

AVI BIOPHARMA INC  
Form 10-K/A  
May 24, 2010

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K/A**

(Amendment No. 2)

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

**For the fiscal year ended December 31, 2009**

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

**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_

**Commission File Number: 001-14895**

**AVI BioPharma, Inc.**

(Exact name of registrant as specified in its charter)

**Oregon**

(State or other jurisdiction of incorporation or organization)

**93-0797222**

(I.R.S. Employer Identification No.)

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3450 Monte Villa Parkway, Suite 101, Bothell, Washington  
(Address of principal executive offices)

98021  
(Zip Code)

Registrant's telephone number, including area code: (425) 354 5038

Securities registered under Section 12(b) of the Act: **None**

Securities registered under Section 12(g) of the Act:

**Common Stock with \$.0001 par value**

(Title of Class)

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller Reporting Company

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2009 was approximately \$128,954,972. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of the Registrant's Common Stock as of the close of business on May 21, 2010 was 110,384,820.

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**Explanatory Note**

AVI BioPharma, Inc. is filing this Amendment No. 2 on Form 10-K/A ( Amendment No. 2 ) to amend its Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (the Form 10-K ), which was filed with the Securities and Exchange Commission (the SEC ) on March 16, 2010 and previously amended by the Amendment No. 1 on Form 10-K/A filed with the SEC on April 28, 2010. The purpose of this Amendment No. 2 is to amend footnote 12 (Subsequent Events (unaudited)) to the financial statements in Part II. Except as described above, this Amendment No. 2 does not amend, update or change any other items or disclosures in the Form 10-K.

**PART II**

**Item 8. Financial Statements and Supplementary Data.**

The information required by this Item 8 begins on page F-1 in Item 15 of Part IV of this report on Form 10-K and is incorporated into this item by reference.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

(a) The following documents are filed as part of this Report:

(1) *Financial Statements*

The following financial statements of the Company and the Report of KPMG LLP, Independent Auditors, are included in Part IV of this Report on the pages indicated:.

<u>Report of KPMG LLP, Independent Registered Public Accounting Firm</u>	F-1
<u>Report of Arthur Andersen, Independent Auditors</u>	F-2
<u>Balance Sheets</u>	F-3
<u>Statements of Operations</u>	F-4
<u>Statements of Shareholders' Equity and Comprehensive Income (Loss)</u>	F-5
<u>Statements of Cash Flows</u>	F-6
<u>Notes to Financial Statements</u>	F-7

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### (2) Financial Statement Schedules

All schedules are omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

### (3) Exhibits

The following exhibits are filed herewith and this list is intended to constitute the exhibit index:

<b>Exhibit No.</b>	<b>Description</b>
1.1	Underwriting Agreement dated November 14, 2005. (15)
1.2	Placement Agency Agreement between AVI BioPharma, Inc. and Citigroup Global Markets Inc., Oppenheimer & Co. Inc., and Maxim Group, LLC, dated December 12, 2007. (22)
1.3	Engagement Letter dated January 28, 2009 between AVI BioPharma, Inc. and Rodman & Renshaw, LLC. (41)
2.1	Agreement and Plan of Merger dated March 12, 2008 by and among AVI BioPharma, Inc., EB Acquisition Corp., Ercole Biotech, Inc. and the Stockholder Representative. (35)
3.1	Third Restated Articles of Incorporation of AntiVirals Inc. (1)
3.2	First Restated Bylaws of AVI BioPharma, Inc. (28)
3.3	First Amendment to Third Restated Articles of Incorporation. (4)
3.4	Amendment to Article 2 of the Company Third Restated Articles of Incorporation. (11)
3.5	First Amendment to First Restated Bylaws of AVI BioPharma, Inc. (53)
4.1	Form of Specimen Certificate for Common Stock. (1)
4.2	Warrant to purchase 485,290 shares of the Company's common stock dated November 14, 2005. (16)

