed during late June 1997. The existing lease requires monthly payments of $8,424. The new facility lease (also a non-cancelable operating lease) runs from July 1997 (expected

date of occupancy) through June 2004 and contains two five year options to renew at fair value rates in effect at that time. Mininum lease requirements (assuming a July 1, 1997 occupancy date) for each of the next five years and thereafter under the aforementioned leases follows:

Years ending December 31:	
1997	$ 283,300
1998	465,600
1999	483,100
2000	500,500
2001	500,500
2002-2004	1,377,700
Total	$3,610,700

The Company is obligated to reimburse the lessor-developer for approximately $1.4 million for tenant improvements, primarily to construct the specialized research and development laboratories for the new facility.

University Research Grants

The Company has committed an aggregate of $276,000 to several Universities to conduct general scientific research programs and to provide for a two year Fellowship Grant.

8. STOCKHOLDERS' EQUITY (DEFICIT)

Revenue Participation Units

In 1988 and 1989, AIT raised private placement funds via a financial instrument specified as a Revenue Participation Unit ("RPU"). The Company raised an aggregate of $676,000 from the issuance of seventy-five RPU's at prices ranging from $9,000 to $10,000 per RPU. The RPU's entitled holders to cash payments based on stipulated percentages of revenues. Holders of RPUs were entitled to convert to Common Stock at any time and AIT had the option to redeem the RPU's subject to certain conditions by paying cash or in exchange for Common Stock.

In July 1996, the Company offered, and all RPU holders accepted, an option to convert each RPU unit into 4,000 shares of Common Stock (300,000 shares in the aggregate) in exchange for waiving all rights as an RPU holder.

Common Stock

During 1993, the Company issued 40,000 shares of Common Stock at $1.35 per share, the market value on issuance date, for an aggregate amount of, $54,000, to a financial consultant in exchange for investment banking services.

During 1994, three investors bought 13,000 shares of restricted (restrictions as to transferability) Common Stock at $2.50 per share, for an aggregate amount of, $32,500, through a private placement. During 1995, six investors bought 22,000 shares of restricted Common Stock at $2.50 per share, for an aggregate amount of, $55,000, through a private placement.

From January 1, 1996 to June 20, 1996, 266,800 shares of restricted (restrictions as to transferability) Common Stock were issued at $2.50 per share, for an aggregate amount of $633,650 (net of commission), through a private placement.

In June 1996, the Company filed a registration statement with the Securities and Exchange Commission offering to the public 2,500,000 units (the "Units"), each unit consisting of one share of the Company's Common Stock, no par value (the "Common Stock"), and one Warrant to purchase one share of Common Stock (the "Warrants"). The registration statement became effective on September 26, 1996, and on October 1, 1996, the Company realized $17,363,003 in net proceeds from the sale of the 2,500,000 units.

On October 11, 1996, the principal underwriter of the offering exercised a portion of its overallotment option and purchased 200,000 Units for net cash of $1,389,280. Legal, accounting, printing and other expenses of the offering amounted to $575,502. The Units separated immediately following issuance and the Common Stock and Warrants that made up the Units trade only as separate securities.

Reverse Stock Split

In June 1996, the Board of Directors authorized, with shareholder approval, a reverse split of the Company's outstanding Common Stock on the basis of 1 share for each 2.5 shares of the then outstanding Common Stock. The outstanding and authorized Common Stock continues to have no par value. The Board of Directors also authorized, with shareholder approval, an increase in the authorized Common Stock from 10 million to 25 million shares and the creation of a new class of Preferred Stock with the authorization to issue up to 5 million shares of such Preferred Stock. All references to Common Stock amounts and loss per share in the accompanying financial statements give effect to the reverse stock split.

9. STOCK OPTIONS

The Company has two stock option plans: the 1987 Stock Incentive Plan (the "1987 Plan") and the 1991 Stock Incentive Plan (the "1991 Plan") (collectively, the "Plans"). The Plans were adopted by the Company's shareholders and Board of Directors in December 1987 and May 1991, respectively, and provide for the granting of incentive and nonqualified stock options as well as other stock-based compensation. The 1987 and 1991 Plans authorized for issuance up to 20,000 and 140,000 shares, respectively, of the Company's Common Stock. On August 7, 1996, the Company's shareholders approved an amendment to the 1991 Plan increasing the number of authorized shares by 60,000, to a total of 293,154 shares as of that date. As of January 1, 1997, the number of shares authorized under the 1991 plan automatically increased by 53,618 (one percent of the total shares outstanding on that date) to a total of 346,772. Options which have been

granted under the 1991 Plan contain vesting provisions determined by the Board of Directors which range from one to three years.

Under the Plans, shares of the Company's Common Stock may be granted to directors, officers and employees of the Company, except that incentive stock options may not be granted to non-employee directors.

The Plans provide for issuance of incentive stock options having exercise prices equal to the fair market values of the stock at the times of grant of the options or, in certain circumstances, at option prices at least equal to 110 percent of the fair market value of the stock at the time the options are granted. An option granted under the Plans is exercisable in such a manner and within such period, not to exceed ten years from the date of the grant, as shall be set forth in a stock option agreement between the employee and the Company.

Stock options have also been issued outside of the aforementioned plans to various consultants. During the period of December 1993 through December 1996, the Company issued a total of 194,000 options to purchase Common Stock to two technical consultants and a financial consultant in exchange for past and future services. The options are exercisable through December 31, 2001 at an exercise price of $0.025 per share. As the exercise price was lower than the fair market value of the stock on the date the options were granted, compensation expense was recorded for the difference between the option exercise price and the estimated fair market value of the stock as determined by the Board of Directors on the grant date. All options and warrants issued outside of the plan were vested and exercisable upon issuance. In September 1990, the Company issued a warrant to the President of the Company to purchase 88,173 shares of Common Stock at $3.75 per share. The warrant expires August 31, 2000.

A summary of stock option activities for the years ended December 31, 1994, 1995 and 1996 follows:

	1994		1995		1996	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	198,173	$0.28	198,173	$0.28	240,173	$0.24
Granted	-	-	42,000	0.025	207,000	3.39
Exercised	-	-	-	-	-	-
Forfeited	-	-	-	-	-	-
Expired	-	-	-	-	-	-
Outstanding, at end of year	198,173	$0.28	240,173	$0.24	447,173	$3.15
Exercisable, at end of year	198,173	$0.28	240,173	$0.24	270,173	$0.21

Of the options outstanding at December 31, 1996, 302,173 of the 447,173 options have exercise prices between $0.025 and $3.75, with a weighted average exercise price of $0.44 and a weighted average remaining contractual life of 3.7 years. At December 31, 1996, 270,173 of these options were exercisable. The remaining 145,000 options have exercise prices between $4.13 and $4.50, with a weighted average exercise price of $4.31 and a weighted average remaining contractual life of 6.7 years. None of these options were exercisable at December 31, 1996. As of December 31, 1996, there were 165,000 options outstanding under the 1991 Plan and no options outstanding under the 1987 Plan.

The Company applies APB Opinion No. 25 and related interpretations in accounting for stock options, and does not recognize compensation expense when the exercise price

of the options equals the fair market value of the underlying shares at the date of grant. Directors' stock options are treated in the same manner as employee stock options for accounting purposes. Under SFAS No. 123, the Company is required to present certain pro forma earnings information determined as if employee stock options were accounted for under the fair value method of that statement.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 1995 and 1996, respectively: risk-free interest rates of 5.86 and 6.52 percent; zero expected dividend yields; expected lives of 5 years; expected volatility of 50 percent.

For purposes of the following required pro forma information, the weighted average fair value of stock options granted in 1995 and 1996 was $2.48 and $2.14, respectively. The total estimated fair value is amortized to expense over the vesting period.

	1995	1996
Pro forma net loss	$999,593	$1,218,389
Pro forma net loss per share	$0.41	$0.36

10. SALARY DEFERRAL PLAN

The Company established a 401(k) Salary Deferral Plan on January 1, 1990. The Plan allows eligible employees to defer part of their income on a tax-free basis. Contributions by the Company to the Plan are discretionary upon approval by the Board of Directors. To date, the Company has not made any contributions into the Plan.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT.

The following table sets forth certain information with respect to each person who is an executive officer or a director of the Company:

Name	Age	Position
Executive Officers and Directors		
Alvin J. Glasky, Ph.D.	63	Chairman of the Board, Chief Executive Officer, President and Director

Mark J. Glasky	34	Director
Frank M. Meeks	51	Director
Carol O'Cleireacain, Ph.D.	50	Director
Paul H. Silverman, Ph.D., D.Sc.	71	Director
Samuel Gulko	65	Chief Financial Officer
Rosalie H. Glasky	60	Secretary and Treasurer
Key Employees and Consultant		
Michelle S. Glasky, Ph.D.	37	Director of Scientific Affairs
Ronald F. Ritzmann, Ph.D.	53	Director, Psychopharmacological Research
Shelton K. Stern	62	Director, Administrative Services
Michel P. Rathbone, M.D., Ph.D.	53	Consultant, Medical Director

Executive Officers and Directors

Alvin J. Glasky, Ph.D., has been Chief Executive Officer, President and a director of AIT since its inception in June 1987, and has served as the Chairman of the Board, Chief Executive Officer, President and a director of the Company since July 1989, when AIT became a wholly-owned subsidiary of the Company. From March 1986 to January 1987, Dr. Glasky was Executive Director of the American Social Health Association, a non-profit organization. From 1968 until March 1986, Dr. Glasky was the President and Chairman of the Board of Newport Pharmaceuticals International, Inc., a publicly-held pharmaceutical company that developed, manufactured and marketed prescription medicines. From 1966 to 1968, Dr. Glasky served as Director of Research for ICN Pharmaceutical, Inc. and as Director of the ICN-Nucleic Acid Research Institute in

Irvine, California. During that period he was also an assistant professor in the Pharmacology Department of the Chicago Medical School. Dr. Glasky currently holds a research professor position at Olive View/UCLA Medical Center. Dr. Glasky received a B.S. degree in Pharmacy from the University of Illinois College of Pharmacy in 1954 and a Ph.D. degree in Biochemistry from the University of Illinois Graduate School in 1958. Dr. Glasky was also a Post-Doctoral Fellow, National Science Foundation, in Sweden.

Mark J. Glasky has been a director of the Company since August 1994. Since 1982, Mr. Glasky has been employed by Bank of America NT&SA in various corporate lending positions and currently serves as Vice President-Relationship Manager. Mr. Glasky obtained a B.S. degree in International Finance from the University of Southern California in 1983 and an M.B.A. degree in Corporate Finance from the University of Texas at Austin in 1987.

Frank M. Meeks has been a director of the Company since July 1989. Since September 1992, Mr. Meeks has been pursuing personal investments in real estate, property management and oil and gas. Mr. Meeks was employed by Environmental Developers, Inc., a real estate development and construction company, from June 1979 until March 1993, first as Vice President and finally as Financial Vice President. Mr. Meeks obtained a B.S. degree in Business Administration from Wittenberg University in 1966, and an M.B.A. degree from Emory University in 1967. Mr. Meeks is a non-practicing certified public accountant and a licensed real estate broker.

Carol O'Cleireacain, Ph.D., has been a director of the Company since September 1996. Dr. O'Cleireacain has served as an independent economic consultant since 1994, and has been a Visiting Fellow at The Brookings Institution since May 1996. Dr. O'Cleireacain previously served as the Director of the New York City Office of Management and Budget from August 1993 until December 1993. From February 1990 until August 1993 Dr. O'Cleireacain was the Commissioner of the New York City Department of Finance. Dr. O'Cleireacain also serves on the Council of Foreign Relations among her appointments and other professional associations. Dr. O'Cleireacain received a B.A. degree in Economics from the University of Michigan in 1968, an M.A. degree in Economics from the University of Michigan in 1970 and her Ph.D. In Economics from the University of London, London School of Economics in 1977.

Paul H. Silverman, Ph.D., D.Sc. has been a director of the Company since September 1996. Dr. Silverman has been an Associate Chancellor for the Center for Health Sciences at the University of California, Irvine since

January 1994. Since March 1993, Dr. Silverman has also been an Adjunct Professor in the Department of Medicine at the University of California, Irvine and the Director of Corporate and Government Affairs at the Beckman Laser Institute and Medical Clinic in Irvine, California. From August 1992 until January 1994, Dr. Silverman was Director of Scientific Affairs at Beckman Instruments, Inc. From November 1990 until December 1993, Dr. Silverman was the Director of the Systemwide Biotechnology Research and Education Program for the University of California. Prior to 1990, Dr. Silverman served as the Director of the Donner Laboratory at the University of California, Berkeley, as the President of the University of Maine at Orono, as the President of research foundation of the State University of New York, and as the head of the Department of Immunoparasitology at Glaxo, Ltd. Dr. Silverman received his Ph.D. in Parasitology and Epidemiology and his Doctor of Science degree from the University of Liverpool, England.

Samuel Gulko has served as the Chief Financial Officer of the Company, on a part-time basis, since September 1996. From 1968 until March 1987, Mr. Gulko served

as a partner in the audit practice of Ernst & Young, LLP, Certified Public Accountants. From April 1987 to the present, Mr. Gulko has been self-employed as a Certified Public Accountant and business consultant, as well as the part-time Chief Financial Officer of several companies, including a computer peripheral manufacturer (from April 1987 to March 1991) and a chain of medical clinics (from April 1987 to September 1990), and Mr. Gulko has served as the Chief Executive Officer as well as Chief Financial Officer of a small medical management company from October 1990 to the present. Mr. Gulko obtained his B.S. degree in Accounting from the University of Southern California in 1958.

Rosalie H. Glasky has served as Treasurer and Secretary of the Company since November 1991.

Key Employees and Consultant

Michelle S. Glasky, Ph.D. joined the Company in July 1996. Prior to joining the Company, Dr. M. Glasky worked at the Department of Pathology, University of Southern California School of Medicine as a Research Associate and Laboratory Administrator from February 1991 until July 1996. Dr. M. Glasky served as a consultant to the Company from August 1990 until July 1996. Dr. M. Glasky received a B.A. degree in Microbiology from the University of California, San Diego in 1981 and a Ph.D. degree in Biomedical Sciences from the University of Texas Health Science Center in 1988. Dr. M. Glasky was also a Post-Doctoral Fellow at the Stanford University School of Medicine.

Ronald F. Ritzmann, Ph.D. has served as the Company's Director of Psychopharmacological Research since 1989. In addition, Dr. Ritzmann currently holds an Assistant Professorship in Psychiatry at UCLA. Dr. Ritzmann received a B.A. degree in Psychology from Northern Illinois University in 1965, an M.A. degree in Experimental Psychology from Northern Illinois University in 1968 and a Ph.D. degree in Neuroscience from Northern Illinois University in 1973.

Shelton K. Stern joined the Company in July 1996 as the Director of Administrative Services. Prior to joining the Company, Mr. Stern was Manager, Personnel Planning and Development for the Shiley Division of Pfizer, Inc. from June 1980 to September 1995 (in 1992, the company name was changed to Sorin Biomedical and in 1994 it became Mallinckrodt Medical). Mr. Stern obtained his B.A. degree in Education from the State University of New York in 1955 and an M.S. degree in Administration from Hofstra University in 1959.

Michel P. Rathbone, M.D., Ph.D. has served as Consultant, Medical Director to the Company since July 1996. Dr. Rathbone has been a professor in the Departments of Medicine (Neurology) and Biomedical Sciences (Neurosciences) at McMaster University in Ontario, Canada since 1976. Dr. Rathbone is also coordinator of the Hamilton, Ontario Regional Neuro-Oncology Program. Dr. Rathbone has been the principal investigator on 22 research grants from 1985 to the present and has numerous scientific publications. Dr. Rathbone's clinical research interests are therapy of brain tumors, spinal cord injury, motor neuropathy and Alzheimer's disease. His basic research interests are in the

neurotrophins, purines and nerve regeneration. Dr. Rathbone received degrees of Bachelor of Medicine and Bachelor of Surgery from the University of Liverpool Medical School in 1966. Dr. Rathbone received his Ph.D. in Biochemistry from McMaster University in 1972.

Mark J. Glasky and Michelle S. Glasky are the adult son and daughter, respectively, of Dr. Alvin Glasky and Rosalie Glasky. Dr. Alvin Glasky and Rosalie Glasky are husband and wife.

The Board of Directors of the Company currently consists of five directors and there are no vacancies. All directors hold office until the next annual meeting of shareholders or until their successors have been duly elected and qualified. Officers are elected by, and serve at the discretion of, the Board of Directors. The Board of Directors currently has two committees. The Compensation Committee, which consists of Mr. Meeks, Dr. O'Cleireacain and Dr. Silverman, has been established to recommend salaries and incentive compensation for executive officers of the Company. The Audit Committee, which consists of Dr. O'Cleireacain, Mr. Glasky and Mr. Meeks, has been established to review the results and scope of the audit and other services provided by the Company's independent public accountants.

SCIENTIFIC ADVISORY BOARD

The Company has established a Scientific Advisory Board consisting of distinguished scientists whom the Company believes will make a contribution to the development of the Company's business. The Scientific Advisory Board members review the Company's research and development progress, advise the Company of advances in their fields and assist in identifying special product opportunities. Members are compensated on a consulting fee basis for their services and are reimbursed for reasonable travel expenses. Each of Dr. Nelson and Dr. Krassner, in their capacity as members of the Scientific Advisory Board, received options to purchase 6,000 shares of Common Stock for $0.025 per share as compensation for their services during 1996. All of the advisors are employed by employers other than the Company and may have commitments to, or consulting or advisory agreements with, other entities, including potential competitors of the Company, that may limit their availability to the Company. Although these advisors may contribute significantly to the affairs of the Company, none are required to devote more than a small portion of his time to the Company in their capacity as members of the Scientific Advisory Board. The members of the Scientific Advisory Board currently are as follows:

Stuart M. Krassner, Ph.D. has been affiliated with the University of California, Irvine since 1965, currently as Professor of Biological Sciences and formerly in several administrative positions, most recently as Associate Dean of Research and Graduate Studies. Dr. Krassner has conducted research at both the Rockefeller University (New York) and the Swiss Tropical Institute (Basel). Dr. Krassner's research interests included parasitology and immunology and has numerous publications in those fields. Dr. Krassner received his doctorate degree in Parasitology from Johns Hopkins University in 1961.

Eric L. Nelson, Ph.D. has been a pharmaceutical research consultant since 1986. He was a founder, and served as Chairman until 1986, of Nelson Research and Development Corporation, a publicly held corporation engaged in research and development of drug receptor technology applied to the development of pharmaceutical products and novel drug delivery systems. Prior to 1972, Dr. Nelson spent eleven years at Allergan Pharmaceuticals, Inc., where as Vice President of Research he was responsible for establishing Allergan's entire research organization. Dr. Nelson received his doctorate degree in Microbiology from UCLA in 1951 and has authored numerous publications. He is the inventor on various patents in the areas of microbiology, immunology, molecular biology and pharmacology.

Michel Rathbone, M.D., Ph.D. See " - Key Employees and Consultant."

Paul H. Silverman, Ph.D., D.Sc. See " - Executive Officers and Directors."

COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Based solely upon its review of the copies of reporting forms furnished to the Company, and written representations that no other reports were required, the Company believes that all filing requirements under Section 16(a) of the Securities Exchange Act of 1934 applicable to its directors, officers and any persons holding 10% or more of the Company's Common Stock with respect to the Company's fiscal year ended December 31, 1996, were satisfied, except that the Form 3 Initial Statement of Beneficial Ownership of Securities filed by Mr. Meeks in September 1996 inadvertently omitted 460 shares of Common Stock owned of record by Mr Meeks' wife and which, under Section 16(a) of the Securities Exchange Act of 1934, are deemed to be beneficially owned by Mr. Meeks. Mr. Meeks has disclaimed beneficial ownership of these shares of Common Stock, and a filing with the correct information has been made with the Securities and Exchange Commission.

ITEM 10. EXECUTIVE COMPENSATION.

SUMMARY COMPENSATION

The following table sets forth summary information concerning the compensation of the Company's Chief Executive Officer (the "Named Executive Officer") for services rendered to the Company in all capacities during the fiscal years ended December 31, 1995 and 1996. No other executive officer of the Company received compensation in 1996 in excess of $100,000.

				LONG TERM COMPENSATION AWARDS
		ANNUAL COMPENSATION		SECURITIES UNDERLYING
NAME AND PRINCIPAL POSITION	YEAR	SALARY	BONUS	OPTIONS(#)
Alvin J. Glasky, Ph.D. Chairman, Chief Executive Officer and President	1996	$165,398(1)	--	75,000
	1995	125,400(1)	--	--

(1) Includes an auto allowance of $450 per month. Of the total amounts, $72,998 has been paid and $92,400 has been accrued for 1996, and $20,000 has been paid and $105,400 has been accrued for 1995. See "Employment Agreement".

OPTION GRANTS

The following table sets forth the options granted during the period commencing January 1, 1996 and ending December 31, 1996 to the executive officers named in the Summary Compensation table:

STOCK OPTIONS GRANTED IN FISCAL YEAR ENDED DECEMBER 31, 1996

NAME	OPTIONS GRANTED (NO. OF SHARES)	PERCENTAGE OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE PRICE ($/SHARE)	EXPIRATION DATE
Alvin J. Glasky	75,000(1)	85%	$4.13	07/01/2001

(1) Option becomes exercisable in three equal annual installments from the date of grant.