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- 4.3 Form of Warrant to Purchase Common Stock, issued in connection with the Placement Agency Agreement dated December 12, 2007. (23)
- 4.4 Form of Common Stock Purchase Warrant. (42)
- 4.5 Form of Common Stock Purchase Warrant. (51)
- 10.1 1992 Stock Incentive Plan (as amended through May 11, 2000). (1)
- 10.2 Employment Agreement with Denis R. Burger, Ph.D. dated November 4, 1996. (1)
- 10.3 Employment Agreement with Alan P. Timmins dated November 4, 1996. (1)
- 10.4 Employment Agreement with Dwight Weller, Ph.D. dated November 4, 1996. (1)
- 10.5 Technology Transfer Agreement between Anti-Gene Development Group and AntiVirals Inc., dated February 9, 1992. (1)
- 10.6 Amendment to Technology Transfer Agreement between Anti-Gene Development Group and AntiVirals Inc. dated January 20, 1996. (1)
- 10.7 License and Option Agreement between Anti-Gene Development Group and AntiVirals Inc., dated February 9, 1993. (1)
- 10.8 Commercial Lease between Research Way Investments, Landlord, and AntiVirals Inc., Tenant, dated June 15, 1992. (1)
- 10.9 Lease between Benjamin Franklin Plaza, Inc., Landlord, and AntiVirals Inc., Tenant, dated June 17, 1992. (1)
- 10.10 First Amendment to Lease between Benjamin Franklin Plaza, Inc., Landlord, and AntiVirals Inc., Tenant, dated July 24, 1995. (1)
- 10.11 Employment Agreement with Patrick L. Iversen, Ph.D. dated July 14, 1997. (2)
- 10.12 ImmunoTherapy Corporation 1997 Stock Option Plan. (3)
- 10.13 License Agreement between ImmunoTherapy Corporation and Ohio State University, dated March 12, 1996. (3)
- 10.14 License Agreement between ImmunoTherapy Corporation and Ohio State University, dated December 26, 1996. (3)
- 10.15 Amendment to License Agreement between ImmunoTherapy Corporation and Ohio State University, dated September 23, 1997. (3)
- 10.16 Purchase Agreement, dated December 15, 1999, by and between AVI BioPharma, Inc. and certain Investors. (5)
- 10.17 Registration Rights Agreement, dated December 15, 1999, by and between AVI BioPharma, Inc. and certain Investors. (5)
- 10.18 Purchase Agreement, dated December 16, 1999, by and between AVI BioPharma, Inc. and certain Investors. (5)
- 10.19 Registration Rights Agreement, dated December 16, 1999, by and between AVI BioPharma, Inc. and certain Investors. (5)
- 10.20 Subscription Agreement, dated December 1, 1999, by and between SuperGen, Inc. and AVI BioPharma, Inc. (5)
- 10.21 2000 Amendment to Technology Transfer Agreement between Anti-Gene Development Group and AVI BioPharma, Inc. (6)
- 10.22 United States of America Sales, Distribution, and Development Agreement, dated April 4, 2000, between SuperGen, Inc. and AVI BioPharma, Inc. (7)
- 10.23 Common Stock and Warrant Purchase Agreement, dated April 4, 2000, between SuperGen, Inc. and AVI BioPharma, Inc. (7)
- 10.24 Registration Rights Agreement, dated April 14, 2000, between SuperGen, Inc. and AVI BioPharma, Inc. (7)
- 10.25 2000 Employee Share Purchase Plan. (8)
- 10.26 Employment Agreement with Mark M. Webber dated May 11, 2000. (9)
- 10.27 Lease Agreement with Spieker Partners, LP dated May 8, 2001. (9)
- 10.28\* Investment Agreement dated May 22, 2001 between the Company and Medtronic Asset Management, Inc. (9)
- 10.29 Warrant dated June 20, 2001 issued to Medtronic Asset Management, Inc. (9)
- 10.30 Registration Rights Agreement dated June 20, 2001 between the Company and Medtronic Asset Management, Inc. (9)
- 10.31\* License and Development Agreement dated June 20, 2001 between the Company and Medtronic, Inc. (9)
- 10.32\* Supply Agreement dated June 20, 2001 between the Company and Medtronic, Inc. (9)
- 10.33 Securities Purchase Agreement dated March 25, 2002 between the Company and certain purchasers ( 2002 SPA ). (10)
- 10.34 Form of Warrant issued by the Company to certain purchasers under the 2002 SPA. (10)
- 10.35 Registration Rights Agreement dated March 25, 2002 between the Company and certain purchasers. (10)
- 10.36 2002 Equity Incentive Plan. (11)
- 10.37 Securities Purchase Agreement dated January 19, 2005 between the Company and certain purchasers ( 2005 SPA ). (12)
- 10.38 Form of Purchase Warrant issued by the Company to certain purchasers under the 2005 SPA. (12)
- 10.39 Amendment to employment agreement of Denis R. Burger, Ph.D. (14)
- 10.40 Amendment to employment agreement of Alan P. Timmins. (14)
- 10.41 Amendment to employment agreement of Patrick L. Iversen, Ph.D. (14)
- 10.42 Amendment to employment agreement of Dwight D. Weller, Ph.D. (14)
- 10.43 Amendment to employment agreement of Peter D. O Hanley, M.D., Ph.D. (14)
- 10.44 Amendment to employment agreement of Mark M. Webber. (14)