OPTIONS EXERCISES AND FISCAL YEAR-END VALUES

The following table sets forth the options exercised during the period commencing January 1, 1996 and ending December 31, 1996 by the executive officers named in the Summary Compensation table:

AGGREGATE STOCK OPTIONS EXERCISED IN FISCAL YEAR ENDED DECEMBER 31, 1996 AND FISCAL YEAR-END OPTION VALUES

NAME	NUMBER OF SHARES ACQUIRED ON EXERCISE	VALUE REALIZED	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT FISCAL YEAR-END		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT FISCAL YEAR-END(1)	
			EXERCISABLE	UNEXERCISED	EXERCISED	UNEXERCISED
Alvin J. Glasky	-	-	-	75,000	-	-

(1) Based upon the closing price of the Common Stock on December 31, 1996, as reported by the NASDAQ National Market ($4.125 per share).

EMPLOYMENT AGREEMENT

The Company has an employment agreement with Dr. Alvin J. Glasky, effective as of July 1, 1996. The agreement requires Dr. Glasky to devote all of his productive time, attention, knowledge and skill to the affairs of the Company during the term of the agreement. The agreement provides for an annual base salary of $200,000 with annual increases and an annual bonus based on the Company's attainment of certain performance objectives. The agreement ends on June 30, 1999 and may be terminated by the Company with or without cause as defined in the agreement. The agreement also provides for guaranteed servance payments equal to Dr. Glasky's annual base salary over the remaining life of the agreement upon the termination of employment without cause or upon a change in control of the Company. In connection with entering into this agreement, Dr. Glasky was granted an incentive stock option to purchase 75,000 shares of Common Stock at an exercise price of $4.13 per share, which vests in three equal increments over the life of Dr. Glasky's employment agreement.

COMPENSATION OF DIRECTORS

Each of the Company's non-employee directors receives $1,000 for each Board of Directors meeting and $500 for each committee meeting attended (with the Chairperson

of the Committee receiving $1,000). The directors are also reimbursed for certain expenses in connection with attendance at Board meetings. The Company has granted to each non-employee director an option to purchase 10,000 shares

of Common Stock at $4.50 per share.

STOCK OPTION PLANS

The Company has two stock option plans: the 1987 Incentive Stock Option Plan (the "1987 Plan") and the 1991 Stock Incentive Plan (the "1991 Plan, and together with the 1987 Plan, the "Plans"). The Plans were adopted by the Company's shareholders and Board of Directors in December 1987 and May 1991, respectively, and provide for the granting of "incentive stock options," within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"). The 1991 Plan also provides for the grant of nonqualified stock options, stock appreciation rights ("SARs") and bonus stock. The 1987 and 1991 Plans authorized for issuance up to 20,000 and 140,000 shares, respectively, of the Company's Common Stock. The number of shares issuable under the 1991 Plan is increased each January 1 by a number equal to one percent of the Company's then total outstanding shares. On August 7, 1996, the Company's shareholders approved an amendment to the 1991 Plan increasing the number of authorized shares by 60,000, to a total of 293,154 shares as of that date. As of January 1, 1997, the number of shares authorized under the 1991 plan automatically increased by 53,618 (one percent of the total shares outstanding on that date) to a total of 346,772. Under The Plans, incentive stock options may be granted to employees, and nonqualified stock options, SARs and bonus stock provided for in the 1991 Plan may be granted to employees of the Company and other persons whose participation in the 1991 Plan is determined to be in the Company's best interests. The Plans are administered by the Board of Directors or a committee appointed by the Board (the "Committee"), which has sole discretion and authority, consistent with the provisions of the Plans, to determine which eligible participants will receive options, the time when options will be granted, the terms of options granted and the number of shares which will be subject to options granted under the Plans. As of January 1, 1997, there were options to purchase 165,000 shares of Common Stock outstanding under the 1991 Plan and no options outstanding under the 1987 Plan.

In the event of a merger of the Company with or into another corporation or the sale of substantially all of the assets of the Company, all outstanding options and SARs granted under the 1991 Plan shall be assumed or equivalent options and SARs substituted by the successor corporation. In the event a successor corporation refuses to assume or substitute the options and SARs, the exercisability of the options and SARs under the 1991 Plan shall be accelerated.

The exercise price of incentive stock options must be not less than the fair market value of a share of Common Stock on the date of the option is granted (110% with respect to optionees who own at least 10% of the outstanding Common Stock). Nonqualified options shall have such exercise price as determined by the Committee. The Committee has the authority to determine the time or times at which options granted under the Plans become exercisable, provided that options expire no later than ten years from the date of grant (five years with respect to optionees who own at least 10% of the outstanding Common Stock). Options are nontransferable, other than upon death, by will and the laws of descent and distribution, and incentive stock options may be exercised only by an employee while employed by the Company or within three months after termination of employment (one year for termination resulting from death or disability).

SECTION 401(K) PLAN

In January 1990, the Company adopted the AIT Cash or Deferred Profit Sharing Plan (the "401(k) Plan") covering the Company's full-time employees located in the United States. The 401(k) Plan is intended to qualify under Section 401(k) of the Code, so that contributions to the 401(k) Plan by employees or by the Company, and the investment earnings thereon, are not taxable to employees until withdrawn from the 401(k) Plan, and so that contributions by the Company, if any, will be deductible by the Company when made. Pursuant to the 401(k) Plan, employees may elect to reduce their current compensation by up to the statutorily prescribed annual limit ($9,500 in 1996) and to have the amount of such reduction contributed to the 401(k) Plan. The

401(k) Plan permits, but does not require, additional matching contributions to the 401(k) Plan by the Company on behalf of all participants in the 401(k) Plan. The Company has not made any contributions to the 401(k) Plan.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth certain information with respect to the beneficial ownership of the Company's Common Stock as of March 14, 1997 by (i) each person (or group of affiliated persons) who is known by the Company to own beneficially 5% or more of the Common Stock, (ii) each of the Company's directors, (iii) the Named Executive Officer, and (iv) all executive officers and directors of the Company as a group. The information as to each person or entity has been furnished by such person or entity, and unless otherwise indicated, the persons named in the table have sole voting and sole investment power with respect to all shares beneficially owned, subject to community property laws where applicable.

NAME AND ADDRESS OF BENEFICIAL OWNERSHIP(1)	SHARES BENEFICIALLY OWNED(1)	PERCENT OF SHARES OUTSTANDING
Alvin J. Glasky, Ph.D.(2) . . . . . One Technology Drive, Suite I-821 Irvine, CA 92618	1,318,911	24.2%
Mark J. Glasky(3)(4)	32,134	*
Frank M. Meeks(5)	27,500	*
Carol O'Cleireacain, Ph.D.(6)	5,000	*
Paul H. Silverman, Ph.D., Sc.(6)	5,000	*
All Executive Officers and Directors as a group (seven persons)(9)	1,449,107	26.4

- ---

* less than 1%

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of Common Stock subject to options and warrants currently exercisable or convertible, or exercisable or convertible within 60 days of March 14, 1997, are deemed beneficially owned and outstanding

for computing the percentage of the person holding such securities, but are not considered outstanding for computing the percentage of any other person.

(2) Includes 88,173 shares issuable within 60 days of March 14, 1997 upon exercise of the Glasky Warrant and 4,000 shares owned BY the AIT Cash or Deferred Profit Sharing Plan (401(k)), of which Dr. Glasky is the trustee. Does not include 50,462 shares beneficially owned by Dr. Glasky's wife, Rosalie H. Glasky, and 32,134 shares beneficially owned by Mark J. Glasky, Dr. Glasky's adult son, for which Dr. Glasky disclaims beneficial ownership.

(3) Mark J. Glasky is the adult son of Dr. Alvin J. Glasky.

(4) Includes 7,500 shares subject to options held by Mr. Glasky which are currently exercisable or exercisable within 60 days of March 14, 1997,

and 1,000 shares subject to currently exercisable Warrants.

(5) Includes 7,500 shares subject to options held by Mr. Meeks which are currently exercisable or exercisable within 60 days of March 14, 1997. Does not include 460 shares beneficially owned by Mr. Meeks' wife, for which Mr. Meeks disclaims beneficial ownership.

(6) Includes 5,000 shares subject to options held by each of Drs. O'Cleireacain and Silverman which are currently exercisable or exercisable within 60 days of March 14, 1997.

(7) Includes 88,173 shares issuable upon the exercise of the Glasky Warrant, 34,000 shares subject to options which are currently exercisable or exercisable within 60 days of March 14, 1997, 2,050 shares subject to curently exercisable Warrants.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In September 1990, the Company issued a warrant to Dr. Alvin J. Glasky (the "Glasky Warrant") to purchase up to 88,173 shares of Common Stock of the Company at any time between September 1, 1990 and August 31, 1995 for $3.75 per share. Effective August 31, 1995, the expiration date of the Glasky Warrant was extended to August 31, 2000.

On June 30, 1990, in exchange for cancellation of $503,148 of indebtedness for unpaid compensation, the Company issued a total of 402,518 shares of Common Stock in the following amounts: Dr. Alvin Glasky 184,000 shares; Sanford Glasky (the brother of Dr. Alvin Glasky), 60,012 shares; JoAnne Law, 24,344 shares; Luana Kruse 19,200 shares; Rosalie Glasky (the wife of Dr. Glasky), 28,066 shares; and John W. Baldridge, 86,906 shares (the "1990 Restricted Stock Exchange"). On December 30, 1993, in exchange for cancellation of $690,795 of indebtedness for unpaid compensation and accrued expenses, the Company issued a total of 276,318 shares of Common Stock in the following amounts: Dr. Alvin Glasky, 169,001 shares; Sanford Glasky, 49,837 shares; JoAnne Law, 16,560 shares; Luana Kruse 19,800 shares; Rosalie Glasky, 19,178 shares; and John W. Baldridge, 1,942 shares (the "1993 Restricted Stock Exchange"). Both the 1990 Restricted Stock Exchange and the 1993 Restricted Stock Exchange involved a risk of forfeiture whereby if the Company did not generate a minimum of $500,000 in total operating revenues from inception through December 31, 1995, all shares would be returned to the Company with the holders forfeiting all rights to the shares and forfeiting any claim to the previously accrued but unpaid compensation. Effective December 31, 1995, five of the parties, all of whom were present or past employees of the Company,

entered into agreements with the Company whereby the forfeiture date was extended from December 31, 1995 to December 31, 1997 in exchange of increasing the minimum total operating revenues which the Company would need to achieve in order to avoid forfeiture of the shares from $500,000 to $1,000,000, with such revenues to be achieved by December 31, 1997. If the Company achieves $1,000,000 in total operating revenues by December 31,1997, the holders of the shares subject to forfeiture are entitled to certain registration rights covering those shares. One party to the 1990 and 1993 Restricted Stock Exchanges has claimed that his shares are vested, that there was no need for him to enter into the new agreement extending the forfeiture date and therefore he has not entered into an agreement under the new terms with respect to the 88,848 shares held by him (the "Forfeited Shares"). Although the Company believes that the Forfeited Shares were forfeited under the terms of the Restricted Stock Exchanges 1990 and 1993, the Company has accounted for the Forfeited Shares as outstanding until such time as the Company can obtain the surrender of the Forfeited Shares.

On June 6, 1991, the Company entered into an agreement (the "1991 Patent Agreement") with Dr. Alvin Glasky whereby Dr. Glasky assigned to the Company all rights to the inventions covered by United States Patent No. 5,091,432 and any corresponding foreign applications and patents, including all continuations, divisions, reissues and renewals of said applications and any patents issued out of or based upon said applications (the "Assigned Rights"). The 1991 Patent Agreement was amended on July 26, 1996. The 1991 Patent

Agreement, as amended, calls for the Company to pay Dr. Glasky a two percent royalty on all revenues derived by the Company from the use and sale by the Company of any products covered by these patents and applications or any patents derived from them. In the event that Dr. Glasky's employment is terminated by the Company without cause, the royalty rate shall be increased to five percent and in the event that Dr. Glasky dies during the term of the 1991 Patent Agreement, Dr. Glasky's family or estate shall be entitled to continue to receive royalties at the rate of two percent. The 1991 Patent Agreement terminates on the later of its ten year anniversary or the expiration of the final patent included within the Assigned Rights. On June 30, 1996, the Company and Dr. Glasky entered into an agreement whereby Dr. Glasky assigned to AIT all rights to the inventions covered by United States Patent No. 5,447,938 (the "1996 Patent Agreement"). The scope of the 1996 Patent Agreement as well as its terms and conditions are identical in all material respects to the 1991 Patent Agreement; provided, however, that the aggregate royalty amount with respect to any product shall be two percent (five percent in the event of termination without cause), even if a product is based on both patents. The 1996 Patent Agreement was also amended on July 26, 1996. Dr. Glasky will not receive any royalties with respect to sales of products which utilize patent rights licenses to the Company by McMaster University. See "ITEM 1 - Description of Business - Patents and Proprietary Rights."

On December 31, 1993, the Company issued 200,000 shares of Common Stock to Dr. Glasky in Exchange for cancellation of $500,000 of indebtedness for loans made by Dr. Glasky to the Company. Dr. Glasky received certain registration rights with respect to these shares. The remaining $257,900 in principal on the loans payable and accrued interest of $300,404 due to Dr. Glasky were converted into a $558,304 Secured Promissory Note due January 1, 1996 bearing interest at 7% per annum (the "1993 Note"). The 1993 Note is secured by all assets of the Company. On January 1, 1996, the due date of the 1993 Note was extended to December 31, 1996 and the interest rate was increased to 9% per annum. In June 1996, the due date of the 1993 Note was extended to December 31, 1997.

In July 1996, all of the holders of the 75 outstanding Revenue Participation Units ("RPUs") converted their RPUs into an aggregate of 300,000 shares of Common Stock.

As a part of this transaction, Dr. Glasky converted his 28 outstanding RPUs into a total of 112,000 shares of Common Stock. See Note 8 of Notes to Consolidated Financial Statements.

ITEM 13. EXHIBITS, LIST AND REPORTS ON FORM 8-K.

(a) Exhibits

EXHIBIT NO.	DESCRIPTION
3.1	Amended and Restated Articles of Incorporation of the Registrant, as filed on August 7, 1996. (Filed as Exhibit 3.2 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)
3.2	Bylaws of the Registrant. (Filed as Exhibit 3.3 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)
4.1	Form of Registration Rights Agreement dated as of July 23, 1996, entered into between the Registrant and certain investors named therein. (Filed as Exhibit 4.1 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)
4.2	Form of Registration Rights Agreement dated December 30, 1993, entered into between the Registrant and each of Alvin J. Glasky, Sanford J. Glasky, Joanne Law, Luana M. Kruse, Rosalie H. Glasky and John W. Baldridge. (Filed as Exhibit 4.2 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)
4.3	Form of Representatives' Warrant Agreement dated as of September 25, 1996, entered into in

connection with the public offering of the Company's securities on September 26, 1996. (Filed as Exhibit 4.3 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

4.4 Form of Stock Purchase Agreement dated December 30, 1993, including amendment effective December 30, 1995, between the Registrant and each of Alvin J. Glasky, Sanford Glasky, Joanne Law, Luana Kruse, Rosalie Glasky and John Baldridge. (Filed as Exhibit 4.4 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

4.5 Form of Stock Purchase Agreement dated June 30, 1990, as amended on May 27, 1992, June 30, 1993 and December 30, 1993, and amendment thereto effective December 30, 1995, between the Registrant and each of Alvin J. Glasky, Sanford Glasky, Joanne Law, Luana Kruse, Rosalie Glasky and John Baldridge. (Filed as Exhibit 4.5 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

4.6 Warrant Agreement entered into between Neotherapeutics, Inc. and U.S. Stock Transfer Corporation dated as of September 25, 1996. (Filed as Exhibit 4.6 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.1 Incentive Stock Option Plan dated December 18, 1987. (Filed as Exhibit 10.1 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.2 * 1991 Stock Incentive Plan. (Filed as Exhibit 10.2 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

EXHIBIT NO.	DESCRIPTION

10.3 * Employment Agreement between the Registrant and Alvin J. Glasky, Ph.D. (Filed as Exhibit 10.3 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.4 Note dated June 21, 1996 between the Registrant and Alvin J. Glasky and related Security Agreement dated August 31, 1990. (Filed as Exhibit 10.4 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.5 Warrant to purchase Common Stock of the Registrant dated August 31, 190 held by Alvin J. Glasky. (Filed as Exhibit 10.6 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.6 Agreement dated as of June 6, 1991, as amended on July 26, 1996, by and between the Registrant and Alvin J. Glasky. (Filed as Exhibit 10.7 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.7 Agreement dated as of June 30, 1991, as amended on July 26, 1996, by and between the Registrant and Alvin J. Glasky. (Filed as Exhibit 10.8 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.8 * Form of Indemnification Agreement between the Registrant and each of its officers and directors. (Filed as Exhibit 10.10 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.9 Underwriting Agreement dated as of September 25, 1996, among the Company, Paulson Investment Company, Inc. and First Colonial Securities Group, Inc. (Filed as Exhibit 1.1 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.10 Letter Agreement dated March 18, 1993, including addendums dated April 1, 1993, December 31, 1993, April 6, 1995 and May 3, 1996, and amendment dated July 26, 1996, between the Registrant and North American Capital Partners. (Filed as Exhibit 1.2 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

10.11 Industrial Lease Agreement, dated January 16, 1997, between the Company and the Irvine Company.

10.12 Addendum to Note dated June 21, 1996 between the Registrant and Alvin J. Glasky.

21.1 Subsidiaries of Registrant. (Filed as Exhibit 21.1 to the Registration Statement on Form SB-2 as amended (No. 333-05342-LA), and incorporated herein by reference.)

23.1 Consent of Arthur Andersen, L.L.P.

- ---

* Indicates a management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K. The Company did not file any reports on Form 8-K during the quarter ended December 31, 1996.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEOTHERAPEUTICS, INC.

Date: March 24, 1997

By: /s/ ALVIN J. GLASKY
Alvin J. Glasky, Ph.D.
President and Chief Executive Officer

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

SIGNATURE	TITLE	DATE
/s/ ALVIN J. GLASKY Alvin J. Glasky, Ph.D.	Chairman of the Board, Chief Executive Officer, President and Director (Principal Executive Officer)	March 24, 1997
/s/ SAMUEL GULKO Samuel Gulko	Chief Financial Officer (Principal Accounting and Financial Officer)	March 24, 1997
/s/ MARK J. GLASKY Mark J. Glasky	Director	March 24, 1997
/s/ FRANK M. MEEKS Frank M. Meeks	Director	March 24, 1997
/s/ CAROL O'CLEIREACAIN Carol O'Cleireacain, Ph.D.	Director	March 24, 1997
/s/ PAUL H. SILVERMAN Paul H. Silverman Ph.D., D.Sc.	Director	March 24, 1997

EXHIBIT 10.11

INDEX TO INDUSTRIAL LEASE
(Single Tenant; Net)

EXHIBITS

INDUSTRIAL LEASE
(SINGLE TENANT; NET)

BETWEEN

THE IRVINE COMPANY

AND

NEOTHERAPEUTICS, INC.

INDUSTRIAL LEASE
(SINGLE TENANT; NET)

THIS LEASE is made as of the 16th day of January, 1997, by and between THE IRVINE COMPANY, a Michigan corporation, hereafter called "Landlord," and NEOTHERAPEUTICS, INC., a Colorado corporation, hereinafter called "Tenant."

ARTICLE I. BASIC LEASE PROVISIONS

Each reference in this Lease to the "Basic Lease Provisions" shall mean and refer to the following collective terms, the application of which shall be governed by the provisions in the remaining Articles of this Lease.

1. Premises: The Premises are more particularly described in Section 2.1.

   Address of Building: 157 Technology Drive, Irvine, CA 92618

2. Project Description (if applicable): Corporate Business Center

3. Use of Premises: General administrative office and laboratories for the development of new drugs.

4. Estimated Commencement Date: June 1, 1997

5. Lease Term: Eighty-Four (84) months, plus such additional days as may be required to cause this Lease to terminate on the final day of the calendar month.

6. Basic Rent: Thirty-Eight Thousand Eight Hundred Dollars ($38,800.00) per month.

   Basic Rent is subject to adjustment as follows:

The Basic Rent shall be increased, as of the commencement of the thirty-first (31st) month of the Lease Term and again at the commencement of the sixty-first (61st) month of the Lease Term (the "Rental Adjustment Date(s)"), by the percentage increase, if any, in the United States Department of Labor, Bureau of Labor Statistics, Consumer Price Index for all Urban Consumers, Los Angeles-Anaheim-Riverside Area Average, all items (1982-84=100) (the "Index"). The adjustment shall be calculated by comparing the Index published for the third month preceding the applicable Rental Adjustment Date with the Index published for the third month preceding the last prior Rental Adjustment Date (or the third month preceding the Commencement Date in the case of the first rental adjustment), and the Basic Rent then in effect shall be increased by the amount of the percentage increase, if any, between those published Index amounts. In no event shall the Basic Rent be reduced by reason of such computation. If at any Rental Adjustment Date the Index shall not exist, Landlord may substitute another index published by any governmental agency reasonably acceptable to Tenant. Landlord shall use diligent efforts to calculate and give Tenant notice of any such increase in the Basic Rent on or near each Rental Adjustment Date, and Tenant shall commence to pay the increased Basic Rent effective on the applicable Rental Adjustment Date. In the event Landlord is unable to deliver to Tenant the notice of the increased Basic Rent at least five (5) days prior to any Rental Adjustment Date, Tenant shall commence to pay the increased Basic Rent on the first day of the month following the delivery of such notice (the "Payment Date"), provided Landlord's notice has been given at least five (5) days in advance. Tenant shall also pay, together with the first payment of the increased Basic Rent, an amount determined by multiplying the amount of the increase in Basic Rent times the number of months that have elapsed between the Rental Adjustment Date and the Payment Date.

Notwithstanding the foregoing, the parties agree that as of any Rental Adjustment Date, the revised Basic Rent due to all cumulative increases pursuant to this paragraph shall neither (i) exceed the amount obtained by increasing the initial Basic Rent from the Commencement Date to said Rental Adjustment at the rate of six percent (6%) per annum, compounded annually, nor (ii) be less than the amount obtained by increasing the initial Basic Rent from the Commencement Date to said Rental Adjustment Date at the rate of three percent (3%) per annum, compounded annually.

7. Guarantor(s): N/A

8. Floor Area of Premises: approximately 34,320 rentable square feet

9. Security Deposit: $50,210.00

10. Broker(s): Grubb & Ellis

11. Additional Insureds: Insignia Commercial Group, Inc.

12. Address for Payments and Notices:

LANDLORD	TENANT
Insignia Commercial Group, Inc. One Technology Drive, Suite F-207 Irvine, CA 92618	NeoTherapeutics, Inc. 157 Technology Irvine, CA 92618

with a copy of notices to:
Irvine Industrial Company
P.O. Box 6370
Newport Beach, CA 92658-6370
Attn: Vice President, Industrial Operations

13. Tenant's Liability Insurance Requirement: $2,000,000.00

14. Vehicle Parking Spaces: One Hundred Two (102)

15. Estimated Space Plan Approval Date: N/A

Exhibits:

A	Description of Premises	E	Rules and Regulations
B	Environmental Questionnaire	X	Work Letter
C	Landlord's Disclosures	Y	Project Site Plan
D	Insurance Requirements		

ARTICLE II. PREMISES

SECTION 2.1. LEASED PREMISES. Landlord leases to Tenant and Tenant leases from Landlord the premises shown in Exhibit A (the "Premises"), including the building identified in Item 1 of the Basic Lease Provisions (which together with the underlying real property, is called the "Building"), and containing approximately the floor area set forth in Item 8 of the Basic Lease Provisions. The Premises is a portion of the project shown in Exhibit Y (the "Project").

SECTION 2.2. ACCEPTANCE OF PREMISES. Tenant acknowledges that neither Landlord nor any representative of Landlord has made any representation or warranty with respect to the Premises or the Building or the suitability or fitness of either for any purpose, including without limitation any representations or warranties regarding zoning or other land use matters, and that neither Landlord nor any representative of Landlord has made any representations or warranties regarding (i) what other tenants or uses may be permitted or intended in the Building and the Project, or (ii) any exclusivity of use by Tenant with respect to its permitted use of the Premises as set forth in Item 3 of the Basic Lease Provisions. Tenant further acknowledges that neither Landlord nor any representative of Landlord has agreed to undertake any alterations or additions or construct any improvements to the Premises except as expressly provided in this Lease. The taking of possession or use of the Premises by Tenant for any purpose other than construction shall conclusively establish that the Premises and the Building were in satisfactory condition and in conformity with the provisions of this Lease in all respects, except for those matters which Tenant shall have brought to Landlord's attention on a written punch list. The list shall be limited to any items required to be accomplished by Landlord under the Work Letter attached as Exhibit X, and shall be delivered to Landlord within thirty (30) days after the term ("Term") of this Lease commences as provided in Article III below. If no items are required of Landlord under the Work Letter, by taking possession of the Premises Tenant accepts the improvements in their existing condition, and waives any right or claim against Landlord arising out of the condition of the Premises. Nothing contained in this Section shall affect the commencement of the Term or the obligation of Tenant to pay rent. Landlord shall diligently complete all punch list items of which it is notified as provided above.

SECTION 2.3. BUILDING NAME AND ADDRESS. Tenant shall not utilize any name selected by Landlord from time to time for the Building and/or the Project as any part of Tenant's corporate or trade name. Landlord shall have the right to change the name, address, number or designation of the Building or Project without liability to Tenant.

ARTICLE III. TERM

SECTION 3.1. GENERAL.

(a) The Term shall be for the period shown in Item 5 of the Basic Lease Provisions. Subject to the provisions of Section 3.2 below, the Term shall commence ("Commencement Date") on the earlier of (a) the date

upon which all relevant governmental authorities have approved the Tenant Improvements in accordance with applicable building codes, as evidenced by written approval thereof in accordance with the building permits issued for the Tenant Improvements or issuance of a temporary or final certificate of occupancy for the Premises, or (b) the date Tenant acquires possession or commences use of the Premises for any purpose other than construction of Tenant Improvements by Tenant under the Work Letter. Within ten (10) days after possession of the Premises is tendered to Tenant, the parties shall memorialize on a form provided by Landlord the actual Commencement Date and the expiration date ("Expiration Date") of this Lease. Tenant's failure to execute that form shall not affect the validity of Landlord's determination of those dates.

(b) Provided that Tenant is not in default under any provision of this Lease, either at the time of exercise of the extension right granted herein or at the time of the commencement of such extension, and provided further that Tenant is occupying more than fifty percent (50%) of the floor area of the Premise and/or has not assigned its interest in this Lease, Tenant shall have two (2) successive options to extend the Term of this Lease for periods of sixty (60) months each. Tenant shall exercise its right to extend the Term by and only by delivering to Landlord, not less than nine (9) months or more than twelve (12) months prior to the then-current expiration date of the Term, Tenant's irrevocable written notice of its commitment to extend (the "Commitment Notice"). The Basic Rent payable under the Lease during any extension of the Term shall be at the fair market rental, including subsequent adjustments, for comparable office/research and development space being leased by Landlord in the Irvine Spectrum area; provided that such rate shall in no event be less than the rate payable by Tenant during the final month of the initial Term. In the event that the parties are not able to agree on the fair market rental within one hundred twenty (120) days prior to the expiration date of the Term, then either party may elect, by written notice to the other party, to cause said rental, including subsequent adjustments, to be determined by appraisal as follows.

Within ten (10) days following receipt of such appraisal election, the parties shall attempt to agree on an appraiser to determine the fair market rental. If the parties are unable to agree in that time, then each party shall designate an appraiser within ten (10) days thereafter. Should either party fail to so designate an appraiser within that time, then the appraiser designated by the other party shall determine the fair rental value. Should each of the parties timely designate an appraiser, then the two appraisers so designated shall appoint a third appraiser who shall, acting alone, determine the fair rental value of the Premises. Any appraiser designated hereunder shall have an M.A.I. certification with not less than five (5) years experience in the valuation of commercial industrial buildings in Orange County, California.

Within thirty (30) days following the selection of the appraiser, such appraiser shall determine the fair market rental value, including subsequent adjustments of the Premises. In determining such value, the appraiser shall first consider rental comparables for the Project, provided that if adequate comparables do not exist then the appraiser may consider transactions involving similarly improved space in the Irvine Spectrum area with appropriate adjustments for differences in location and quality of project. In no event shall the appraiser attribute factors for brokerage commissions to reduce said fair market rental. The fees of the appraiser(s) shall be shared equally by both parties.

Within twenty (20) days after the determination of the fair market rental, Landlord shall prepare a reasonably appropriate amendment to this Lease for the extension period and Tenant shall execute and return same to Landlord within ten (10) days. Should the fair market rental not be established by the commencement of the extension period, then Tenant shall continue paying rent at the rate in effect during the last month of the initial Term, and a lump sum adjustment shall be made promptly upon the determination of such new rental.

If Tenant fails to timely comply with any of the provisions of this paragraph, Tenant's right to extend the Term shall be extinguished and the Lease shall automatically terminate as of the expiration

date of the Term, without any extension and without any liability to Landlord. Any attempt to assign or transfer any right or interest created by this paragraph shall be void from its inception. Tenant shall have no other right to extend the Term beyond the single sixty (60) month extension created by this paragraph.

SECTION 3.2. DELAY IN POSSESSION. If Landlord, for any reason whatsoever, cannot deliver possession of the Premises to Tenant on or before the Estimated Commencement Date, this Lease shall not be void or voidable nor shall Landlord be liable to Tenant for any resulting loss or damage. However, Tenant shall not be liable for any rent and the Commencement Date shall not occur until Landlord delivers possession of the Premises and the Premises are in fact available for Tenant's occupancy with any Tenant Improvements that have been approved as per Section 3.1(a) above, except that if Landlord's failure to so deliver possession on the Estimated Commencement Date is attributable to any action or inaction by Tenant (including without limitation any Tenant Delay described in the Work Letter, if any, attached to this Lease), then the Commencement Date shall not be advanced to the date on which possession of the Premises is tendered to Tenant, and Landlord shall be entitled to full performance by Tenant (including the payment of rent) from the date Landlord would have been able to deliver the Premises to Tenant but for Tenant's delay(s). Notwithstanding anything to the contrary contained in this Section 3.2, however, if for any reason other than "Tenant Delays" (as defined in the Work Letter) or other matters beyond Landlord's reasonable control, the Commencement Date has not occurred by the date that is one hundred eighty (180) days following the Estimated Commencement Date, then Tenant may, by written notice to Landlord given at any time thereafter but prior to the actual occurrence of the Commencement Date, elect to terminate this Lease. Notwithstanding the foregoing, if at any time during the construction period, Landlord reasonably believes that the Commencement Date will not occur on or before one hundred eighty (180) days following the Estimated Commencement Date, Landlord may notify Tenant in writing of such fact and of a new outside date on or before which the Commencement Date will occur, and Tenant must elect within ten (10) days of receipt of such notice to either terminate this Lease or waive its right to terminate this Lease provided the Commencement Date occurs on or prior to the new outside date established by Landlord in such notice to Tenant. Tenant's failure to elect to terminate this Lease within such ten (10) day period shall be deemed Tenant's waiver of its right to terminate this Lease as provided in this paragraph as to the previous outside date, but not as to the new outside date established by said notice. Notwithstanding anything to the contrary contained in this Section 3.2, however, if for any reason other than "Tenant Delays" (as defined in the Work Letter), the Commencement Date has not occurred by that date that is one (1) year following the Estimated Commencement Date, then Tenant may, by written notice to Landlord given within twenty (20) business days thereafter but prior to the actual Commencement Date, elect to terminate this Lease.

ARTICLE IV. RENT AND OPERATING EXPENSES

SECTION 4.1. BASIC RENT. From and after the Commencement Date, Tenant shall pay to Landlord without deduction or offset, Basic Rent for the Premises in the total amount shown (including subsequent adjustments, if any) in Item 6 of the Basic Lease Provisions. Any rental adjustment shown in Item 6 shall be deemed to occur on the specified monthly anniversary of the Commencement Date, whether or not that date occurs at the end of a calendar month. The rent shall be due and payable in advance commencing on the Commencement Date (as prorated for any partial month) and continuing thereafter on the first day of each successive calendar month of the Term. No demand, notice or invoice shall be required for the payment of Basic Rent. An installment of rent in the amount of one (1) full month's Basic Rent at the initial rate specified in Item 6 of the Basic Lease Provisions shall be delivered to Landlord concurrently with Tenant's execution of this Lease and shall be applied against the Basic Rent first due hereunder.

SECTION 4.2. OPERATING EXPENSES.

(a) Tenant shall pay to Landlord, as additional rent, "Building Costs" and "Property Taxes," as those terms are defined below,

incurred by Landlord in the operation of the Building and Project. For convenience of reference, Property Taxes and Building Costs shall be referred to collectively as "Operating Expenses".

(b) Commencing prior to the start of the first full "Expense Recovery Period" (as defined below) of the Lease, and prior to the start of each full or partial Expense Recovery Period thereafter, Landlord shall give Tenant a written estimate of the amount of Operating Expenses for the Expense Recovery Period. Tenant shall pay the estimated amounts to Landlord in equal monthly installments, in advance, with Basic Rent. If Landlord has not furnished its written estimate for any Expense Recovery Period by the time set forth above, Tenant shall continue to pay cost reimbursements at the rates established for the prior Expense Recovery Period, if any; provided that when the new estimate is delivered to Tenant, Tenant shall, at the next monthly payment date, pay any accrued cost reimbursements based upon the new estimate. For purposes hereof, "Expense Recovery Period" shall mean every twelve month period during the Term (or portion thereof for the first and last lease years) commencing July 1 and ending June 30.

(c) Within one hundred twenty (120) days after the end of each Expense Recovery Period, Landlord shall furnish to Tenant a statement showing in reasonable detail the actual or prorated Operating Expenses incurred by Landlord during the period, and the parties shall within thirty (30) days thereafter make any payment or allowance necessary to adjust Tenant's estimated payments, if any, to Tenant's actual owed amounts as shown by the annual statement. Any delay or failure by Landlord in delivering any statement hereunder shall not constitute a waiver of Landlord's right to require Tenant to pay Operating Expenses pursuant hereto. Any amount due Tenant shall be credited against installments next coming due under this Section 4.2, and any deficiency shall be paid by Tenant together with the next installment. If Tenant has not made estimated payments during the Expense Recovery Period, any amount owing by Tenant pursuant to subsection (a) above shall be paid to Landlord in accordance with Article XVI. Should Tenant fail to object in writing to Landlord's determination of actual Operating Expenses within sixty (60) days following delivery of Landlord's expense statement, Landlord's determination of actual Operating Expenses for the applicable Expense Recovery Period shall be conclusive and binding on the parties and any future claims to the contrary shall be barred. For each Expense Recovery Period from and after July 1, 1998 during the initial Term of this Lease, Landlord hereby agrees that Tenant's proportionate share of "controllable" Building Costs shall not increase by more than five percent (5%) per annum, on a compound basis, over Tenant's share of Building costs for the Expense Recovery Period ending June 30, 1998. As used herein, controllable" Building Costs shall mean the following costs only: (i) landscape maintenance; (ii) parking lot maintenance; (iii) refuse collection; (iv) window washing; (v) janitorial and day porter services; (vi) general building maintenance; (vii) security; (viii) gas and electric utilities; (ix) HVAC maintenance; (x) the management fee, wages, taxes, salaries, fringe benefits for administrative and other personnel directly applicable to the Building and/or the Project; and (xi) cost of Landlord's environmental, tax or other consultants.

Landlord agrees that it will maintain complete and accurate records of all costs, expenses and disbursements paid or incurred by Landlord, its employees, agents and/or contractors, with respect to the Operating Expenses. Provided Tenant is not then in default under this Lease, Tenant shall have the right to have Tenant's financial officer, a trained accountant (which may be an employee of Tenant) or a certified public accountant to audit Landlord's Operating Expenses, subject to the terms and conditions hereof. In no event, however, shall such auditor be compensated by Tenant on a "contingency" basis, or on any other basis tied to the results of said audit. Tenant shall give notice to Landlord of Tenant's intent to audit within sixty (60) days following delivery of Landlord's expense statement for each of the Expense Recovery Periods. Following reasonable notice to Landlord, such audit shall be conducted at a mutually agreeable time during normal business hours at the office of Landlord or its management agent where the records are maintained. If Tenant's audit determines that

actual Operating Expenses have been overstated by more than five percent (5%), then subject to Landlord's right to review and/or contest the audit results,

Landlord shall reimburse Tenant for the reasonable out-of-pocket costs of such audit. Tenant's rent shall be appropriately adjusted to reflect any overstatement in Operating Expenses. In the event of a dispute between Landlord and Tenant regarding the results of such audit, either party may elect to submit the matter for binding arbitration with JAMS/ENDISPUTE, as provided in Section 22.7 of this Lease.

All of the information obtained by Tenant and/or its auditor in connection with such audit, as well as any compromise, settlement, or adjustment reached between Landlord and Tenant as a result thereof, shall be held in strict confidence and, except as may be required pursuant to litigation and except for inadvertent disclosures despite Tenant's reasonable efforts to keep the disclosed information confidential, shall not be disclosed to any third party, directly or indirectly, by Tenant or its auditor or any of their officers, agents or employees. Landlord may require Tenant's auditor to execute a separate confidentiality agreement affirming the foregoing as a condition precedent to any audit.

(d) Even though the Lease has terminated and the Tenant has vacated the Premises, when the final determination is made of Operating Expenses for the Expense Recovery Period in which the Lease terminates, Tenant shall upon notice pay the entire increase due over the estimated expenses paid. Conversely, any overpayment made in the event expenses decrease shall be rebated by Landlord to Tenant.

(e) If, at any time during any Expense Recovery Period, any one or more of the Operating Expenses are increased to a rate(s) or amount(s) in excess of the rate(s) or amount(s) used in calculating the estimated expenses for the year, then the estimate of Operating Expenses shall be increased for the month in which such rate(s) or amount(s) becomes effective and for all succeeding months by an amount equal to the increase. Landlord shall give Tenant written notice of the amount or estimated amount of the increase, the month in which the increase will become effective, and the month for which the payments are due. Tenant shall pay the increase to Landlord as a part of Tenant's monthly payments of estimated expenses as provided in paragraph (b) above, commencing from and after Landlord's notice to Tenant with the month in which such increase shall be in effect.

(f) The term "Building Costs" shall include all expenses of operation and maintenance of the Building and of the Building's proportionate share of the Project, if applicable (determined as the rentable square footage of the Building divided by the rentable square footage of all space in the Project), to the extent such expenses are not billed to and paid directly by Tenant, and shall include the following charges by way of illustration but not limitation: water and sewer charges; insurance premiums or reasonable premium equivalents should Landlord elect to self-insure any risk that Landlord is authorized to insure hereunder; license, permit, and inspection fees; heat; light; power; air conditioning; supplies; materials; equipment; tools; the cost of any environmental, insurance, tax or other consultant utilized by Landlord in connection with the Building and/or Project; establishment of reasonable reserves for replacements and/or repair of Common Area improvements (if applicable), equipment and supplies; costs incurred in connection with compliance of any laws or changes in laws applicable to the Building or the Project; the cost of any capital investments (other than tenant improvements for specific tenants) to the extent of the amortized amount thereof over the useful life of such capital investments calculated at a market cost of funds, all as reasonably determined by Landlord, for each such year of useful life during the Term; costs associated with the procurement and maintenance of an intrabuilding network cable service agreement for any intrabuilding network cable telecommunications lines within the Project, and any other installation, maintenance, repair and replacement costs associated with such lines; labor; reasonably allocated wages and salaries, fringe benefits, and payroll taxes for administrative and other personnel directly applicable to the Building and/or Project, including both Landlord's personnel and outside personnel; any expense incurred pursuant to Sections 6.1, 6.2, 6.4, 7.2, and 10.2; and a reasonable overhead/management fee for the professional operation of the Building and Project. Notwithstanding anything to the contrary contained herein, the amount of such overhead/management fee to be charged to Tenant shall be determined by multiplying the actual fee charged (which from time to time may be with respect to the entire Project, a portion of the Project only, the Building only, or the Project together with other properties owned by Landlord and/or its affiliates) by a fraction, the numerator of which is the floor area of the Premises (as set forth in Item No. 8 of the Basic Lease Provisions) and the denominator of which is the total square footage of space charged with such fee actually leased to tenants

(including Tenant). It is understood that Building Costs shall include competitive charges for direct services provided by any subsidiary or division of Landlord.

(g) The term "Property Taxes" as used herein shall include the following: (i) all real estate taxes or personal property taxes, as such property taxes may be reassessed from time to time; and (ii) other taxes, charges and assessments which are levied with respect to this Lease or to the Building and/or the Project, and any improvements, fixtures and equipment and other property of Landlord located in the Building and/or the Project, except that general net income and franchise taxes imposed against Landlord shall be excluded; and (iii) all

assessments and fees for public improvements, services, and facilities and impacts thereon, including without limitation arising out of any Community Facilities Districts, "Mello Roos" districts, similar assessment districts, and any traffic impact mitigation assessments or fees; (iv) any tax, surcharge or assessment which shall be levied in addition to or in lieu of real estate or personal property taxes, other than taxes covered by Article VIII; and (v) costs and expenses incurred in contesting the amount or validity of any Property Tax by appropriate proceedings.

SECTION 4.3. SECURITY DEPOSIT. Concurrently with Tenant's delivery of this Lease, Tenant shall deposit with Landlord the sum, if any, stated in Item 9 of the Basic Lease Provisions, to be held by Landlord as security for the full and faithful performance of Tenant's obligations under this Lease (the "Security Deposit"). Subject to the last sentence of this Section, the Security Deposit shall be understood and agreed to be the property of Landlord upon Landlord's receipt thereof, and may be utilized by Landlord in its discretion towards the payment of all prepaid expenses by Landlord for which Tenant would be required to reimburse Landlord under this Lease, including without limitation brokerage commissions and Tenant Improvement costs. Upon any default by Tenant, including specifically Tenant's failure to pay rent or to abide by its obligations under Sections 7.1 and 15.3 below, whether or not Landlord is informed of or has knowledge of the default, the Security Deposit shall be deemed to be automatically and immediately applied, without waiver of any rights Landlord may have under this Lease or at law or in equity as a result of the default, as a setoff for full or partial compensation for Landlord's damages arising from that default. If any portion of the Security Deposit is applied after a default by Tenant, Tenant shall within five (5) days after written demand by Landlord deposit cash with Landlord in an amount sufficient to restore the Security Deposit to its original amount. Landlord shall not be required to keep this Security Deposit separate from its general funds, and Tenant shall not be entitled to interest on the Security Deposit. If Tenant fully performs its obligations under this Lease, the Security Deposit or any balance thereof shall be returned to Tenant (or, at Landlord's option, and unless otherwise expressly agreed to in the applicable consent to assignment agreement, to the last assignee of Tenant's interest in this Lease) after the expiration of the Term, provided that Landlord may retain the Security Deposit to the extent and until such time as all amounts due from Tenant in accordance with this Lease have been determined and paid in full.