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10.45	Securities Purchase Agreement dated November 14, 2005 between the Company and certain purchasers. (16)
10.46*	Supply Agreement, dated March 10, 2006, by and between Cook Group Incorporated and AVI BioPharma, Inc. (17)
10.47*	License and Development Agreement, dated March 10, 2006, by and between Cook Group Incorporated and AVI BioPharma, Inc. (17)
10.48*	Investment Agreement, dated March 10, 2006, by and between Cook Group Incorporated and AVI BioPharma, Inc. (17)
10.49*	License Agreement dated January 26, 2006 by and between with Chiron Corporation and AVI BioPharma, Inc. (18)
10.50	Stock Purchase Agreement dated January 26, 2006 by and between with Chiron Corporation and AVI BioPharma, Inc. (18)
10.51	Second Lease Extension and Modification Agreement dated January 24, 2006 by and between Research Way Investments and AVI BioPharma, Inc. (19)
10.52*	Collaboration and License Agreement, dated December 19, 2006, by and between Ercole Biotech, Inc. and AVI BioPharma, Inc. (20)
10.53	Series A-2 Preferred Stock and Common Stock Purchase Agreement, dated December 19, 2006, by and between Ercole Biotech, Inc. and AVI BioPharma, Inc. (21)
10.54*	Cross License Agreement dated January 8, 2007 by and between Eleos, Inc. and AVI BioPharma, Inc. (24)
10.55	Separation and Release Agreement dated March 27, 2007 by and between Denis R. Burger, Ph.D. and AVI BioPharma, Inc. (25)
10.56*	Second License and Collaboration Agreement dated May 1, 2007 by and between Ercole Biotech, Inc. and AVI BioPharma, Inc. (26)
10.57	Real Property Purchase Agreement, dated April 19, 2007, by and between WKL Investments Airport, LLC and AVI BioPharma, Inc. (27)
10.58*	Sponsored Research Agreement between AVI BioPharma, Inc. and Charley s Fund, Inc., effective October 12, 2007. (29)
10.59	Shareholder s Trust Agreement between and among AVI BioPharma, Inc., AVI Shareholder Advocacy Trust, The Shareholder Advocate LLC, and Richard Macary, dated October 29, 2007. (30)
10.60	Amended and Restated Employment Agreement between Alan P. Timmins and AVI BioPharma, Inc., dated October 26, 2007. (31)
10.61	Professional Services Agreement between James B. Hicks Ph.D., LLC and AVI BioPharma, Inc., dated October 26, 2007. (32)
10.62	Letter Agreement executed by George Haywood, dated October 29, 2007. (33)
10.63	Employment Agreement dated February 8, 2008 by and between AVI BioPharma, Inc. and Leslie Hudson, Ph.D. (34)
10.64	Ercole Biotech, Inc. Convertible Promissory Note dated March 12, 2008. (36)
10.65	Employment Agreement dated April 10, 2008 by and between AVI BioPharma, Inc. and Dr. Ryszard Kole. (37)
10.66*	Employment Agreement dated July 24, 2008 by and between AVI BioPharma, Inc. and J. David Boyle II. (38)
10.67*	Amendment No. 1 to Employment Agreement dated August 1, 2008 by and between AVI BioPharma, Inc. and J. David Boyle II. (39)
10.68	Severance and Release Agreement effective October 27, 2008 by and between AVI BioPharma, Inc. and Peter O Hanley. (40)
10.69	Employment Agreement dated January 26, 2009 between AVI BioPharma, Inc. and Stephen Bevan Shrewsbury, M.D. (43)
10.70	Securities Purchase Agreement dated January 29, 2009 between AVI BioPharma, Inc. and the Purchasers. (44)
10.71	Letter Agreement Regarding Board of Director Representation between AVI BioPharma, Inc. and Eastbourne Capital Management, LLC. (45)
10.72	Agreement between AVI BioPharma, Inc. and the U.S. Defense Threat Reduction Agency dated May 5, 2009. (46)
10.73*	Employment Agreement dated May 19, 2009 between AVI BioPharma, Inc. and Paul Medeiros. (47)
10.74	Agreement between AVI BioPharma, Inc. and the U.S. Defense Threat Reduction Agency dated May 28, 2009. (48)
10.75*	First Amendment to Sponsored Research Agreement between AVI BioPharma, Inc. and Charley s Fund, Inc. dated June 2, 2009. (49)
10.76	Lease dated July 24, 2009 by and between BMR-3450 Monte Villa Parkway, LLC and AVI BioPharma, Inc. (50)
10.77	Amendment of Contract between AVI BioPharma, Inc. and the U.S. Defense Threat Reduction Agency (contract no HDTRA 1-07-C0010), effective September 30, 2009. (52)
10.78*	Collaboration and License Agreement between Isis Pharmaceuticals and Ercole Biotech, Inc. dated May 16, 2003 (filed with Form 10-K on March 16, 2010)
10.79	Settlement Agreement dated April 20, 2010 among AVI BioPharma, Inc. and the Shareholder Group (54)
10.80	Separation Agreement dated April 20, 2010 between AVI BioPharma, Inc. and Leslie Hudson, Ph.D. (55)
14.1	Code of Business Conduct and Ethics. (13)
21.1	Subsidiaries of the Registrant. (filed with Form 10-K on March 16, 2010)
23.1	Consent of Independent Registered Public Accounting Firm. (filed with Form 10-K on March 16, 2010)

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- 31.1 Certification of the Company's Interim Chief Executive Officer and Chief Financial Officer, J. David Boyle II, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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- (1) Incorporated by reference to Exhibits to Registrant's Registration Statement on Form SB-2, as amended and filed with the Securities and Exchange Commission on May 29, 1997 (Commission Registration No. 333-20513).
  - (2) Incorporated by reference to Exhibits to Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 1997, and filed with the Securities and Exchange Commission on March 30, 1998.
  - (3) Incorporated by reference to Exhibits to Registrant's Registration Statement on Form S-4, as amended, and filed with the Securities and Exchange Commission on August 7, 1998 (Commission Registration No. 333-60849).
  - (4) Incorporated by reference to Exhibits to Registrant's current report on Form 8-K, as filed with the Securities and Exchange Commission on September 30, 1998 (Commission Registration No. 000-22613).
  - (5) Incorporated by reference to Exhibits to Registrant's Registration Statement on Form S-3, as amended, and filed with the Securities and Exchange Commission on December 21, 1999 (Commission Registration No. 333-93135).
  - (6) Incorporated by reference to Exhibits to Registrant's Registration Statement on Form S-1 and filed with the Securities and Exchange Commission on June 16, 2000 (Commission Registration No. 333-39542).
  - (7) Incorporated by reference to Exhibits to Registrant's Registrations Statement on Form S-3, and filed with the Securities and Exchange Commission on September 15, 2000 (Commission Registration No. 333-45888).
  - (8) Incorporated by reference to Appendix A to Registrant's Definitive Proxy Statement on Form 14-A, as amended, filed with the Securities and Exchange Commission on April 12, 2000.
  - (9) Incorporated by reference to Exhibits to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001, and filed with the Securities and Exchange Commission on August 14, 2001, as amended on April 23, 2002.
  - (10) Incorporated by reference to Exhibits to Registrant's current report on Form 8-K, as filed with the Securities and Exchange Commission on April 2, 2002.
  - (11) Incorporated by reference to appendixes to Registrant's Definitive Proxy Statement on Schedule 14-A, as filed with the Securities and Exchange Commission on April 11, 2002.
  - (12) Incorporated by reference to registrants current report on Form 8-K, as filed with the Securities and Exchange Commission on January 20, 2005.
  - (13) Incorporated by reference to Exhibits to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, and filed with the Securities and Exchange Commission on March 15, 2004.
  - (14) Incorporated by reference to Registrant's current report on Form 8-K, as filed with the Securities and Exchange Commission on February 28, 2005.
  - (15) Incorporated by reference to Registrant's current report on Form 8-K, as filed with the Securities and Exchange Commission on November 21, 2005.
  - (16) Incorporated by reference to Exhibits to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, and filed with the Securities and Exchange Commission on March 16, 2006.
  - (17) Incorporated by reference to Exhibits to Registrant's Registrations Statement on Form S-3, and filed with the Securities and Exchange Commission on April 11, 2006 (Commission Registration No. 333-133211).
  - (18)