ARTICLE V. USES

SECTION 5.1. USE. Tenant shall use the Premises only for the purposes stated in Item 3 of the Basic Lease Provisions, all in accordance with applicable laws and restrictions and pursuant to approvals to be obtained by Tenant from all relevant and required governmental agencies and authorities. The parties agree that any contrary use shall be deemed to cause material and irreparable harm to Landlord and shall entitle Landlord to injunctive relief in addition to any other available remedy. Tenant, at its expense, shall procure,

maintain and make available for Landlord's inspection throughout the Term, all governmental approvals, licenses and permits required for the proper and lawful conduct of Tenant's permitted use of the Premises. Tenant shall not do or permit anything to be done in or about the Premises which will in any way interfere with the rights of other occupants of the Building or the Project, or use or allow the Premises to be used for any unlawful purpose, nor shall Tenant permit any nuisance or commit any waste in the Premises or the Project. Tenant shall not do or permit to be done anything which will invalidate or increase the cost of any insurance policy(ies) covering the Building, the Project and/or their contents, and shall comply with all applicable insurance underwriters rules and the requirements of the Pacific Fire Rating Bureau or any other organization performing a similar function. Tenant shall comply at its expense with all present and future laws, ordinances, restrictions, regulations, orders, rules and requirements of all governmental authorities that pertain to Tenant or its use of the Premises, including without limitation all federal and state occupational health and safety requirements, whether or not Tenant's compliance will necessitate expenditures or interfere with its use and enjoyment of the Premises. Tenant shall comply at its expense with all present and future covenants, conditions, easements or restrictions now or hereafter affecting or encumbering the Building and/or Project, and any amendments or modifications thereto, including without limitation the payment by Tenant of any periodic or special dues or assessments charged against the Premises or Tenant which may be allocated to the Premises or Tenant in accordance with the provisions thereof. Tenant shall promptly upon demand reimburse Landlord for any additional insurance premium charged by reason of Tenant's failure to comply with the provisions of this Section, and shall indemnify Landlord from any liability and/or expense resulting from Tenant's noncompliance. As used in this Section 5.1, the term "permit" shall be deemed to mean "knowingly permit" in connection with anything that Tenant permits to be done on or about the Common Areas of the Project, as opposed to the Premises itself. Notwithstanding anything to the contrary contained in this Section 5.1, in the event Tenant's obligation for compliance with all future and present laws, ordinances, restrictions, regulations, orders, rules and requirements of all governmental authorities, and with all present and future covenants, conditions, easements or restrictions now or hereafter affecting or encumbering the Building and/or the Project, results in a capital improvement on Tenant's part (or Tenant's being obligated to reimburse Landlord for a capital improvement), Tenant shall only be responsible for the amortized cost of such capital improvement (amortized at a market cost of funds as reasonably determined by Landlord) over the useful life of said improvement during the Term.

SECTION 5.2 SIGNS. Except as approved in writing by Landlord, in its sole discretion, Tenant shall have no right to maintain identification signs in any location in, on or about the Premises, the Building or the Project and shall not place or erect any signs, displays or other advertising materials that are visible from the exterior of the Building. The size, design, graphics, material, style, color and other physical aspects of any permitted sign shall be subject to Landlord's written approval prior to installation (which approval may be withheld in Landlord's discretion), any covenants, conditions or restrictions encumbering the Premises, Landlord's signage program for the Project, as in effect from time to time and approved by the City of Irvine ("Signage Criteria"), and any applicable municipal or other governmental permits and approvals. Tenant acknowledges having received and reviewed a copy of the current Signage Criteria for the Project. Tenant shall be responsible for the cost of any permitted sign, including the fabrication, installation, maintenance and removal thereof. If Tenant fails to maintain its sign, or if Tenant fails to remove same upon termination of this Lease and repair any damage caused by such removal, Landlord may do so at Tenant's expense.

SECTION 5.3 HAZARDOUS MATERIALS.

(a) For purposes of this Lease, the term "Hazardous Materials" includes (i) any "hazardous materials" as defined in Section 25501(k) of the California Health and Safety Code, (ii) any other substance or matter which results in liability to any person or entity from exposure to such substance or matter under any statutory or common law theory, and (iii) any substance or matter which is in excess of permitted levels set forth in any federal, California or local law or regulation pertaining to any hazardous or toxic substance, material or waste.

(b) Tenant shall not cause or permit any Hazardous Materials to be brought upon, stored, used, generated, released or disposed of on, under, from or about the Premises (including without limitation the soil and groundwater thereunder) without the prior written consent of Landlord.

Notwithstanding the foregoing, Tenant shall have the right, without obtaining prior written consent of Landlord, to utilize within the Premises standard household

cleaning products and office products that may contain Hazardous Materials (such as photocopy toner, "White Out", and the like), provided however, that (i) Tenant shall maintain such products in their original retail packaging, shall follow all instructions on such packaging with respect to the storage, use and disposal of such products, and shall otherwise comply with all applicable laws with respect to such products, and (ii) all of the other terms and provisions of this Section 5.3 shall apply with respect to Tenant's storage, use and disposal of all such products. Landlord may, in its sole discretion, place such conditions as Landlord deems appropriate with respect to any such Hazardous Materials, and may further require that Tenant demonstrate that any such Hazardous Materials are necessary or useful to Tenant's business and will be generated, stored, used and disposed of in a manner that complies with all applicable laws and regulations pertaining thereto and with good business practices. Tenant understands that Landlord may utilize an environmental consultant to assist in determining conditions of approval in connection with the storage, generation, release, disposal or use of Hazardous Materials by Tenant on or about the Premises, and/or to conduct periodic inspections of the storage, generation, use, release and/or disposal of such Hazardous Materials by Tenant on and from the Premises, and Tenant agrees that any costs incurred by Landlord in connection therewith, to the extent of a violation by Tenant of the provisions of this Section 5.3 of the Lease, shall be reimbursed by Tenant to Landlord as additional rent hereunder upon demand.

(c) Prior to the execution of this Lease, Tenant shall complete, execute and deliver to Landlord an Environmental Questionnaire and Disclosure Statement (the "Environmental Questionnaire") in the form of Exhibit B attached hereto. Landlord hereby consents to the use by Tenant of the kinds and quantities of Hazardous Materials shown in the foregoing-delivered Environmental Questionnaire, provided Tenant shall comply with all applicable laws and regulations pertaining to the generation, storage, use and disposal of such Hazardous Materials. The completed Environmental Questionnaire shall be deemed incorporated into this Lease for all purposes, and Landlord shall be entitled to rely fully on the information contained therein. On each anniversary of the Commencement Date until the expiration or sooner termination of this Lease, Tenant shall disclose to Landlord in writing the names and amounts of all Hazardous Materials which were stored, generated, used, released and/or disposed of on, under or about the Premises for the twelve-month period prior thereto, and which Tenant desires to store, generate, use, release and/or dispose of on, under or about the Premises for the succeeding twelve-month period. In addition, to the extent Tenant is permitted to utilize Hazardous Materials upon the Premises, Tenant shall promptly provide Landlord with complete and legible copies of all the following environmental documents relating thereto: reports filed pursuant to any self-reporting requirements; permit applications, permits, monitoring reports, workplace exposure and community exposure warnings or notices and all other reports, disclosures, plans or documents (even those which may be characterized as confidential) relating to water discharges, air pollution, waste generation or disposal, and underground storage tanks for Hazardous Materials; orders, reports, notices, listings and correspondence (even those which may be considered confidential) of or concerning the release, investigation of, compliance, cleanup, remedial and corrective actions, and abatement of Hazardous Materials; and all complaints, pleadings and other legal documents filed by or against Tenant related to Tenant's use, handling, storage, release and/or disposal of Hazardous Materials.

(d) Landlord and its agents shall have the right, but not the obligation, to inspect, sample and/or monitor the Premises and/or the soil or groundwater thereunder at any time to determine whether Tenant is complying with the terms of this Section 5.3, and in connection therewith Tenant shall provide Landlord with full access to all relevant facilities, records and personnel. If Tenant is not in compliance with any of the provisions of this Section 5.3, or in the event of a release of any Hazardous Material on, under or about the Premises caused or permitted by Tenant, its agents, employees, contractors, licensees or invitees, Landlord and its agents shall have the right, but not the obligation, without limitation upon any of Landlord's other

rights and remedies under this Lease, to immediately enter upon the Premises without notice and to discharge Tenant's obligations under this Section 5.3 at Tenant's expense, including without limitation the taking of emergency or long-term remedial action. Landlord and its agents shall endeavor to minimize interference with Tenant's business in connection therewith, but shall not be liable for any such interference. In addition, Landlord, at Tenant's expense, shall have the right, but not the obligation, to join and participate in any legal proceedings or actions initiated in connection with any claims arising out of the storage, generation, use, release and/or disposal by Tenant or its agents, employees, contractors, licensees or invitees of Hazardous Materials on, under, from or about the Premises.

(e) If the presence of any Hazardous Materials on, under, from or about the Premises or the Project caused or permitted by Tenant or its agents, employees, contractors, licensees or invitees results in (i) injury to any person, (ii) injury to or any contamination of the Premises or the Project, or (iii) injury to or contamination of any real or personal property wherever situated, Tenant, at its expense, shall promptly take all actions necessary to return the Premises and the Project and any other affected real or personal property owned by Landlord to the condition existing prior to the introduction of such Hazardous Materials and to remedy

or repair any such injury or contamination, including without limitation, any cleanup, remediation, removal, disposal, neutralization or other treatment of any such Hazardous Materials. Notwithstanding the foregoing, Tenant shall not, without Landlord's prior written consent, take any remedial action in response to the presence of any Hazardous Materials on, under or about the Premises or the Project or any other affected real or personal property owned by Landlord or enter into any similar agreement, consent, decree or other compromise with any governmental agency with respect to any Hazardous Materials claims; provided however, Landlord's prior written consent shall not be necessary in the event that the presence of Hazardous Materials on, under or about the Premises or the Project or any other affected real or personal property owned by Landlord (i) imposes an immediate threat to the health, safety or welfare of any individual or (ii) is of such a nature that an immediate remedial response is necessary and it is not possible to obtain Landlord's consent before taking such action. To the fullest extent permitted by law, Tenant shall indemnify, hold harmless, protect and defend (with attorneys acceptable to Landlord) Landlord and any successors to all or any portion of Landlord's interest in the Premises and the Project and any other real or personal property owned by Landlord from and against any and all liabilities, losses, damages, diminution in value, judgments, fines, demands, claims, recoveries, deficiencies, costs and expenses (including without limitation attorneys' fees, court costs and other professional expenses), whether foreseeable or unforeseeable, arising directly or indirectly out of the use, generation, storage, treatment, release, on- or off-site disposal or transportation of Hazardous Materials on, into, from, under or about the Premises, the Building and the Project and any other real or personal property owned by Landlord caused or permitted by Tenant, its agents, employees, contractors, licensees or invitees, specifically including without limitation the cost of any required or necessary repair, restoration, cleanup or detoxification of the Premises, the Building and the Project and any other real or personal property owned by Landlord, and the preparation of any closure or other required plans, whether or not such action is required or necessary during the Term or after the expiration of this Lease. If Landlord at any time discovers that Tenant or its agents, employees, contractors, licensees or invitees may have caused or permitted the release of a Hazardous Material on, under, from or about the Premises or the Project or any other real or personal property owned by Landlord, Tenant shall, at Landlord's request, immediately prepare and submit to Landlord a comprehensive plan, subject to Landlord's approval, specifying the actions to be taken by Tenant to return the Premises or the Project or any other real or personal property owned by Landlord to the condition existing prior to the introduction of such Hazardous Materials. Upon Landlord's approval of such cleanup plan, Tenant shall, at its expense, and without limitation of any rights and remedies of Landlord under this Lease or at law or in equity, immediately implement such plan and proceed to cleanup such Hazardous Materials in accordance with all applicable laws and as required by such plan and this Lease. The provisions of this subsection (e) shall expressly survive the expiration or sooner termination of this Lease. As used

in this Section 5.3(e), the terms "permit" and "permitted" shall be deemed to mean "knowingly permit" and "knowingly permitted" in connection with anything that Tenant permits, or has permitted, to be done on or about the Common Areas of the Project, as opposed to the Premises itself.

(f) Landlord hereby discloses to Tenant, and Tenant hereby acknowledges, certain facts relating to Hazardous Materials at the Project known by Landlord to exist as of the date of this Lease, as more particularly described in Exhibit C attached hereto. Tenant shall have no liability or responsibility with respect to the Hazardous Materials conditions described in Exhibit C, nor with respect to any Hazardous Materials which Tenant proves: (i) were not caused or permitted by Tenant, its agents, employees, contractors, licensees or invitees; (ii) were the result of violations of any "Hazardous Materials Laws" (as hereinafter defined) relating to the Premises, the Building, or the Project (the Premises, the Building, and the Project shall be collectively referred to herein as the "Property") which violations existed as of the Commencement Date, or (iii) were present in, on, under or about any part of the Property as of the Commencement Date, or that were brought into, onto, about, or under any part of the Property by anyone other than Tenant or its agents, employees, contractors, licensees or invitees. "Hazardous Materials Laws" shall mean and include all federal, state, and local laws relating to the environment or to Hazardous Materials, including, but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (42 U.S.C. Section 9601 et seq.), each as amended from time to time. Notwithstanding the foregoing, Tenant agrees to notify its agents, employees, contractors, licensees, and invitees of any exposure or potential exposure to Hazardous Materials at the Premises that Landlord brings to Tenant's attention.

(g) To "Landlord's knowledge" (as hereinafter defined), Landlord has complied, and the Property is in compliance as of the date of this Lease, with all Hazardous Materials Laws, and no notice of violation of any Hazardous Materials Law with respect thereto, or any permit, license or other authorization relating thereto has been received, nor is any such notice pending or, to Landlord's knowledge, threatened. To Landlord's knowledge, no underground or above-ground storage tanks or surface impoundments are located on or under any part of the Property. Except in compliance with Hazardous Materials Laws, neither Landlord, nor to Landlord's knowledge, any prior owner, operator, tenant or occupant of any part of the Property, has generated, used, treated, spilled, stored, transferred, disposed, released

or caused a threatened release in, at, under, into, from, to or on any part of the Property of any Hazardous Materials. Except as disclosed to Tenant, Landlord has not received any notice or claim to the effect that either Landlord or any part of the Property is or may be liable to any governmental authority or private party as a result of the release or threatened release of any Hazardous Materials. As used herein, "Landlord's knowledge" shall mean the actual knowledge, as of the Commencement Date of this Lease, of the current employees of Landlord charged with responsibility for the environmental compliance of the Property with Hazardous Materials Laws, but without obligation whatsoever for on- or off-site inquiry, investigation or inspection.

(h) Landlord shall take responsibility, at its sole cost and expense, for any governmentally-ordered clean-up, remediation, removal, disposal, neutralization, monitoring or other treatment of the Hazardous Materials conditions disclosed on EXHIBIT C attached hereto, and in connection with other Hazardous Materials which were present in, on under or about any part of the Property as of the Commencement Date. The foregoing obligation on the part of Landlord shall include the reasonable costs (including, without limitation, reasonable attorney's fees) of defending Tenant (with attorneys reasonably acceptable to Tenant) from and against any legal action or proceeding instituted by any governmental agency in connection with such clean-up, remediation, removal, disposal, neutralization or other treatment of such conditions, provided that Tenant promptly tenders such defense to Landlord. The obligation on the part of Landlord contained in this Section 5.3(h) is personal to Landlord and shall not be binding on, nor inure against any successor in interest to Landlord as of the owner of the Premises, including without limitation, any lender acquiring the Premises by foreclosure of its mortgage or deed of trust or deed in lieu of foreclosure.

ARTICLE VI. COMMON AREAS; SERVICES

SECTION 6.1. UTILITIES AND SERVICES. Tenant shall be responsible for and shall pay promptly, directly to the appropriate supplier, all charges for water, gas, electricity, sewer, heat, light, power, telephone, refuse pickup, janitorial service, interior landscape maintenance and all other utilities, materials and services furnished directly to Tenant or the Premises or used by Tenant in, on or about the Premises during the Term, together with any taxes thereon. Landlord shall not be liable for damages or otherwise for any failure or interruption of any utility or other service furnished to the Premises, and no such failure or interruption shall be deemed an eviction or entitle Tenant to terminate this Lease or withhold or abate any rent due hereunder. Notwithstanding the foregoing, if as a result of the actions of Landlord, its agents, contractors or employees, for more than three (3) consecutive business days following written notice to Landlord, there is no HVAC or electricity services to the Premises, or such an interruption of other essential utilities and building services, such as fire protection or water, so that the Premises cannot be used by Tenant, in Tenant's judgment reasonably exercised, then Tenant's Basic Rent shall thereafter be abated until the Premises are again usable by Tenant; provided, however, that if Landlord is diligently pursuing the repair of such utilities or services and Landlord provides substitute services reasonably suitable for Tenant's purposes, as for example, bringing in portable air-conditioning equipment, then there shall not be an abatement of Basic Rent. Any disputes concerning the foregoing shall be resolved by JAMS arbitration pursuant to Section 22.7 of this Lease. The foregoing provisions shall not apply in case of damage to, or destruction of, the Premises, which shall be governed by the provisions of Article XI of the Lease. Landlord shall, upon at least 24 hours prior notice to Tenant and during normal business hours (except in cases of emergency), have free access to all electrical and mechanical installations of Landlord.

SECTION 6.2. OPERATION AND MAINTENANCE OF COMMON AREAS. During the Term, Landlord shall operate and maintain in a first-class condition all Common Areas within the Project. The term "Common Areas" shall mean all areas which are not held for exclusive use by persons entitled to occupy space, and all other appurtenant areas and improvements provided by Landlord for the common use of Landlord and tenants and their respective employees and invitees, including without limitation parking areas and structures, driveways, sidewalks, landscaped and planted areas, hallways and interior stairwells not located within the premises of any tenant, common electrical rooms and roof access entries, common entrances and lobbies, elevators, and restrooms not located within the premises of any tenant.

SECTION 6.3. USE OF COMMON AREAS. The occupancy by Tenant of the Premises shall include the use of the Common Areas in common with Landlord and with all others for whose convenience and use the Common Areas may be provided by Landlord, subject, however, to compliance with all rules and regulations as are prescribed from time to time by Landlord. Landlord shall operate and maintain the Common Areas in the manner Landlord may determine to be appropriate. All costs incurred by Landlord for the maintenance and operation of the Common Areas shall be included in Building Costs unless any particular cost incurred can be charged to a specific tenant of the Project. Landlord shall at all times during the Term have exclusive control of the Common Areas, and may restrain any use or occupancy, except as authorized by Landlord's rules and regulations. Tenant shall keep the Common Areas clear of

any obstruction or unauthorized use related to Tenant's operations. Except as expressly provided in Section 10.3(b) of this Lease, nothing in this Lease shall be deemed to impose liability upon Landlord for any damage to or loss of the property of, or for any injury to, Tenant, its invitees or employees. Landlord may temporarily close any portion of the Common Areas for repairs, remodeling and/or alterations, to prevent a public dedication or the accrual of prescriptive rights, or for any other reason deemed sufficient by Landlord, without liability to Landlord.

SECTION 6.4. PARKING. Tenant shall be entitled to the number of

vehicle parking spaces set forth in Item 14 of the Basic Lease Provisions, which spaces shall be unreserved and unassigned, on those portions of the Common Areas designated by Landlord for parking. Tenant shall not use more parking spaces than such number. All parking spaces shall be used only for parking by vehicles no larger than full size passenger automobiles or pickup trucks. Tenant shall not permit or allow any vehicles that belong to or are controlled by Tenant or Tenant's employees, suppliers, shippers, customers or invitees to be loaded, unloaded or parked in areas other than those designated by Landlord for such activities. If Tenant permits or allows any of the prohibited activities described above, then Landlord shall have the right, without notice, in addition to such other rights and remedies that Landlord may have, to remove or tow away the vehicle involved and charge the costs to Tenant. Parking within the Common Areas shall be limited to striped parking stalls, and no parking shall be permitted in any driveways, access ways or in any area which would prohibit or impede the free flow of traffic within the Common Areas. There shall be no overnight parking of any vehicles of any kind unless otherwise authorized by Landlord, and vehicles which have been abandoned or parked in violation of the terms hereof may be towed away at the owner's expense. Except as expressly provided in Section _10.3(b) of this Lease, nothing contained in this Lease shall be deemed to create liability upon Landlord for any damage to motor vehicles of visitors or employees, for any loss of property from within those motor vehicles, or for any injury to Tenant, its visitors or employees. Landlord shall have the right to establish, and from time to time amend, and to enforce against all users all reasonable rules and regulations (including the designation of areas for employee parking) that Landlord may deem necessary and advisable for the proper and efficient operation and maintenance of parking within the Common Areas. Landlord shall have the right to construct, maintain and operate lighting facilities within the parking areas; to change the area, level, location and arrangement of the parking areas and improvements therein; to restrict parking by tenants, their officers, agents and employees to employee parking areas; to enforce parking charges (by operation of meters or otherwise); and to do and perform such other acts in and to the parking areas and improvements therein as, in the use of good business judgment, Landlord shall determine to be advisable. Notwithstanding the foregoing, in no event shall Landlord enforce additional parking charges against Tenant during the initial Term of this Lease. Any person using the parking area shall observe all directional signs and arrows and any posted speed limits. In no event shall Tenant interfere with the use and enjoyment of the parking area by other tenants of the Project or their employees or invitees. Parking areas shall be used only for parking vehicles. Washing, waxing, cleaning or servicing of vehicles, or the storage of vehicles for 24-hour periods, is prohibited unless otherwise authorized by Landlord. Tenant shall be liable for any damage to the parking areas caused by Tenant or Tenant's employees, suppliers, shippers, customers or invitees, including without limitation damage from excess oil leakage. Tenant shall have no right to install any fixtures, equipment or personal property in the parking areas.