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Incorporated by reference to Exhibits to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, and filed with the Securities and Exchange Commission on May 10, 2006.

- (19) Incorporated by reference to Exhibits to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006, and filed with the Securities and Exchange Commission on August 9, 2006.

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- (20) Incorporated by reference to Exhibit 10.56 to the Registrant's Form 10-K for the fiscal year ended December 31, 2006, filed with the Securities and Exchange Commission on March 16, 2007.
- (21) Incorporated by reference to Exhibit 10.57 to the Registrant's Form 10-K for the fiscal year ended December 31, 2006, filed with the Securities and Exchange Commission on March 16, 2007.
- (22) Incorporated by reference to Exhibit 1.01 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on December 13, 2007.
- (23) Incorporated by reference to Exhibit 4.5 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on December 13, 2007.
- (24) Incorporated by reference to Exhibit 10.58 to the Registrant's Form 10-Q for the quarterly period ended March 31, 2007, filed with the Securities and Exchange Commission on May 10, 2007.
- (25) Incorporated by reference to Exhibit 10.59 to the Registrant's Form 10-Q for the quarterly period ended March 31, 2007, filed with the Securities and Exchange Commission on May 10, 2007.
- (26) Incorporated by reference to Exhibit 10.60 to the Registrant's Form 10-Q for the quarterly period ended June 30, 2007, filed with the Securities and Exchange Commission on August 9, 2007.
- (27) Incorporated by reference to Exhibit 10.61 to the Registrant's Form 10-Q for the quarterly period ended June 30, 2007, filed with the Securities and Exchange Commission on August 9, 2007.
- (28) Incorporated by reference to Exhibit 3.5 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on February 7, 2008.
- (29) Incorporated by reference to Exhibit 10.58 to the Registrant's Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission on March 17, 2008.
- (30) Incorporated by reference to Exhibit 10.59 to the Registrant's Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission on March 17, 2008.
- (31) Incorporated by reference to Exhibit 10.60 to the Registrant's Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission on March 17, 2008.
- (32) Incorporated by reference to Exhibit 10.61 to the Registrant's Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission on March 17, 2008.
- (33) Incorporated by reference to Exhibit 10.62 to the Registrant's Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission on March 17, 2008.
- (34) Incorporated by reference to Exhibit 10.63 to the Registrant's Form 10-Q for the quarterly period ended March 31, 2008, filed with the Securities and Exchange Commission on May 12, 2008.
- (35) Incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on March 13, 2008.
- (36) Incorporated by reference to Exhibit 10.62 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on March 13, 2008.
- (37) Incorporated by reference to Exhibit 10.64 to the Registrant's Form 10-Q for the quarterly period ended June 30, 2008, filed with the Securities and Exchange Commission on August 11, 2008.
- (38) Incorporated by reference to Exhibit 10.65 to the Registrant's Form 10-Q for the quarterly period ended September 30, 2008, filed with the Securities and Exchange Commission on November 10, 2008.
- (39) Incorporated by reference to Exhibit 10.66 to the Registrant's Form 10-Q for the quarterly period ended September 30, 2008, filed with the Securities and Exchange Commission on November 10, 2008.