SECTION 6.5. CHANGES AND ADDITIONS BY LANDLORD. Landlord reserves the right to make alterations or additions to the Project, or to the attendant fixtures, equipment and Common Areas. Landlord may at any time relocate or remove any of the various buildings (other than the Building), parking areas, and other Common Areas, and may add buildings and areas to the Project from time to time. No change shall entitle Tenant to any abatement of rent or other claim against Landlord, provided that the change does not deprive Tenant of reasonable access to or use of the Premises.

ARTICLE VII. MAINTAINING THE PREMISES

SECTION 7.1. TENANT'S MAINTENANCE AND REPAIR. Tenant at its sole expense shall comply with all applicable laws and governmental regulations governing the Premises and make all repairs necessary to keep the Premises in the condition as existed on the Commencement Date (or on any later date that the improvements may have been installed), excepting ordinary wear and tear, including without limitation the electrical and mechanical systems, any air conditioning, ventilating or heating equipment which serves the Premises, all walls, glass, windows, doors, door closures, hardware, fixtures, electrical, plumbing, fire extinguisher equipment and other equipment. Any damage or deterioration of the Premises shall not be deemed ordinary wear and tear if the same could have been prevented by good maintenance practices by Tenant. As part of its maintenance obligations hereunder, Tenant shall, at Landlord's request, provide Landlord with copies of all maintenance schedules, reports and

notices prepared by, for or on behalf of Tenant. Tenant shall obtain preventive maintenance contracts from a licensed heating and air conditioning contractor to provide for regular inspection and maintenance of the heating, ventilating and air conditioning systems servicing the Premises, all subject to Landlord's approval. All repairs shall be at least equal in quality to the original work, shall be made only by a licensed contractor approved in writing in advance by Landlord (which approval shall not be unreasonably withheld), and shall be made only at the time or times approved by Landlord. Any contractor utilized by Tenant shall be subject to Landlord's standard requirements for contractors, as modified from time to time. Landlord shall have the right at all times (upon at least 24 hours' prior notice) to inspect Tenant's maintenance of all equipment (including without limitation air conditioning, ventilating and heating equipment), and may impose reasonable restrictions and requirements with respect to repairs, as provided in Section 7.3, and the provisions of Section 7.4 shall apply to all repairs. Alternatively, Landlord may elect to make any repair or maintenance required hereunder on behalf of Tenant and at Tenant's expense, and Tenant shall promptly reimburse Landlord for all costs incurred upon submission of an invoice. Notwithstanding anything to the contrary contained in this Section 7.1, in the event Tenant's obligation for compliance with all applicable laws and governmental regulations, or making repairs, results in a capital improvement on Tenant's part (or Tenant's being obligated to reimburse Landlord for a capital improvement), Tenant shall only be responsible for the amortized cost of such capital improvement (amortized at a market cost of funds as reasonably determined by Landlord) over the useful life of such improvements during the Term.

SECTION 7.2. LANDLORD'S MAINTENANCE AND REPAIR. Subject to Section 7.1 and Article XI, Landlord shall provide service, maintenance and repair with respect to the roof, foundations, and footings of the Building, all landscaping, walkways, parking areas, Common Areas, exterior lighting, and the exterior surfaces of the exterior walls of the Building, except that Tenant at its expense shall make all repairs which Landlord deems reasonably necessary as a result of the act or negligence of Tenant, its agents, employees, invitees, subtenants or contractors. Landlord shall have the right to employ or designate any reputable person or firm, including any employee or agent of Landlord or any of Landlord's affiliates or divisions, to perform any service, repair or maintenance function. Landlord need not make any other improvements or repairs except as specifically required under this Lease, and nothing contained in this Section shall limit Landlord's right to reimbursement from Tenant for maintenance, repair costs and replacement costs as provided elsewhere in this Lease. Except as expressly provided in Section 7.6 of this Lease, Tenant understands that it shall not make repairs at Landlord's expense nor, in any event, by rental offset. Tenant further understands that Landlord shall not be required to make any repairs to the roof, foundations or footings unless and until Tenant has notified Landlord in writing of the need for such repair and Landlord shall have a reasonable period of time thereafter to commence and complete said repair, if warranted. All costs of any maintenance and repairs on the part of Landlord provided hereunder shall be considered part of Building Costs.

SECTION 7.3. ALTERATIONS. Tenant shall make no alterations, additions or improvements to the Premises without the prior written consent of Landlord, which consent may be given or withheld in Landlord's sole discretion. Notwithstanding the foregoing, Landlord shall not unreasonably withhold its consent to any alterations, additions or improvements to the Premises which cost less than One Dollar ($1.00) per square foot of the improved portions of the Premises (excluding warehouse square footage) and do not (i) affect the exterior of the Building or outside areas (or be visible from adjoining sites), or (ii) affect or penetrate any of the structural portions of the Building, including but not limited to the roof, or (iii) require any change to the basic floor plan of the Premises, any change to any structural or mechanical systems of the Premises, or any governmental permit as a prerequisite to the construction thereof, or (iv) interfere in any manner with the proper functioning of or Landlord's access to any mechanical, electrical, plumbing or HVAC systems, facilities or equipment located in or serving the Building, or (v) diminish the value of the Premises. Landlord may impose, as a condition to its consent, any requirements that Landlord in its discretion may deem reasonable or desirable, including but not limited to a requirement that all work be covered by a lien and completion bond satisfactory to Landlord and

requirements as to the manner, time, and contractor for performance of the work. Tenant shall obtain all required permits for the work and shall perform the work in compliance with all applicable laws, regulations and ordinances, all covenants, conditions and restrictions affecting the Project, and the Rules and Regulations (hereafter defined). If any governmental entity requires, as a condition to any proposed alterations, additions or improvements to the Premises by Tenant, that improvements be made to the Common Areas, and if Landlord consents to such improvements to the Common Areas, then Tenant shall, at Tenant's sole expense, make such required improvements to the Common Areas in such manner, utilizing such materials, and with such contractors (including, if required by Landlord, Landlord's contractors) as Landlord may require in its sole discretion. Under no circumstances shall Tenant make any improvement which incorporates any Hazardous Materials, including without limitation asbestos-containing construction materials into the Premises. Any request for Landlord's consent shall be made in writing and shall contain architectural plans describing the work in detail reasonably satisfactory to Landlord. Unless Landlord otherwise requires in writing at the time of its consent thereto, all alterations, additions or improvements affixed to the Premises (excluding moveable trade fixtures and

furniture) shall become the property of Landlord and shall be surrendered with the Premises at the end of the Term, except that Landlord may, by notice to Tenant given at the time of Landlord's consent thereto, require Tenant to remove by the Expiration Date, or sooner termination date of this Lease, all or any alterations, decorations, fixtures, additions, improvements and the like installed either by Tenant or by Landlord at Tenant's request and to repair any damage to the Premises arising from that removal (excluding, however, the Tenant Improvements constructed pursuant to the Work Letter, which shall remain as Landlord's property at the expiration of the Term). Except as otherwise provided in this Lease or in any Exhibit to this Lease, should Landlord make any alteration or improvement to the Premises for Tenant, Landlord shall be entitled to prompt reimbursement from Tenant for all costs incurred.

SECTION 7.4. MECHANIC'S LIENS. Tenant shall keep the Premises free from any liens arising out of any work performed, materials furnished, or obligations incurred by or for Tenant. Upon request by Landlord, Tenant shall promptly cause any such lien to be released by posting a bond in accordance with California Civil Code Section 3143 or any successor statute. In the event that Tenant shall not, within thirty (30) days following the imposition of any lien, cause the lien to be released of record by payment or posting of a proper bond, Landlord shall have, in addition to all other available remedies, the right to cause the lien to be released by any means it deems proper, including payment of or defense against the claim giving rise to the lien. All expenses so incurred by Landlord, including Landlord's attorneys' fees, shall be reimbursed by Tenant promptly following Landlord's demand, together with interest from the date of payment by Landlord at the maximum rate permitted by law until paid. Tenant shall give Landlord no less than twenty (20) days' prior notice in writing before commencing construction of any kind on the Premises so that Landlord may post and maintain notices of nonresponsibility on the Premises.

SECTION 7.5. ENTRY AND INSPECTION. Landlord shall during normal business hours, upon at least 24 hours' written or oral notice and with a Tenant escort if Tenant so chooses (except in emergencies, when no notice or escort shall be required) have the right to enter the Premises to inspect them, to supply services in accordance with this Lease, to protect the interests of Landlord in the Premises, and to submit the Premises to prospective or actual purchasers or encumbrance holders (or, during the last one hundred and eighty (180) days of the Term or when an uncured Tenant default exists, to prospective tenants), all without being deemed to have caused an eviction of Tenant and without abatement of rent except as provided elsewhere in this Lease. Landlord shall have the right, if desired, but subject to Tenant's reasonable security requirements, to retain a key which unlocks all of the doors in the Premises, excluding Tenant's vaults and safes, and Landlord shall have the right to use any and all means which Landlord may deem proper to open the doors in an emergency in order to obtain entry to the Premises, and any entry to the Premises obtained by Landlord shall not under any circumstances be deemed to be a forcible or unlawful entry into, or a detainer of, the Premises, or any eviction of Tenant from the Premises.

7.6 TENANT'S SELF-HELP. If Landlord shall fail to perform any repair obligations required under this Lease within thirty (30) days following Tenant's written request for such repairs, or if Landlord shall fail to perform any repairs required under this Lease of an emergency condition within 24 hours' written notice from Tenant, then Tenant may elect to make such repairs at Landlord's expense by complying with the following provisions of this Section 7.6. Before making any such repair, Tenant shall deliver to Landlord a notice for the need for such repair ("Self-Help Notice"), which notice shall specifically advise Landlord that Tenant intends to exercise its self-help right hereunder. Should Landlord fail, within ten (10) days following receipt of the Self-Help Notice (or within 24 hours following notice in the event of necessary emergency repairs), to commence the necessary repair or to make other arrangements reasonably satisfactory to Tenant, then Tenant shall have the right to make such repair on behalf of Landlord. Landlord shall promptly reimburse Tenant for the reasonable costs of such repairs, but in no event shall Tenant have the right to offset rent against such costs. In the event that the work could affect the Building's structural, mechanical, electrical, heating, ventilating, air conditioning, life safety or plumbing components or systems, then Tenant shall use only those contractors used by Landlord in the Project for such work. If those contractors are unwilling or unable to perform the work, Tenant may retain the services of qualified, reputable and licensed, bonded contractors with like experience in similar building systems. Tenant shall be responsible for obtaining any necessary governmental permits before commencing the repair work, and Tenant shall assume the risk of any damage, loss or injury resulting from such work.

ARTICLE VIII. TAXES AND ASSESSMENTS ON TENANT'S PROPERTY

Tenant shall be liable for and shall pay, before delinquency, all taxes and assessments levied against all personal property of Tenant located in the Premises, against all improvements to the Premises made by Landlord or Tenant which are above Landlord's Project standard in quality and/or quantity for comparable space within the Project ("Above Standard Improvements"), and against any alterations, additions or like improvements made to the

Premises by or on behalf of Tenant. When possible Tenant shall cause its personal property, Above Standard Improvements and alterations to be assessed and billed separately from the real property of which the Premises form a part. If any taxes on Tenant's personal property, Above Standard Improvements and/or alterations are levied against Landlord or Landlord's property and if Landlord pays the same, or if the assessed value of Landlord's property is increased by the inclusion of a value placed upon the personal property, Above Standard Improvements and/or alterations of Tenant and if Landlord pays the taxes based upon the increased assessment, Tenant shall pay to Landlord the taxes so levied against Landlord or the proportion of the taxes resulting from the increase in the assessment. In calculating what portion of any tax bill which is assessed against Landlord separately, or Landlord and Tenant jointly, is attributable to Tenant's Above Standard Improvements, alterations and personal property, Landlord's reasonable determination shall be conclusive.

ARTICLE IX. ASSIGNMENT AND SUBLETTING

SECTION 9.1. RIGHTS OF PARTIES.

(a) Notwithstanding any provision of this Lease to the contrary, Tenant will not, either voluntarily or by operation of law, assign, sublet, encumber, or otherwise transfer all or any part of Tenant's interest in this lease, or permit the Premises to be occupied by anyone other than Tenant, without Landlord's prior written consent, which consent shall not unreasonably be withheld in accordance with the provisions of Section 9.1.(b). No assignment (whether voluntary, involuntary or by operation of law) and no subletting shall be valid or effective without Landlord's prior written consent and, at Landlord's election, any such assignment or subletting or attempted assignment or subletting shall constitute a material default of this Lease.

Landlord shall not be deemed to have given its consent to any assignment or subletting by any other course of action, including its acceptance of any name for listing in the Building directory. To the extent not prohibited by provisions of the Bankruptcy Code, 11 U.S.C. Section 101 et seq. (the "Bankruptcy Code"), including Section 365(f)(1), Tenant on behalf of itself and its creditors, administrators and assigns waives the applicability of Section 365(e) of the Bankruptcy Code unless the proposed assignee of the Trustee for the estate of the bankrupt meets Landlord's standard for consent as set forth in Section 9.1(b) of this Lease. If this Lease is assigned to any person or entity pursuant to the provisions of the Bankruptcy Code, any and all monies or other considerations to be delivered in connection with the assignment shall be delivered to Landlord, shall be and remain the exclusive property of Landlord and shall not constitute property of Tenant or of the estate of Tenant within the meaning of the Bankruptcy Code. Any person or entity to which this Lease is assigned pursuant to the provisions of the Bankruptcy Code shall be deemed to have assumed all of the obligations arising under this Lease on and after the date of the assignment, and shall upon demand execute and deliver to Landlord an instrument confirming that assumption.

(b) If Tenant desires to transfer an interest in this Lease, it shall first notify Landlord of its desire and shall submit in writing to Landlord: (i) the name and address of the proposed transferee; (ii) the nature of any proposed subtenant's or assignee's business to be carried on in the Premises; (iii) the terms and provisions of any proposed sublease or assignment, including a copy of the proposed assignment or sublease form; (iv) _evidence of insurance of the proposed assignee or subtenant complying with the requirements of Exhibit D hereto; (v) a completed Environmental Questionnaire from the proposed assignee or subtenant; and (vi) any other information requested by Landlord and reasonably related to the transfer. Except as provided in Subsection (e) of this Section, Landlord shall not unreasonably withhold its consent, provided: (1) the use of the Premises will be consistent with the provisions of this Lease and with Landlord's commitment to other tenants of the Project; (2) the proposed assignee or subtenant is not currently subject to any enforcement order issued by any governmental authority in connection with the use, disposal or storage of a Hazardous Material; (3) at Landlord's election, insurance requirements shall be brought into conformity with Landlord's then current leasing practice; (4) any proposed subtenant or assignee demonstrates that it is financially responsible by submission to Landlord of all reasonable information as Landlord may request concerning the proposed subtenant or assignee, including, but not limited to, a balance sheet of the proposed subtenant or assignee as of a date within ninety (90) days of the request for Landlord's consent and statements of income or profit and loss of the proposed subtenant or assignee for the two-year period preceding the request for Landlord's consent, and/or a certification signed by the proposed subtenant or assignee that it has not been evicted or been in arrears in rent at any other leased premises for the 3-year period preceding the request for Landlord's consent; (5) the proposed assignee or subtenant is not an existing tenant of the Project or a prospect with whom Landlord is negotiating to become a tenant at the Project; and (6) the proposed transfer will not impose additional burdens or adverse tax effects on Landlord. If Tenant has any exterior sign rights under this Lease, such rights are personal to Tenant and may not be assigned or transferred to any assignee of this Lease or subtenant of the Premises without Landlord's prior written consent, which may be withheld in Landlord's reasonable discretion, provided that such signage complies with the provision of Section 5.2 of this Lease and that Landlord's sole and absolute consent shall apply

to the assignee's or sublessee's name on said signage.

If Landlord consents to the proposed transfer, Tenant may within ninety (90) days after the date of the consent effect the transfer upon the terms described in the information furnished to Landlord; provided that any material change in the terms shall be subject to Landlord's consent as set forth in this Section. Landlord shall approve or disapprove any requested transfer within thirty (30) days following receipt of Tenant's written request, the information set forth above, and the fee set forth below.

(c) Notwithstanding the provisions of Subsection (b) above, in lieu of consenting to a proposed assignment or any subletting (or

sublettings) in excess of fifty percent (50%) of the floor area of the Premises in the aggregate, Landlord may elect to (i) sublease the Premises (or the portion proposed to be subleased), or take an assignment of Tenant's interest in this Lease, upon the same terms as offered to the proposed subtenant or assignee (excluding terms relating to the purchase of personal property, the use of Tenant's name or the continuation of Tenant's business), or (ii) terminate this Lease as to the portion of the Premises proposed to be subleased or assigned with a proportionate abatement in the rent payable under this Lease, effective on the date that the proposed sublease or assignment would have become effective. Landlord may thereafter, at its option, assign or re-let any space so recaptured to any third party, including without limitation the proposed transferee of Tenant.

(d) Tenant agrees that fifty percent (50%) of any amounts paid by the assignee or subtenant, however described, in excess of (i) the Basic Rent payable by Tenant hereunder, or in the case of a sublease of a portion of the Premises, in excess of the Basic Rent reasonably allocable to such portion, plus (ii) Tenant's direct out-of-pocket costs which Tenant certifies to Landlord have been paid to provide occupancy related services to such assignee or subtenant of a nature commonly provided by landlords of similar space, shall be the property of Landlord and such amounts shall be payable directly to Landlord by the assignee or subtenant or, at Landlord's option, by Tenant. At Landlord's request, a written agreement shall be entered into by and among Tenant, Landlord and the proposed assignee or subtenant confirming the requirements of this subsection.

(e) Tenant shall pay to Landlord a fee of Five Hundred Dollars ($500.00) if and when any transfer hereunder is requested by Tenant. Such fee is hereby acknowledged as a reasonable amount to reimburse Landlord for its costs of review and evaluation of a proposed assignee/sublessee, and Landlord shall not be obligated to commence such review and evaluation unless and until such fee is paid.

SECTION 9.2. EFFECT OF TRANSFER. No subletting or assignment, even with the consent of Landlord, shall relieve Tenant of its obligation to pay rent and to perform all its other obligations under this Lease, including, without limitation, the obligations contained in Section 10.3 of this Lease. Each assignee, other than Landlord, shall be deemed to assume all obligations of Tenant under this Lease and shall be liable jointly and severally with Tenant for the payment of all rent, and for the due performance of all of Tenant's obligations, under this Lease. No transfer shall be binding on Landlord unless any document memorializing the transfer is delivered to Landlord and both the assignee/subtenant and Tenant deliver to Landlord an executed consent to transfer instrument prepared by Landlord and consistent with the requirements of this Article. The acceptance by Landlord of any payment due under this Lease from any other person shall not be deemed to be a waiver by Landlord of any provision of this Lease or to be a consent to any transfer. Consent by Landlord to one or more transfers shall not operate as a waiver or estoppel to the future enforcement by Landlord of its rights under this Lease.

SECTION 9.3. SUBLEASE REQUIREMENTS. The following terms and conditions shall apply to any subletting by Tenant of all or any part of the Premises and shall be deemed included in each sublease:

(a) Each and every provision contained in this Lease (other than with respect to the payment of rent hereunder) is incorporated by reference into and made a part of such sublease, with "Landlord" hereunder meaning the sublandlord therein and "Tenant" hereunder meaning the subtenant therein.

(b) Tenant hereby irrevocably assigns to Landlord all of Tenant's interest in all rentals and income arising from any sublease of the Premises, and Landlord may collect such rent and income and apply same toward Tenant's obligations under this Lease; provided, however, that unless and until a default occurs in the performance of Tenant's obligations under this Lease, Tenant shall have the right to receive and collect the sublease rentals. Landlord shall not, by reason of this assignment or the collection of sublease rentals, be deemed liable to the subtenant for the performance of any of Tenant's obligations under the sublease. Tenant hereby irrevocably authorizes and directs any subtenant, upon receipt of a written notice from Landlord stating that an uncured default exists in the performance of Tenant's obligations under this Lease, to pay to Landlord all sums then and thereafter due under the sublease. Tenant agrees that the subtenant may rely on that notice without any

duty of further inquiry and notwithstanding any notice or claim by Tenant to the contrary. Tenant shall have no right or claim against the subtenant or Landlord for any rentals so paid to Landlord.