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- (40) Incorporated by reference to Exhibit 10.68 to the Registrant's Form 10-K for the fiscal year ended December 31, 2008, filed with the Securities and Exchange Commission on March 10, 2009.
- (41) Incorporated by reference to Exhibit 1.3 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on January 30, 2009.
- (42) Incorporated by reference to Exhibit 4.4 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on January 30, 2009.
- (43) Incorporated by reference to Exhibit 10.71 to the Registrant's Form 10-Q for the quarterly period ended March 31, 2009, filed with the Securities and Exchange Commission on May 11, 2009.
- (44) Incorporated by reference to Exhibit 10.67 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on January 30, 2009.
- (45) Incorporated by reference to Exhibit 10.68 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on January 30, 2009.
- (46) Incorporated by reference to Exhibit 10.72 to the Registrant's Form 10-Q for the quarterly period ended June 30, 2009, filed with the Securities and Exchange Commission on August 10, 2009.
- (47) Incorporated by reference to Exhibit 10.73 to the Registrant's Form 10-Q for the quarterly period ended June 30, 2009, filed with the Securities and Exchange Commission on August 10, 2009.
- (48) Incorporated by reference to Exhibit 10.74 to the Registrant's Form 10-Q for the quarterly period ended June 30, 2009, filed with the Securities and Exchange Commission on August 10, 2009.
- (49) Incorporated by reference to Exhibit 10.75 to the Registrant's Form 10-Q for the quarterly period ended June 30, 2009, filed with the Securities and Exchange Commission on August 10, 2009.
- (50) Incorporated by reference to Exhibit 10.76 to the Registrant's Form 10-Q for the quarterly period ended September 30, 2009, filed with the Securities and Exchange Commission on November 9, 2009.
- (51) Incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on August 24, 2009.
- (52) Incorporated by reference to Exhibit 10.77 to the Registrant's Form 10-Q for the quarterly period ended September 30, 2009, filed with the Securities and Exchange Commission on November 9, 2009.
- (53) Incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 22, 2010.
- (54) Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 22, 2010.
- (55) Incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 22, 2010.

(b) Exhibits.

The exhibits listed under Item 15(a)(3) hereof are filed as part of this Form 10-K/A other than Exhibit 32.1, which shall be deemed furnished.

(c) Financial Statement Schedules.

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All schedules are omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

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\* A Confidential Treatment Request for certain information in this document has been filed with the Securities and Exchange Commission. The information for which treatment has been sought has been deleted from such exhibit and the deleted text replaced by an asterisk (\*).

Indicates management contract or compensatory plan, contract or arrangement.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 24, 2010

AVI BIOPHARMA, INC.

By: /s/ J. David Boyle II  
J. David Boyle II  
Interim Chief Executive Officer and President, Senior Vice President, and Chief  
Financial Officer

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

AVI BioPharma, Inc:

We have audited the accompanying balance sheets of AVI BioPharma, Inc. (a development stage enterprise) as of December 31, 2009 and 2008, and the related statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2009 and the information included in the cumulative from inception presentations for the period January 1, 2002 to December 31, 2009 (not separately presented herein). 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. The financial statements of AVI BioPharma, Inc. for the period July 22, 1980 (inception) to December 31, 2001 were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated February 21, 2002.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 AVI BioPharma, Inc. (a development stage enterprise) as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2009 and the information included in the cumulative from inception presentations for the period January 1, 2002 to December 31, 2009 (not separately presented herein), in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of AVI BioPharma, Inc.'s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report, dated March 16, 2010 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Portland, Oregon  
March 16, 2010

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**Report of Independent Public Accountants**

To the Board of Directors and Shareholders of

AVI BioPharma, Inc.