(c) In the event of the termination of this Lease, Landlord may, at its sole option, take over Tenant's entire interest in any sublease and, upon notice from Landlord, the subtenant shall attorn to Landlord. In no event, however, shall Landlord be liable for any previous act or omission by Tenant under the sublease or for the return of any advance rental payments or deposits under the sublease that have not been actually delivered to Landlord, nor shall Landlord be bound by any sublease modification executed without Landlord's consent or for any advance rental payment by the subtenant in excess of one month's rent. The general provisions of this Lease, including without limitation those pertaining to insurance and indemnification, shall be deemed incorporated by reference into the sublease despite the termination of this Lease.

SECTION 9.4. CERTAIN TRANSFERS. The sale of all or substantially all of Tenant's assets (other than bulk sales in the ordinary course of business) or, if Tenant is a corporation, an unincorporated association, or a partnership, the transfer, assignment or hypothecation of any stock or interest in such corporation, association, or partnership in the aggregate of fifty percent (50%)(except for publicly traded shares of stock) shall be deemed an assignment within the meaning and provisions of this Article. Notwithstanding the foregoing, Landlord's consent shall not be required for the assignment of this Lease as a result of a merger by Tenant with or into another entity, as the result of a transfer of all or substantially all of Tenant's assets, or as the result of the acquisition of Tenant's shares of the stock, so long as (i) the net worth of the successor entity after such transfer or merger is at least equal to the greater of the net worth of Tenant as of the execution of this Lease by Landlord or the net worth of Tenant immediately prior to the date of such transfer or merger, evidence of which, satisfactory to Landlord, shall be presented to Landlord prior to such transfer or merger, (ii) Tenant shall provide to Landlord, prior to such transfer or merger, written notice of such transfer or merger and such assignment documentation and other information as Landlord may request in connection therewith, and (iii) all of the other terms and requirements of this Article shall apply with respect to such assignment.

ARTICLE X. INSURANCE AND INDEMNITY

SECTION 10.1. TENANT'S INSURANCE. Tenant, at its sole cost and expense, shall provide and maintain in effect the insurance described in Exhibit D. Evidence of that insurance must be delivered to Landlord prior to the Commencement Date.

SECTION 10.2. LANDLORD'S INSURANCE. Landlord shall provide the following types of insurance, with or without deductible and in amounts and coverages as may be determined by Landlord in its discretion: "all risk" property insurance, subject to standard exclusions, covering the Building or Project. Landlord may, at its election, obtain insurance for such other risks as Landlord or its mortgagees may from time to time deem appropriate, including leasehold improvements made by Landlord, and commercial general liability coverage. Landlord shall not be required to carry insurance of any kind on Tenant's property, including leasehold improvements, trade fixtures, furnishings, equipment, plate glass, signs and all other items of personal property, and shall not be obligated to repair or replace that property should damage occur. All proceeds of insurance maintained by Landlord upon the Building and Project shall be the property of Landlord, whether or not Landlord is obligated to or elects to make any repairs. In no event shall the limits of such policy be considered as limiting the liability of Landlord under this Lease. At Landlord's option, Landlord may self-insure all or any portion of the risks for which Landlord elects to, or is obligated to, provide insurance hereunder.

SECTION 10.3. JOINT INDEMNITY.

(a) Tenant's Indemnity. To the fullest extent permitted by law, Tenant shall defend, indemnify, protect, save and hold harmless Landlord, its agents, and any and all affiliates of Landlord, including, without limitation, any corporations or other entities controlling, controlled by or under common control with Landlord, from and against any and all claims, liabilities, costs or expenses arising either before or after the Commencement Date from Tenant's use or occupancy of the Premises or the Building, or from the conduct of its business, or from any activity, work, or thing done, permitted or suffered by Tenant or its agents, employees, invitees or licensees in or about the Premises or the Building, or from any default in the performance of any obligation on Tenant's part to be performed under this Lease, or from any act or negligence of Tenant or its agents, employees, visitors, patrons, guests, invitees or licensees; provided Tenant does not indemnify Landlord for any claims, liabilities, costs or expenses to the extent the same is caused by the negligence or willful misconduct on the part of Landlord, or its agents or employees, or for which Tenant is otherwise indemnified hereunder. In cases of alleged negligence asserted by third parties against Landlord which arise out of, are occasioned by, or in any way attributable to Tenant's, its agents, employees,

contractors, licensees or invitees use and occupancy of the Premises or the Building, or from the conduct of its business or from any activity, work or thing done, permitted or suffered by Tenant or its agents, employees, invitees or licensees on Tenant's part to be performed under this Lease, or from any act of negligence of Tenant, its agents, employees, licensees or invitees, Tenant shall accept any tender of defense for Landlord and shall, notwithstanding any allegation of negligence or willful misconduct on the part of the Landlord, defend Landlord and protect and hold Landlord harmless and pay all costs, expenses and attorneys' fees incurred in connection with such litigation, provided that Tenant shall not be liable for any such injury or damage, and Landlord shall reimburse Tenant for the reasonable attorney's fees and costs for the attorney representing both parties, all to the extent and in the proportion that such injury or damage is ultimately determined by a court of competent jurisdiction (or in connection with any negotiated settlement agreed to by Landlord) to be attributable to the negligence or willful misconduct of Landlord. Upon Landlord's request, Tenant shall at Tenant's sole cost and expense, retain a separate attorney selected by Landlord to represent Landlord in any such suit if Landlord determines that the representation of both Tenant and Landlord by the same attorney would cause a conflict of interest; provided, however, that to the extent and in the proportion that the injury or damage which is the subject of the suit is ultimately determined by a court of competent jurisdiction (or in connection with any negotiated settlement agreed to by Landlord) to be attributable to the negligence or willful misconduct of Landlord, Landlord shall reimburse Tenant for the reasonable legal fees and costs of the separate attorney retained by Tenant. The provisions of this Subsection 10.3(a) shall expressly survive the expiration or sooner termination of this Lease.

(b) Landlord's Indemnity. To the fullest extent permitted by law, but subject to the express limitations on liability contained in this Lease (including, without limitation, the provisions of Sections 10.4, 10.5 and 14.8 of this Lease), Landlord shall defend, indemnify, protect, save and hold harmless Tenant, its agents and any and all affiliates of Tenant, including, without limitation, any corporations, or other entities controlling, controlled by or under common control with Tenant, from and against any and all claims, liabilities, costs or expenses arising either before or after the Commencement Date from the maintenance or repair of the Common Areas, the Project and/or the Building by Landlord or its employees, authorized agents or contractors; provided that Landlord does not indemnify Tenant for any claims, liabilities, costs or expenses to the extent the same is caused by the negligence or willful misconduct on the part of Tenant, or its agents, employees, licensees or invitees, or for which Landlord is otherwise indemnified hereunder. In cases of alleged negligence asserted by third parties against Tenant which arise out of, are occasioned by, or in any way attributable to the maintenance or repair of the Common Areas, the Project or the Building by Landlord or its contractors, authorized agents or employees, Landlord shall accept any tender defense for Tenant and shall, notwithstanding any allegation of negligence or willful misconduct on the part of Tenant, defend Tenant and protect and hold Tenant harmless and pay all cost, expense

and attorneys' fees incurred in connection with such litigation, provided that Landlord shall not be liable for any such injury or damage, and Tenant shall reimburse Landlord for the reasonable attorney's fees and costs for the attorney representing both parties, all to the extent and in the proportion that such injury or damage is ultimately determined by a court of competent jurisdiction (or in connection with any negotiated settlement agreed to by Tenant) to be attributable to the negligence or willful misconduct of Tenant. Upon Tenant's request, Landlord shall at Landlord's sole cost and expense, retain a separate attorney selected by Tenant to represent Tenant in any such suit if Tenant determines that the representation of both Tenant and Landlord by the same attorney would cause conflict of interest; provided, however, that to the extent and the proportion that the injury or damage which is the subject of the suit is ultimately determined by a court of competent jurisdiction (or in connection with any negotiated settlement agreed to by Tenant) to be attributable to the negligence or willful misconduct of Tenant, Tenant shall reimburse Landlord for the reasonable legal fees and costs of the separate attorney retained by Landlord. The provisions of this Subsection 10.3(b) shall expressly survive the expiration or sooner termination of this Lease.

SECTION 10.4. LANDLORD'S NONLIABILITY. Subject to the express indemnity obligations contained in Section 10.3(b) of this Lease, Landlord shall not be liable to Tenant, its employees, agents and invitees, and Tenant hereby waives all claims against Landlord, for loss of or damage to any property, or any injury to any person, or any other loss, cost, damage, injury or liability whatsoever resulting from fire, explosion, falling plaster, steam, gas, electricity, water or rain which may leak or flow from or into any part of the Building or from the breakage, leakage, obstruction or other defects of the pipes, sprinklers, wires, appliances, plumbing, air conditioning, electrical works or other fixtures in the Building, whether the damage or injury results from conditions arising in the Premises or in other portions of the Project. Notwithstanding any provision of this Lease to the contrary, including, without limitation, the provisions of Section 10.3(b) of this Lease, Landlord shall in no event be liable to Tenant, its employees, agents, and invitees, and Tenant hereby waives all claims against Landlord, for loss or interruption of Tenant's business or income (including, without limitation, any consequential damages and lost profit or opportunity costs), or any other loss, cost, damage, injury or liability resulting from, but not limited to, Acts of God, acts of civil disobedience or insurrection, acts of omissions (criminal or otherwise) of any third parties, including without limitation, any other tenants within the Project or their agents, employees, contractors, guests

or invitees. It is understood that any such conditions may require the temporary evacuation or closure of all or a portion of the Building. Except as provided in Sections 6.1, 11.1 and 12.1 below, there shall be no abatement of rent and no liability of Landlord by reason of any injury to or interference with Tenant's business (including without limitation consequential damages and lost profit or opportunity costs) arising from the making of any repairs, alterations or improvements to any portion of the Building, including repairs to the Premises, nor shall any related activity by Landlord constitute an actual or constructive eviction; provided, however, that in making repairs, alterations or improvements, Landlord shall interfere as little as reasonably practicable with the conduct of Tenant's business in the Premises. Neither Landlord nor its agents shall be liable for interference with light or other similar intangible interests. Tenant shall immediately notify Landlord in case of fire or accident in the Premises, the Building or the Project and of defects in any improvements or equipment.

SECTION 10.5. WAIVER OF SUBROGATION. Landlord and Tenant each hereby waives all rights of recovery against the other and the other's agents on account of loss and damage occasioned to the property of such waiving party to the extent only that such loss or damage is required to be insured against under any "all risk" property insurance policies required by this Article X; provided however, that (i) the foregoing waiver shall not apply to the extent of Tenant's obligations to pay deductibles under any such policies and this Lease, and (ii) if any loss is due to the act, omission or negligence or willful misconduct of Tenant or its agents, employees, contractors, guests or invitees, Tenant's liability insurance shall be primary and shall cover all losses and damages prior to any other insurance hereunder. By this waiver it is the intent of the parties that neither Landlord nor Tenant shall be liable

to any insurance company (by way of subrogation or otherwise) insuring the other party for any loss or damage insured against under any "all-risk" property insurance policies required by this Article, even though such loss or damage might be occasioned by the negligence of such party, its agents, employees, contractors, guests or invitees. The provisions of this Section shall not limit the indemnification provisions elsewhere contained in this Lease.

ARTICLE XI. DAMAGE OR DESTRUCTION

SECTION 11.1. RESTORATION.

(a) If the Building is damaged, Landlord shall proceed diligently and in good faith to obtain all required permits and to repair that damage as soon as reasonably possible, at its expense, unless: (i) Landlord reasonably determines that the cost of repair is not covered by Landlord's fire and extended coverage insurance plus such additional amounts Tenant elects, at its option, to contribute, excluding however the deductible (for which Tenant shall be responsible for Tenant's proportionate share); (ii) Landlord reasonably determines that the Premises cannot, with reasonable diligence, be fully repaired by Landlord (or cannot be safely repaired because of the presence of hazardous factors, including without limitation Hazardous Materials, earthquake faults, and other similar dangers) within two hundred seventy (270) days after the date of the damage; (iii) an event of default by Tenant has occurred and is continuing at the time of such damage; or (iv) the damage occurs during the final twelve (12) months of the Term. Should Landlord elect not to repair the damage for one of the preceding reasons, Landlord shall so notify Tenant in writing within thirty (30) days after the damage occurs and this Lease shall terminate as of the date of that notice.

(b) Unless Landlord elects to terminate this Lease in accordance with subsection (a) above, this Lease shall continue in effect for the remainder of the Term; provided that so long as Tenant is not in default under this Lease, if the damage is so extensive that Landlord reasonably determines that the Premises cannot, with reasonable diligence, be repaired by Landlord (or cannot be safely repaired because of the presence of hazardous factors, earthquake faults, and other similar dangers) so as to allow Tenant's substantial use and enjoyment of the Premises within two hundred seventy (270) days after the date of damage, then Tenant may elect to terminate this Lease by written notice to Landlord within the thirty (30) day period stated in subsection (a).

(c) Commencing on the date of any damage to the Building, and ending on the sooner of the date the damage is repaired or the date this Lease is terminated, the rental to be paid under this Lease shall be abated in the same proportion that the floor area of the Building that is rendered unusable by the damage from time to time bears to the total floor area of the Building, provided that Tenant is then carrying the required business interruption insurance described in Exhibit D.

(d) Notwithstanding the provisions of subsections (a), (b) and (c) of this Section, and subject to the provisions of Section 10.5 above, the cost of any repairs shall be borne by Tenant, and Tenant shall not be entitled to rental abatement or termination rights, if the damage is due to the negligence of Tenant or its employees, subtenants, invitees or representatives. In addition, the provisions of this Section shall not be deemed to require Landlord to repair any improvements or fixtures that Tenant is obligated to repair or insure

pursuant to any other provision of this Lease.

(e) Tenant shall fully cooperate with Landlord in removing Tenant's personal property and any debris from the Premises to facilitate all inspections of the Premises and the making of any repairs. Notwithstanding anything to the contrary contained in this Lease, if Landlord in good faith believes there is a risk of injury to persons or damage to property from entry into the Building or Premises following any damage or

destruction thereto, Landlord may restrict entry into the Building or the Premises by Tenant, its employees, agents and contractors in a non-discriminatory manner, without being deemed to have violated Tenant's rights of quiet enjoyment to, or made an unlawful detainer of, or evicted Tenant from, the Premises. Upon request, Landlord shall consult with Tenant to determine if there are safe methods of entry into the Building or the Premises solely in order to allow Tenant to retrieve files, data in computers, and necessary inventory, subject however to all indemnities and waivers of liability from Tenant to Landlord contained in this Lease and any additional indemnities and waivers of liability which Landlord may require.

SECTION 11.2. LEASE GOVERNS. Tenant agrees that the provisions of this Lease, including without limitation Section 11.1, shall govern any damage or destruction and shall accordingly supersede any contrary statute or rule of law.

ARTICLE XII. EMINENT DOMAIN

SECTION 12.1. TOTAL OR PARTIAL TAKING. If all or a material portion of the Premises is taken by any lawful authority by exercise of the right of eminent domain, or sold to prevent a taking, either Tenant or Landlord may terminate this Lease effective as of the date possession is required to be surrendered to the authority. In the event title to a portion of the Premises is taken or sold in lieu of taking, and if Landlord elects to restore the Premises in such a way as to alter the Premises materially, either party may terminate this Lease, by written notice to the other party, effective on the date of vesting of title. In the event neither party has elected to terminate this Lease as provided above, then Landlord shall promptly, after receipt of a sufficient condemnation award, proceed to restore the Premises to substantially their condition prior to the taking, and a proportionate allowance shall be made to Tenant for the rent corresponding to the time during which, and to the part of the Premises of which, Tenant is deprived on account of the taking and restoration. In the event of a taking, Landlord shall be entitled to the entire amount of the condemnation award without deduction for any estate or interest of Tenant; provided that nothing in this Section shall be deemed to give Landlord any interest in, or prevent Tenant from seeking any award against the taking authority for, the taking of personal property and fixtures belonging to Tenant, the amortized value of the Tenant Improvements funded by Tenant, or for relocation or business interruption expenses recoverable from the taking authority.

SECTION 12.2. TEMPORARY TAKING. No temporary taking of the Premises shall terminate this Lease or give Tenant any right to abatement of rent, and any award specifically attributable to a temporary taking of the Premises shall belong entirely to Tenant. A temporary taking shall be deemed to be a taking of the use or occupancy of the Premises for a period of not to exceed ninety (90) days.

SECTION 12.3. TAKING OF PARKING AREA. In the event there shall be a taking of the parking area such that Landlord can no longer provide sufficient parking to comply with this Lease, Landlord may substitute reasonably equivalent parking in a location reasonably close to the Building; provided that if Landlord fails to make that substitution within ninety (90) days following the taking and if the taking materially impairs Tenant's use and enjoyment of the Premises, Tenant may, at its option, terminate this Lease by written notice to Landlord. If this Lease is not so terminated by Tenant, there shall be no abatement of rent and this Lease shall continue in effect.

ARTICLE XIII. SUBORDINATION; ESTOPPEL CERTIFICATE; FINANCIALS

SECTION 13.1. SUBORDINATION. At the option of Landlord, this Lease shall be either superior or subordinate to all ground or underlying leases, mortgages and deeds of trust, if any, which may hereafter affect the Premises, and to all renewals, modifications, consolidations, replacements and extensions thereof; provided, that so long as Tenant is not in default under this Lease, this Lease shall not be terminated or Tenant's quiet enjoyment of the Premises disturbed in the event of termination of any such ground or underlying lease, or the foreclosure of any such mortgage or deed of trust, to which Tenant has subordinated this Lease pursuant to this Section. In the event of a termination or foreclosure, Tenant shall become a tenant of and attorn to the successor-in-interest to Landlord upon the same terms and conditions as are

contained in this Lease, and shall execute any instrument reasonably required by Landlord's successor for that purpose. Tenant shall also, upon written request of Landlord, execute and deliver all instruments as may be required from time to time to

subordinate the rights of Tenant under this Lease to any ground or underlying lease or to the lien of any mortgage or deed of trust (provided that such instruments include the nondisturbance and attornment provisions set forth above), or, if requested by Landlord, to subordinate, in whole or in part, any ground or underlying lease or the lien of any mortgage or deed of trust to this Lease.

SECTION 13.2. ESTOPPEL CERTIFICATE.

(a) Tenant shall, at any time upon not less than ten (10) days prior written notice from Landlord, execute, acknowledge and deliver to Landlord, in any form that Landlord may reasonably require, a statement in writing (i) certifying that this Lease is unmodified and in full force and effect (or, if modified, stating the nature of the modification and certifying that this Lease, as modified, is in full force and effect) and the dates to which the rental, additional rent and other charges have been paid in advance, if any, and (ii) acknowledging that, to Tenant's knowledge, there are no uncured defaults on the part of Landlord, or specifying each default if any are claimed, and (iii) setting forth all further information that Landlord may reasonably require. Tenant's statement may be relied upon by any prospective purchaser or encumbrancer of the Premises.

(b) Notwithstanding any other rights and remedies of Landlord, Tenant's failure to deliver any estoppel statement within the provided time shall be conclusive upon Tenant that (i) this Lease is in full force and effect, without modification except as may be accurately represented by Landlord, (ii) there are no uncured defaults in Landlord's performance, and (iii) not more than one month's rental has been paid in advance.

SECTION 13.3 FINANCIALS.

(a) Tenant shall deliver to Landlord, prior to the execution of this Lease and thereafter at any time upon Landlord's request, Tenant's current tax returns and regularly-prepared financial statements, certified true, accurate and complete by the chief financial officer of Tenant, including a balance sheet and profit and loss statement for the most recent prior year (collectively, the "Statements"), which Statements shall accurately and completely reflect the financial condition of Tenant. Landlord agrees that it will keep the Statements confidential, except that Landlord shall have the right to deliver the same to any proposed purchaser or encumbrancer of the Premises.

(b) Tenant acknowledges that Landlord is relying on the Statements in its determination to enter into this Lease, and Tenant represents to Landlord, which representation shall be deemed made on the date of this Lease and again on the Commencement Date, that no material change in the financial condition of Tenant, as reflected in the Statements, has occurred since the date Tenant delivered the Statements to Landlord. The Statements are represented and warranted by Tenant to be materially correct and to accurately and fully reflect Tenant's true financial condition in all material respects as of the date of submission by any Statements to Landlord.

ARTICLE XIV. DEFAULTS AND REMEDIES

SECTION 14.1. TENANT'S DEFAULTS. In addition to any other event of default set forth in this Lease, the occurrence of any one or more of the following events shall constitute a default by Tenant:

(a) The failure by Tenant to make any payment of rent or additional rent required to be made by Tenant, as and when due, where the

failure continues for a period of five (5) days after written notice from Landlord to Tenant; provided, however, that any such notice shall be in lieu of, and not in addition to, any notice required under California Code of Civil Procedure Section 1161 and 1161(a) as amended. For purposes of these default and remedies provisions, the term "additional rent" shall be deemed to include all amounts of any type whatsoever other than Basic Rent to be paid by Tenant pursuant to the terms of this Lease.

(b) Assignment, sublease, encumbrance or other transfer of the Lease by Tenant, either voluntarily or by operation of law, whether by judgment, execution, transfer by intestacy or testacy, or other means, without the prior written consent of Landlord.

(c) The discovery by Landlord that any financial statement provided by Tenant, or by any affiliate, successor or guarantor of Tenant, was materially false.

(d) The failure of Tenant to timely and fully provide any subordination agreement, estoppel certificate or financial statements in accordance with the requirements of

Article XIII.

(e) The failure or inability by Tenant to observe or perform any of the express or implied covenants or provisions of this Lease to be observed or performed by Tenant, other than as specified in any other subsection of this Section, where the failure continues for a period of thirty (30) days after written notice from Landlord to Tenant or such shorter period as is specified in any other provision of this Lease; provided, however, that any such notice shall be in lieu of, and not in addition to, any notice required under California Code of Civil Procedure Section 1161 and 1161(a) as amended. However, if the nature of the failure is such that more than thirty (30) days are reasonably required for its cure, then Tenant shall not be deemed to be in default if Tenant commences the cure within thirty (30) days, and thereafter diligently pursues the cure to completion.

(f) (i) The making by Tenant of any general assignment for the benefit of creditors; (ii) the filing by or against Tenant of a petition to have Tenant adjudged a Chapter 7 debtor under the Bankruptcy Code or to have debts discharged or a petition for reorganization or arrangement under any law relating to bankruptcy (unless, in the case of a petition filed against Tenant, the same is dismissed within thirty (30) days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Lease, if possession is not restored to Tenant within thirty (30) days; (iv) the attachment, execution or other judicial seizure of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Lease, where the seizure is not discharged within thirty (30) days; or (v) Tenant's convening of a meeting of its creditors for the purpose of effecting a moratorium upon or composition of its debts. Landlord shall not be deemed to have knowledge of any event described in this subsection unless notification in writing is received by Landlord, nor shall there be any presumption attributable to Landlord of Tenant's insolvency. In the event that any provision of this subsection is contrary to applicable law, the provision shall be of no force or effect.

SECTION 14.2. LANDLORD'S REMEDIES.

(a) In the event of any default by Tenant, or in the event of the abandonment of the Premises by Tenant, then in addition to any other remedies available to Landlord, Landlord may exercise the following remedies:

(i) Landlord may terminate Tenant's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Tenant shall immediately surrender possession of the Premises to Landlord. Such termination shall not affect any accrued obligations of Tenant under this Lease. Upon termination, Landlord shall have the right to reenter the Premises and remove all persons and property. Landlord shall also be

entitled to recover from Tenant:

(1) The worth at the time of award of the unpaid rent and additional rent which had been earned at the time of termination;

(2) The worth at the time of award of the amount by which the unpaid rent and additional rent which would have been earned after termination until the time of award exceeds the amount of such loss that Tenant proves could have been reasonably avoided;

(3) The worth at the time of award of the amount by which the unpaid rent and additional rent for the balance of the Term after the time of award exceeds the amount of such loss that Tenant proves could be reasonably avoided;

(4) Any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result from Tenant's default, including, but not limited to, the cost of recovering possession of the Premises, marketing costs, commissions and other reasonable expenses of reletting, including necessary repair, the unamortized portion of any tenant improvements and brokerage commissions funded by Landlord in connection with this Lease, reasonable attorneys' fees, and any other reasonable costs; and

(5) At Landlord's election, all other amounts in addition to or in lieu of the foregoing as may be permitted by law. The term "rent" as used in this Lease shall be deemed to mean the Basic Rent and all other sums required to be paid by Tenant to Landlord pursuant to the terms of this Lease. Any sum, other than Basic Rent, shall be computed on the basis of the average monthly amount accruing during the twenty-four (24) month period immediately prior to default, except that if it becomes necessary to compute such rental before the twenty-four (24) month period has occurred, then the computation shall be on the basis of the average monthly amount during the shorter period. As used in subparagraphs (1) and (2) above, the "worth at the time of award" shall be computed by allowing interest at the rate of ten percent (10%) per annum. As used in subparagraph (3) above, the "worth at the time of award"

shall be computed by discounting the amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1%).

(ii) Landlord may elect not to terminate Tenant's right to possession of the Premises, in which event Landlord may continue to enforce all of its rights and remedies under this Lease, including the right to collect all rent as it becomes due. Efforts by the Landlord to maintain, preserve or relet the Premises, or the appointment of a receiver to protect the Landlord's interests under this Lease, shall not constitute a termination of the Tenant's right to possession of the Premises. In the event that Landlord elects to avail itself of the remedy provided by this subsection (ii), Landlord shall not unreasonably withhold its consent to an assignment or subletting of the Premises subject to the reasonable standards for Landlord's consent as are contained in this Lease.

(b) Landlord shall be under no obligation to observe or perform any covenant of this Lease on its part to be observed or performed which accrues after the date of any default by Tenant unless and until the default is cured by Tenant, it being understood and agreed that the performance by Landlord of its obligations under this Lease are expressly conditioned upon Tenant's full and timely performance of its obligations under this Lease. The various rights and remedies reserved to Landlord in this Lease or otherwise shall be cumulative and, except as otherwise provided by California law, Landlord may pursue any or all of its rights and remedies at the same time.

(c) No delay or omission of Landlord to exercise any right or remedy shall be construed as a waiver of the right or remedy or of any default by Tenant. The acceptance by Landlord of rent shall not be a (i) waiver of any preceding breach or default by Tenant of any provision of this

Lease, other than the failure of Tenant to pay the particular rent accepted, regardless of Landlord's knowledge of the preceding breach or default at the time of acceptance of rent, or (ii) a waiver of Landlord's right to exercise any remedy available to Landlord by virtue of the breach or default. The acceptance of any payment from a debtor in possession, a trustee, a receiver or any other person acting on behalf of Tenant or Tenant's estate shall not waive or cure a default under Section 14.1. No payment by Tenant or receipt by Landlord of a lesser amount than the rent required by this Lease shall be deemed to be other than a partial payment on account of the earliest due stipulated rent, nor shall any endorsement or statement on any check or letter be deemed an accord and satisfaction and Landlord shall accept the check or payment without prejudice to Landlord's right to recover the balance of the rent or pursue any other remedy available to it. No act or thing done by Landlord or Landlord's agents during the Term shall be deemed an acceptance of a surrender of the Premises, and no agreement to accept a surrender shall be valid unless in writing and signed by Landlord. No employee of Landlord or of Landlord's agents shall have any power to accept the keys to the Premises prior to the termination of this Lease, and the delivery of the keys to any employee shall not operate as a termination of the Lease or a surrender of the Premises.

SECTION 14.3. LATE PAYMENTS.

(a) Any rent due under this Lease that is not received by Landlord within ten (10) days of the date when due shall bear interest at the "maximum rate permitted by law" from the date due until fully paid. The payment of interest shall not cure any default by Tenant under this Lease. In addition, Tenant acknowledges that the late payment by Tenant to Landlord of rent will cause Landlord to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult and impracticable to ascertain. Those costs may include, but are not limited to, administrative, processing and accounting charges, and late charges which may be imposed on Landlord by the terms of any ground lease, mortgage or trust deed covering the Premises. Accordingly, if any rent due from Tenant shall not be received by Landlord or Landlord's designee within ten (10) days after the date due, then Tenant shall pay to Landlord, in addition to the interest provided above, a late charge in a sum equal to the greater of five percent (5%) of the amount overdue or Two Hundred Fifty Dollars ($250.00) for each delinquent payment. Acceptance of a late charge by Landlord shall not constitute a waiver of Tenant's default with respect to the overdue amount, nor shall it prevent Landlord from exercising any of its other rights and remedies. The parties agree that, as used herein and in Section 14.4, the "maximum rate allowed by law" shall mean the federal discount rate, as announced by the San Francisco Federal Reserve, plus five percent (5%). The initial late charge for any initial delinquent payment by Tenant shall be waived by Landlord.

(b) Following each second consecutive installment of rent that is not paid within ten (10) days following notice of nonpayment from Landlord, Landlord shall have the option (i) to require that beginning with the first payment of rent next due, rent shall no longer be paid in monthly installments but shall be payable quarterly three (3) months in advance and/or (ii) to require that Tenant increase the amount, if any, of the Security Deposit by one hundred percent (100%). Should Tenant deliver to Landlord, at any time during the Term, two (2) or more insufficient checks, the Landlord may require that all monies then and thereafter due from Tenant be paid to Landlord by cashier's check.

SECTION 14.4. RIGHT OF LANDLORD TO PERFORM. All covenants and

agreements to be performed by Tenant under this Lease shall be performed at Tenant's sole cost and expense and without any abatement of rent or right of set-off. If Tenant fails to pay any sum of money, other than rent, or fails to perform any other act on its part to be performed under this Lease, and the failure continues beyond any applicable grace period set forth in Section 14.1, then in addition to any other available remedies, Landlord may, at its election make the payment or perform the other act on Tenant's part. Landlord's election to make the payment or perform the act on Tenant's part shall not give rise to any responsibility of Landlord to continue making the same or similar payments or performing the same or similar acts. Tenant shall, promptly upon demand by Landlord, reimburse Landlord for all sums paid by Landlord and all

necessary incidental costs, together with interest at the maximum rate permitted by law from the date of the payment by Landlord. Landlord shall have the same rights and remedies if Tenant fails to pay those amounts as Landlord would have in the event of a default by Tenant in the payment of rent.

SECTION 14.5. DEFAULT BY LANDLORD. Landlord shall not be deemed to be in default in the performance of any obligation under this Lease unless and until it has failed to perform the obligation within thirty (30) days after written notice by Tenant to Landlord specifying in reasonable detail the nature and extent of the failure; provided, however, that if the nature of Landlord's obligation is such that more than thirty (30) days are required for its performance, then Landlord shall not be deemed to be in default if it commences performance within the thirty (30) day period and thereafter diligently pursues the cure to completion.

SECTION 14.6. EXPENSES AND LEGAL FEES. All sums reasonably incurred by Landlord in connection with any event of default by Tenant under this Lease or holding over of possession by Tenant after the expiration or earlier termination of this Lease, including without limitation all costs, expenses and actual accountants, appraisers, attorneys and other professional fees, and any collection agency or other collection charges, shall be due and payable by Tenant to Landlord on demand, and shall bear interest at the rate of ten percent (10%) per annum. Should either Landlord or Tenant bring any action in connection with this Lease, the prevailing party shall be entitled to recover as a part of the action its reasonable attorneys' fees, and all other costs. The prevailing party for the purpose of this paragraph shall be determined by the trier of the facts.

SECTION 14.7. WAIVER OF JURY TRIAL. LANDLORD AND TENANT EACH ACKNOWLEDGES THAT IT IS AWARE OF AND HAS HAD THE ADVICE OF COUNSEL OF ITS CHOICE WITH RESPECT TO ITS RIGHTS TO TRIAL BY JURY, AND EACH PARTY DOES HEREBY EXPRESSLY AND KNOWINGLY WAIVE AND RELEASE ALL SUCH RIGHTS TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM BROUGHT BY EITHER PARTY HERETO AGAINST THE OTHER (AND/OR AGAINST ITS OFFICERS, DIRECTORS, EMPLOYEES, AGENTS, OR SUBSIDIARY OR AFFILIATED ENTITIES) ON ANY MATTERS WHATSOEVER ARISING OUT OF OR IN ANY WAY CONNECTED WITH THIS LEASE, TENANT'S USE OR OCCUPANCY OF THE PREMISES, AND/OR ANY CLAIM OF INJURY OR DAMAGE.

SECTION 14.8. SATISFACTION OF JUDGMENT. The obligations of Landlord do not constitute the personal obligations of the individual partners, trustees, directors, officers or shareholders of Landlord or its constituent partners. Should Tenant recover a money judgment against Landlord, such judgment shall be satisfied only out of the proceeds of sale received upon execution of such judgment and levied thereon against the right, title and interest of Landlord in the Project and out of the rent or other income from such property receivable by Landlord or out of consideration received by Landlord from the sale or other disposition of all or any part of Landlord's right, title or interest in the Project, and no action for any deficiency may be sought or obtained by Tenant.

SECTION 14.9. LIMITATION OF ACTIONS AGAINST LANDLORD. Any claim, demand or right of any kind by Tenant which is based upon or arises in connection with this Lease shall be barred unless Tenant commences an action thereon within six (6) months after the date that Tenant has actual knowledge of the act, omission, event or default upon which the claim, demand or right arises, has occurred.

ARTICLE XV. END OF TERM

SECTION 15.1. HOLDING OVER. This Lease shall terminate without further notice upon the expiration of the Term, and any holding over by Tenant after the expiration shall not constitute a renewal or extension of this Lease, or give Tenant any rights under this Lease, except when in writing signed by both parties. If Tenant holds over for any period after the expiration (or earlier termination) of the Term without the prior written consent of Landlord, such possession shall constitute a tenancy at sufferance only; such holding over with the prior written consent of Landlord shall constitute a month-to-month tenancy commencing on the first (1st) day following the termination of this Lease. In either of such events, possession shall be subject to all of the terms of this Lease, except that the monthly

Basic Rent shall be the greater of (a) one hundred seventy-five percent (175%) of the Basic Rent for the month immediately preceding the date of termination or (b) the then currently scheduled Basic Rent for comparable space in the Building. If Tenant fails to surrender the Premises upon the expiration of this Lease despite demand to do so by Landlord, Tenant shall be liable in damages for all loss or liability, including without limitation, any claims made by any succeeding tenant relating to such failure to surrender. Acceptance by Landlord of rent after the termination shall not constitute a consent to a holdover or result in a renewal of this Lease. The foregoing provisions of this Section are in addition to and do not affect Landlord's right of re-entry or any other rights of Landlord under this Lease or at law.

SECTION 15.2. MERGER ON TERMINATION. The voluntary or other surrender of this Lease by Tenant, or a mutual termination of this Lease, shall terminate any or all existing subleases unless Landlord, at its option, elects in writing to treat the surrender or termination as an assignment to it of any or all subleases affecting the Premises.

SECTION 15.3. SURRENDER OF PREMISES; REMOVAL OF PROPERTY. Upon the Expiration Date or upon any earlier termination of this Lease, Tenant shall quit and surrender possession of the Premises to Landlord in as good order, condition and repair as when received or as hereafter may be improved by Landlord or Tenant, reasonable wear and tear and repairs which are Landlord's obligation excepted, and shall, without expense to Landlord, remove or cause to be removed from the Premises all personal property and debris, except for any items that Landlord may by written authorization allow to remain. Tenant shall repair all damage to the Premises resulting from the removal, which repair shall include the patching and filling of holes and repair of structural damage, provided that Landlord may instead elect to repair any structural damage at Tenant's expense. If Tenant shall fail to comply with the provisions of this Section, Landlord may effect the removal and/or make any repairs, and the cost to Landlord shall be additional rent payable by Tenant upon demand. If Tenant fails to remove Tenant's personal property from the Premises upon the expiration of the Term, Landlord may remove, store, dispose of and/or retain such personal property, at Landlord's option, in accordance with then applicable laws, all at the expense of Tenant. If requested by Landlord, Tenant shall execute, acknowledge and deliver to Landlord an instrument in writing releasing and quitclaiming to Landlord all right, title and interest of Tenant in the Premises.

ARTICLE XVI. PAYMENTS AND NOTICES

All sums payable by Tenant to Landlord shall be paid, without deduction or offset, in lawful money of the United States to Landlord at its address set forth in Item 12 of the Basic Lease Provisions, or at any other place as Landlord may designate in writing. Unless this Lease expressly provides otherwise, as for example in the payment of rent pursuant to Section 4.1, all payments shall be due and payable within five (5) days after demand. All payments requiring proration shall be prorated on the basis of a thirty (30) day month and a three hundred sixty (360) day year. Any notice, election, demand, consent, approval or other communication to be given or other document to be delivered by either party to the other may be delivered in person or by courier or overnight delivery service to the other party, or may be deposited in the United States mail, duly registered or certified, postage prepaid, return receipt requested, and addressed to the other party at the address set forth in Item 12 of the Basic Lease Provisions, or if to Tenant, at that address or, from and after the Commencement Date, at the Premises (whether or not Tenant has departed from, abandoned or vacated the Premises), or may be delivered by telegram, telex or telecopy, provided that receipt thereof is telephonically confirmed. Either party may, by written notice to the other, served in the manner provided in this Article, designate a different address. If any notice or other document is sent by mail, it shall be deemed served or delivered twenty-four (24) hours after mailing. If more than one person or entity is named as Tenant under this Lease, service of any notice upon any one of them shall be deemed as service upon all of them.

ARTICLE XVII. RULES AND REGULATIONS

Tenant agrees to observe faithfully and comply strictly with the Rules and Regulations, attached as Exhibit E, and any reasonable and nondiscriminatory amendments, modifications and/or additions as may be adopted and published by written notice to tenants by Landlord for the safety, care, security, good order, or cleanliness of the Premises, and Project and Common Areas (if applicable). Landlord shall not be liable to Tenant for any violation of the Rules and Regulations or the breach of any covenant or condition in any lease by any other tenant or such tenant's agents, employees, contractors, quests or invitees. One or more waivers by Landlord of any breach of the Rules and Regulations by Tenant or by any other tenant(s) shall not be a waiver of any subsequent breach of that rule or any other. Tenant's failure to keep and observe the Rules and Regulations shall constitute a default under this Lease. In the case of any conflict between the Rules and Regulations and this Lease, this Lease shall be controlling.

ARTICLE XVIII. BROKER'S COMMISSION

The parties recognize as the broker(s) who negotiated this Lease the firm(s), if any, whose name(s) is (are) stated in Item 10 of the Basic Lease Provisions, and agree that Landlord shall be responsible for the payment of brokerage commissions to those broker(s) unless otherwise provided in this Lease. Tenant warrants that it has had no dealings with any other real estate broker or agent in connection with the negotiation of this Lease, and Tenant agrees to indemnify and hold Landlord harmless from any cost, expense or liability (including reasonable attorneys' fees) for any compensation, commissions or charges claimed by any other real estate broker or agent employed or claiming to represent or to have been employed by Tenant in connection with the negotiation of this Lease. The foregoing agreement shall survive the termination of this Lease. If Tenant fails to take possession of the Premises or if this Lease otherwise terminates prior to the Expiration Date as the result of failure of performance by Tenant, Landlord shall be entitled to recover from Tenant the unamortized portion of any brokerage commission funded by Landlord in addition to any other damages to which Landlord may be entitled.

ARTICLE XIX. TRANSFER OF LANDLORD'S INTEREST

In the event of any transfer of Landlord's interest in the Premises, the transferor shall be automatically relieved of all obligations on the part of Landlord accruing under this Lease from and after the date of the transfer, provided that any funds held by the transferor in which Tenant has an interest shall be turned over, subject to that interest, to the transferee and Tenant is notified of the transfer as required by law. No holder of a mortgage and/or deed of trust to which this Lease is or may be subordinate, and no landlord under a so-called sale-leaseback, shall be responsible in connection with the Security Deposit, unless the mortgagee or holder of the deed of trust or the landlord actually receives the Security Deposit. It is intended that the covenants and obligations contained in this Lease on the part of Landlord shall, subject to the foregoing, be binding on Landlord, its successors and assigns, only during and in respect to their respective successive periods of ownership.

ARTICLE XX. INTERPRETATION

SECTION 20.1. GENDER AND NUMBER. Whenever the context of this Lease requires, the words "Landlord" and "Tenant" shall include the plural as well as the singular, and words used in neuter, masculine or feminine genders shall include the others.

SECTION 20.2. HEADINGS. The captions and headings of the articles and sections of this Lease are for convenience only, are not a part of this Lease and shall have no effect upon its construction or interpretation.

SECTION 20.3. JOINT AND SEVERAL LIABILITY. If more than one person or entity is named as Tenant, the obligations imposed upon each shall be joint and several and the act of or notice from, or notice or refund to, or the signature of, any one or more of them shall be binding on all of them with respect to the tenancy of this Lease, including, but not limited to, any renewal, extension, termination or modification of this Lease.

SECTION 20.4. SUCCESSORS. Subject to Articles IX and XIX, all rights and liabilities given to or imposed upon Landlord and Tenant shall extend to and bind their respective heirs, executors, administrators, successors and assigns. Nothing contained in this Section is intended, or shall be construed, to grant to any person other than Landlord and Tenant and their successors and assigns any rights or remedies under this Lease.

SECTION 20.5. TIME OF ESSENCE. Time is of the essence with respect to the performance of every provision of this Lease.

SECTION 20.6. CONTROLLING LAW. This Lease shall be governed by and interpreted in accordance with the laws of the State of California.

SECTION 20.7. SEVERABILITY. If any term or provision of this Lease, the deletion of which would not adversely affect the receipt of any material benefit by either party or the deletion of which is consented to by the party adversely affected, shall be held invalid or unenforceable to any extent, the remainder of this Lease shall not be affected and each term and provision of this Lease shall be valid and enforceable to the fullest extent permitted by law.

SECTION 20.8. WAIVER AND CUMULATIVE REMEDIES. One or more waivers by Landlord or Tenant of any breach of any term, covenant or condition contained in this Lease

shall not be a waiver of any subsequent breach of the same or any other term, covenant or condition. Consent to any act by one of the parties shall not be deemed to render unnecessary the obtaining of that party's consent to any subsequent act. No breach by Tenant of this Lease shall be deemed to have been waived by Landlord unless the waiver is in a writing signed by Landlord. The rights and remedies of Landlord under this Lease shall be cumulative and in addition to any and all other rights and remedies which Landlord may have.

SECTION 20.9. INABILITY TO PERFORM. In the event that either party shall be delayed or hindered in or prevented from the performance of any work or in performing any act required under this Lease by reason of any cause beyond the reasonable control of that party, then the performance of the work or the doing of the act shall be excused for the period of the delay and the time for performance shall be extended for a period equivalent to the period of the delay. The provisions of this Section shall not operate to excuse Tenant from the prompt payment of rent or from the timely performance of any other obligation under this Lease within Tenant's reasonable control.

SECTION 20.10. ENTIRE AGREEMENT. This Lease and its exhibits and other attachments cover in full each and every agreement of every kind between the parties concerning the Premises, the Building, and the Project, and all preliminary negotiations, oral agreements, understandings and/or practices, except those contained in this Lease, are superseded and of no further effect. Tenant waives its rights to rely on any representations or promises made by Landlord or others which are not contained in this Lease. No verbal agreement or implied covenant shall be held to modify the provisions of this Lease, any statute, law, or custom to the contrary notwithstanding.

SECTION 20.11. QUIET ENJOYMENT. Upon the observance and performance of all the covenants, terms and conditions on Tenant's part to be observed and performed, and subject to the other provisions of this Lease, Tenant shall peaceably and quietly hold and enjoy the Premises for the Term without hindrance or interruption by Landlord or any other person claiming by or through Landlord.

SECTION 20.12. SURVIVAL. All covenants of Landlord or Tenant which reasonably would be intended to survive the expiration or sooner termination of

this Lease, including without limitation any warranty or indemnity hereunder, shall so survive and continue to be binding upon and inure to the benefit of the respective parties and their successors and assigns.

ARTICLE XXI. EXECUTION AND RECORDING

SECTION 21.1. COUNTERPARTS. This Lease may be executed in one or more counterparts, each of which shall constitute an original and all of which shall be one and the same agreement.

SECTION 21.2. CORPORATE AND PARTNERSHIP AUTHORITY. If Tenant is a corporation or partnership, each individual executing this Lease on behalf of the corporation or partnership represents and warrants that he is duly authorized to execute and deliver this Lease on behalf of the corporation or partnership, and that this Lease is binding upon the corporation or partnership in accordance with its terms. Tenant shall, at Landlord's request, deliver a certified copy of its board of directors' resolution or partnership agreement or certificate authorizing or evidencing the execution of this Lease.

SECTION 21.3. EXECUTION OF LEASE; NO OPTION OR OFFER. The submission of this Lease to Tenant shall be for examination purposes only, and shall not constitute an offer to or option for Tenant to lease the Premises. Execution of this Lease by Tenant and its return to Landlord shall not be binding upon Landlord, notwithstanding any time interval, until Landlord has in fact executed and delivered this Lease to Tenant, it being intended that this Lease shall only become effective upon execution by Landlord and delivery of a fully executed counterpart to Tenant.

SECTION 21.4. RECORDING. Tenant shall not record this Lease without the prior written consent of Landlord. Tenant, upon the request of Landlord, shall execute and acknowledge a "short form" memorandum of this Lease for recording purposes.

SECTION 21.5. AMENDMENTS. No amendment or termination of this Lease shall be effective unless in writing signed by authorized signatories of Tenant and Landlord, or by their respective successors in interest. No actions, policies, oral or informal arrangements, business dealings or other course of conduct by or between the parties shall be deemed to modify this Lease in any respect.

SECTION 21.6. EXECUTED COPY. Any fully executed photocopy or similar reproduction of this Lease shall be deemed an original for all purposes.

SECTION 21.7. ATTACHMENTS. All exhibits, amendments, riders and addenda attached to this Lease are hereby incorporated into and made a part of this Lease.

ARTICLE XXII. MISCELLANEOUS

SECTION 22.1. NONDISCLOSURE OF LEASE TERMS. Tenant acknowledges and agrees that the terms of this Lease are confidential and constitute proprietary information of Landlord. Disclosure of the terms could adversely affect the ability of Landlord to negotiate other leases and impair Landlord's relationship with other tenants. Accordingly, Tenant agrees that it, and its partners, officers, directors, employees and attorneys, shall not intentionally and voluntarily disclose the terms and conditions of this Lease to any other tenant or apparent prospective tenant of the Project, either directly or indirectly, without the prior written consent of Landlord, provided, however, that Tenant may disclose the terms to prospective subtenants or assignees under this Lease.

SECTION 22.2. GUARANTY. As a condition to the execution of this Lease by Landlord, the obligations, covenants and performance of the Tenant as herein provided shall be guaranteed in writing by the Guarantor(s) listed in

Item 7 of the Basic Lease Provisions, if any, on a form of guaranty provided by Landlord.

SECTION 22.3. CHANGES REQUESTED BY LENDER. If, in connection with obtaining financing for the Project, the lender shall request reasonable modifications in this Lease as a condition to the financing, Tenant will not unreasonably withhold or delay its consent, provided that the modifications do not materially increase the obligations of Tenant or materially and adversely affect the leasehold interest created by this Lease.

SECTION 22.4. MORTGAGEE PROTECTION. No act or failure to act on the part of Landlord which would otherwise entitle Tenant to be relieved of its obligations hereunder or to terminate this Lease shall result in such a release or termination unless (a) Tenant has given notice by registered or certified mail to any beneficiary of a deed of trust or mortgage covering the Premises whose address has been furnished to Tenant and (b) such beneficiary is afforded a reasonable opportunity to cure the default by Landlord (which in no event shall be less than sixty (60) days), including, if necessary to effect the cure, time to obtain possession of the Premises by power of sale or judicial foreclosure provided that such foreclosure remedy is diligently pursued. Tenant agrees that each beneficiary of a deed of trust or mortgage covering the Premises is an express third party beneficiary hereof, Tenant shall have no right or claim for the collection of any deposit from such beneficiary or from any purchaser at a foreclosure sale unless such beneficiary or purchaser shall have actually received and not refunded the deposit, and Tenant shall comply with any written directions by any beneficiary to pay rent due hereunder directly to such beneficiary without determining whether an event of default exists under such beneficiary's deed of trust.

SECTION 22.5. COVENANTS AND CONDITIONS. All of the provisions of this Lease shall be construed to be conditions as well as covenants as though the words specifically expressing or imparting covenants and conditions were used in each separate provision.

SECTION 22.6. SECURITY MEASURES. Tenant hereby acknowledges that Landlord shall have no obligation whatsoever to provide guard service or other security measures for the benefit of the Premises or the Project. Tenant assumes all responsibility for the protection of Tenant, its agents, invitees and property from acts of third parties. Nothing herein contained shall prevent Landlord, at its sole option, from providing security protection for the Project or any part thereof, in which event the cost thereof shall be included within the definition of Building Costs. Subject to the provisions in this Lease, including without limitation, the provisions of Section 7.3 hereof, Tenant shall have the right to install such security devices in the Premises as Tenant deems reasonably necessary.

SECTION 22.7. JAMS.

(a) All claims or disputes between Landlord and Tenant arising out of, or relating to, the Lease which either party is expressly authorized by a provision hereof to submit to arbitration, shall be decided by the JAMS/Endispute, or its successor, in Orange, California ("JAMS"), unless the parties mutually agree otherwise. Within ten (10) business days following submission to JAMS, JAMS shall designate three arbitrators and each party may, within five (5) business days thereafter, veto one of the three persons so designated. If two different designated arbitrators have been vetoed, the third arbitrator shall hear and decide the matter. Any arbitration pursuant to this Section 22.7 shall be decided within thirty (30) days of submission of JAMS. The decision of the arbitrator shall be final and binding on the parties. All costs associated with arbitration shall be awarded to the prevailing party as determined by the arbitrator.

(b) Notice of the demand for arbitration by either party to the Lease shall be filed in writing with the other party to the Lease and with JAMS and shall be made within a reasonable time after the dispute has arisen. The award rendered by the arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof. Except by written consent of the person or entity sought to be joined, no arbitration arising out of or relating to the Lease shall

include, by consolidation, joinder or in any other manner, any person or entity not a party to the Lease under which such arbitration is filed if (1) such person or entity is substantially involved in a common question of fact or law, (2) the presence of such person or entity is required if complete relief is to be accorded in the arbitration, or (3) the interest or responsibility of such person or entity in the matter is not insubstantial.

(c) The agreement herein among the parties to the Lease and any other written agreement to arbitrate referred to herein shall be specifically enforceable under prevailing law."

[Signatures on following page.]

LANDLORD:	TENANT:
THE IRVINE COMPANY a Michigan corporation	NEOTHERAPEUTICS, INC. a Colorado corporation
By: --- Richard G. Sim, Executive Vice President	By: Name: Title:
By: --- Clarence W. Barker, President, Irvine Industrial Company a division of The Irvine Company	By: Name: Title:

EXHIBIT D

TENANT'S INSURANCE

The following standards for Tenant's insurance shall be in effect at the Premises. Landlord reserves the right to adopt reasonable nondiscriminatory modifications and additions to those standards. Tenant agrees to obtain and present evidence to Landlord that it has fully complied with the insurance requirements.

1. Tenant shall, at its sole cost and expense, commencing on the date Tenant is given access to the Premises for any purpose and during the entire Term, procure, pay for and keep in full force and effect: (i) commercial general liability insurance with respect to the Premises and the operations of or on behalf of Tenant in, on or about the Premises, including but not limited to personal injury, owned and nonowned automobile, blanket contractual, independent contractors, broad form property damage (with an exception to any pollution exclusion with respect to damage arising out of heat, smoke or fumes from a hostile fire), fire and water legal liability, products liability (if a product is sold from the Premises), liquor law liability (if alcoholic beverages are sold, served or consumed within the Premises), and severability of interest, which policy(ies) shall be written on an "occurrence" basis and for not less than the amount set forth in Item 13 of the Basic Lease Provisions, with a combined single limit (with a $50,000 minimum limit on fire legal liability) per occurrence for bodily injury, death, and property damage liability, or the current limit of liability carried by Tenant, whichever is greater, and subject to such increases in amounts as

Landlord may reasonably determine from time to time; (ii) workers' compensation insurance coverage as required by law, together with employers' liability insurance; (iii) with respect to improvements, alterations, and the like required or permitted to be made by Tenant under this Lease, builder's all-risk insurance, in an amount equal to the replacement cost of the work; (iv) insurance against fire, vandalism, malicious mischief and such other additional perils as may be included in a standard "all risk" form in general use in Orange County, California, insuring Tenant's leasehold improvements, trade fixtures, furnishings, equipment and items of personal property of Tenant located in the Premises, in an amount equal to not less than ninety percent (90%) of their actual replacement cost (with replacement cost endorsement); and (v) business interruption insurance in amounts satisfactory to cover one (1) year of loss. In no event shall the limits of any policy be considered as limiting the liability of Tenant under this Lease.

2. In the event Landlord consents to Tenant's use, generation or storage of Hazardous Materials on, under or about the Premises pursuant to Section 5.3 of this Lease, Landlord shall have the continuing right to require Tenant, at Tenant's sole cost and expense (provided the same is available for purchase upon commercially reasonable terms), to purchase insurance specified and approved by Landlord, with coverage not less than Five Million Dollars ($5,000,000.00), insuring (i) any Hazardous Materials shall be removed from the Premises, (ii) the Premises shall be restored to a clean, healthy, safe and sanitary condition, and (iii) any liability of Tenant, Landlord and Landlord's officers, directors, shareholders, agents, employees and representatives, arising from such Hazardous Materials.

3. All policies of insurance required to be carried by Tenant pursuant to this Exhibit D containing a deductible exceeding Ten Thousand Dollars ($10,000.00) per occurrence must be approved in writing by Landlord prior to the issuance of such policy. Tenant shall be solely responsible for the payment of all deductibles.

4. All policies of insurance required to be carried by Tenant pursuant to this Exhibit D shall be written by responsible insurance companies authorized to do business in the State of California and with a Best's rating of not less than "A" subject to final acceptance and approval by Landlord. Any insurance required of Tenant may be furnished by Tenant under any blanket policy carried by it or under a separate policy, so long as (i) the Premises are specifically covered (by rider, endorsement or otherwise), (ii) the limits of the policy are applicable on a "per location" basis to the Premises and provide for restoration of the aggregate limits, and (iii) the policy otherwise complies with the provisions of this Exhibit D. A true and exact copy of each paid up policy evidencing the insurance (appropriately authenticated by the insurer) or a certificate of insurance, certifying that the policy has been issued, provides the coverage required by this Exhibit D and contains the required provisions, shall be delivered to Landlord prior to the date Tenant is given the right of possession of the Premises. Proper evidence of the renewal of any insurance coverage shall also be delivered to Landlord not less than thirty (30) days prior to the expiration of the coverage. Landlord may at any time, and from time to time, inspect and/or copy any and all insurance policies required by this Lease.

5. Each policy evidencing insurance required to be carried by Tenant pursuant to this Exhibit D shall contain the following provisions and/or clauses satisfactory to Landlord: (i) a provision that the policy and the coverage provided shall be primary and that any coverage carried by Landlord shall be noncontributory with respect to any policies carried by Tenant except as to workers' compensation insurance; (ii) a provision including Landlord, the Additional Insureds identified in Item 11 of the Basic Lease Provisions, and any other parties in interest designated by Landlord as an additional insured, except as to workers' compensation

insurance; (iii) a waiver by the insurer of any right to subrogation against Landlord, its agents, employees, contractors and representatives which arises or might arise by reason of any payment under the policy or by reason of any act or omission of Landlord, its agents, employees, contractors or representatives; and (iv) a provision that the insurer will not cancel or change the coverage provided by the policy without first giving Landlord thirty (30) days prior written notice.

6. In the event that Tenant fails to procure, maintain and/or pay for, at the times and for the durations specified in this Exhibit D, any insurance required by this Exhibit D, or fails to carry insurance required by any governmental authority, Landlord may at its election procure that insurance and pay the premiums, in which event Tenant shall repay Landlord all sums paid by Landlord, together with interest at the maximum rate permitted by law and any related costs or expenses incurred by Landlord, within ten (10) days following Landlord's written demand to Tenant.

EXHIBIT E

RULES AND REGULATIONS

This Exhibit sets forth the rules and regulations governing Tenant's use of the Premises leased to Tenant pursuant to the terms, covenants and conditions of the Lease to which this Exhibit is attached and therein made part thereof. In the event of any conflict or inconsistency between this Exhibit and the Lease, the Lease shall control.

1. Tenant shall not place anything or allow anything to be placed near the glass of any window, door, partition or wall which may appear unsightly from outside the Premises.

2. The walls, walkways, sidewalks, entrance passages, courts and vestibules shall not be obstructed or used for any purpose other than ingress and egress of pedestrian travel to and from the Premises, and shall not be used for loitering or gathering, or to display, store or place any merchandise, equipment or devices, or for any other purpose. The walkways, entrance passageways, courts, vestibules and roof are not for the use of the general public and Landlord shall in all cases retain the right to control and prevent access thereto by all persons whose presence in the judgment of the Landlord shall be prejudicial to the safety, character, reputation and interests of the Building and its tenants, provided that nothing herein contained shall be construed to prevent such access to persons with whom Tenant normally deals in the ordinary course of Tenant's business unless such persons are engaged in illegal activities. No tenant or employee or invitee of any tenant shall be permitted upon the roof of the Building.

3. No awnings or other projection shall be attached to the outside walls of the Building. No security bars or gates, curtains, blinds, shades or screens shall be attached to or hung in, or used in connection with, any window or door of the Premises without the prior written consent of Landlord. Neither the interior nor exterior of any windows shall be coated or otherwise sunscreened without the express written consent of Landlord.

4. Tenant shall not mark, nail, paint, drill into, or in any way deface any part of the Premises or the Building. Tenant shall not lay linoleum, tile, carpet or other similar floor covering so that the same shall be affixed to the floor of the Premises in any manner except as approved by Landlord in writing. The expense of repairing any damage resulting from a violation of this rule or removal of any floor covering shall be borne by Tenant.

5. The toilet rooms, urinals, wash bowls and other plumbing apparatus shall not be used for any purpose other than that for which they were constructed and no foreign substance of any kind whatsoever shall be thrown therein. The expense of any breakage, stoppage or damage resulting from the violation of this rule shall be borne by the tenant who, or whose employees or invitees, caused it.

6. Landlord shall direct electricians as to the manner and location of any future telephone wiring. No boring or cutting for wires

will be allowed without the prior consent of Landlord. The locations of the telephones, call boxes and other office equipment affixed to the Premises shall be subject to the prior written approval of Landlord.

7. The Premises shall not be used for manufacturing or for the storage of merchandise except as such storage may be incidental to the permitted use of the Premises. No exterior storage shall be allowed at any time without the prior written approval of Landlord. The Premises shall not be used for cooking or washing clothes without the prior written consent of Landlord, or for lodging or sleeping or for any immoral or illegal purposes.

8. Tenant shall not make, or permit to be made, any unseemly or disturbing noises or disturb or interfere with occupants of this or neighboring buildings or premises or those having business with them, whether by the use of any musical instrument, radio, phonograph, noise, or otherwise. Tenant shall not use, keep or permit to be used, or kept, any foul or obnoxious gas or substance in the Premises or permit or suffer the Premises to be used or occupied in any manner offensive or objectionable to Landlord or other occupants of this or neighboring buildings or premises by reason of any odors, fumes or gases.

9. No animals shall be permitted at any time within the Premises, other than animals used for testing conducted by Tenant (provided that Tenant complies with all applicable laws and regulations pertaining thereto).

10. Tenant shall not use the name of the Building or the Project in connection with or in promoting or advertising the business of Tenant, except as Tenant's address, without the written consent of Landlord. Landlord shall have the right to prohibit any advertising by any Tenant which, in Landlord's reasonable opinion, tends to impair the

reputation of the Project or its desirability for its intended uses, and upon written notice from Landlord any Tenant shall refrain from or discontinue such advertising.

11. Canvassing, soliciting, peddling, parading, picketing, demonstrating or otherwise engaging in any conduct that unreasonably impairs the value or use of the Premises or the Project are prohibited and each Tenant shall cooperate to prevent the same.

12. No equipment of any type shall be placed on the Premises which in Landlord's opinion exceeds the load limits of the floor or otherwise threatens the soundness of the structure or improvements of the Building.

13. No air conditioning unit or other similar apparatus shall be installed or used by any Tenant without the prior written consent of Landlord.

14. No aerial antenna shall be erected on the roof or exterior walls of the Premises, or on the grounds, without in each instance, the prior written consent of Landlord. Any aerial or antenna so installed without such written consent shall be subject to removal by Landlord at any time without prior notice at the expense of the Tenant, and Tenant shall upon Landlord's demand pay a removal fee to Landlord of not less than $200.00.

15. The entire Premises, including vestibules, entrances, doors, fixtures, windows and plate glass, shall at all times be maintained in a safe, neat and clean condition by Tenant. All trash, refuse and waste materials shall be regularly removed from the Premises by Tenant and placed in the containers at the locations designated by Landlord for refuse collection. All cardboard boxes must be "broken down" prior to being placed in the trash container. All styrofoam chips must be bagged or otherwise contained prior to placement in the trash container, so as not to constitute a nuisance. Pallets may not be disposed of in the trash container or enclosures. The burning of trash, refuse or waste materials is prohibited.

16. Tenant shall use at Tenant's cost such pest extermination contractor as Landlord may direct and at such intervals as Landlord may require.

17. All keys for the Premises shall be provided to Tenant by Landlord and Tenant shall return to Landlord any of such keys so provided

upon the termination of the Lease. Tenant shall not change locks or install other locks on doors of the Premises, without the prior written consent of Landlord. In the event of loss of any keys furnished by Landlord for Tenant, Tenant shall pay to Landlord the costs thereof.

18. No person shall enter or remain within the Project while intoxicated or under the influence of liquor or drugs. Landlord shall have the right to exclude or expel from the Project any person who, in the absolute discretion of Landlord, is under the influence of liquor or drugs.

Landlord reserves the right to amend or supplement the foregoing Rules and Regulations and to adopt and promulgate additional rules and regulations applicable to the Premises. Notice of such rules and regulations and amendments and supplements thereto, if any, shall be given to the Tenant.

ADDENDUM TO NOTE NUMBER 63, DATED JUNE 21, 1996

Note Number 63, dated June 21, 1996 between Advanced ImmunoTherapeutics, Inc. as payor and Alvin J. Glasky, payee and having a principal balance of $558,304 and interest payments at 9% payable in quarterly installments is hereby amended as follows:

A) Effective January 1, 1997, interest is payable on a monthly basis.

B) The principal payment date is hereby modified to occur upon the earlier of December 31, 1997 or the execution of a Licensing Agreement with a major pharmaceutical company.

C) Advanced ImmunoTherapeutics, Inc. and its Parent, NeoTherapeutics, Inc. are hereby released from their pledge of all of their assets as collateral for the note. The note is hereinafter an unsecured obligation of the aforementioned Companies.

D) Dr. Alvin J. Glasky hereby agrees to subordinate the principal of this note to that of any institutional indebtedness of Advanced ImmunoTherapeutics, Inc. or its parent, NeoTherapeutics, Inc.

Dated March 10, 1997 at Irvine, California.

AGREED:

/s/ ALVIN J. GLASKY
- -------------------------
Alvin J. Glasky

Advanced ImmunoTherapeutics, Inc.

By: /s/ ROSALIE H. GLASKY

Rosalie H. Glasky, Secretary, Treasurer