We have audited the accompanying balance sheet of AVI BioPharma, Inc. (an Oregon corporation in the development stage) as of December 31, 2001, and the related statements of operations, shareholders' equity and cash flows for each of the two years in the period ended December 31, 2001 and for the period from inception (July 22, 1980) to December 31, 2001. 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 auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 AVI BioPharma, Inc. as of December 31, 2001, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2001 and for the period from inception (July 22, 1980) to December 31, 2001, in conformity with accounting principles generally accepted in the United States.

/s/ Arthur Andersen LLP

Portland, Oregon  
February 21, 2002



## AVI BioPharma, Inc.

(A Development Stage Company)

## Balance Sheets

	December 31, 2009	December 31, 2008
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 48,275	\$ 11,192
Short-term securities - available-for-sale	171	282
Accounts receivable	2,085	4,971
Other current assets	779	599
Total Current Assets	51,310	17,044
Property held for sale	2,372	-
Property and Equipment, net of accumulated depreciation and amortization of \$14,026 and \$12,919	2,466	5,189
Patent Costs, net of accumulated amortization of \$1,762 and \$1,927	3,759	3,268
Other assets	120	35
Total Assets	\$ 60,027	\$ 25,536
<b>Liabilities and Shareholders' Equity</b>		
Current Liabilities:		
Accounts payable	\$ 1,381	\$ 2,014
Accrued employee compensation	922	1,306
Long-term debt, current portion	77	74
Warrant valuation	27,609	1,254
Deferred revenue	3,428	2,190
Other liabilities	90	450
Total Current Liabilities	33,507	7,288
Commitments and Contingencies		
Long-term debt, non-current portion	1,924	2,001
Other long-term liabilities	966	515
Shareholders' Equity:		
Preferred stock, \$.0001 par value, 20,000,000 shares authorized; none issued and outstanding		
Common stock, \$.0001 par value, 200,000,000 shares authorized; 110,495,587 and 71,101,738 issued and outstanding	11	7
Additional paid-in capital	299,088	266,035
Deficit accumulated during the development stage	(275,469)	(250,310)
Total Shareholders' Equity	23,630	15,732
Total Liabilities and Shareholders' Equity	\$ 60,027	\$ 25,536

See accompanying notes to financial statements.

## AVI BioPharma, Inc.

(A Development Stage Company)

## Statements of Operations

(in thousands)	2009	Year ended December 31, 2008	2007	July 22, 1980 (Inception) through December 31, 2009
Revenues from license fees, grants and research contracts	\$ 17,585	\$ 21,258	\$ 10,985	\$ 59,809
Operating expenses:				
Research and development	24,396	27,331	31,058	230,432
General and administrative	8,696	11,469	13,035	74,020
Acquired in-process research and development		9,916		29,461
Operating loss	(15,507)	(27,458)	(33,108)	(274,104)
Other non-operating (loss) income:				
Interest (expense) income and other, net	(454)	344	984	8,323
(Increase) decrease on warrant valuation	(9,198)	3,161	4,956	3,450
Realized gain on sale of short-term securities available-for-sale				3,863
Write-down of short-term securities available-for-sale				(17,001)
	(9,652)	3,505	5,940	(1,365)
Net loss	\$ (25,159)	\$ (23,953)	\$ (27,168)	\$ (275,469)
Net loss per share - basic and diluted	\$ (0.27)	\$ (0.34)	\$ (0.50)	
Weighted average number of common shares outstanding for computing basic and diluted loss per share	93,090	69,491	53,942	

See accompanying notes to financial statements.

## AVI BioPharma, Inc.

(A Development Stage Company)

## Statements of Shareholders Equity and Comprehensive Income (Loss)

(in thousands)	Partnership Units	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Deficit Accumulated During the Development Stage	Total Shareholders Equity
BALANCE AT JULY 22, 1980 (Inception)				\$	\$	\$	\$
Issuance of partnership units, warrants and common stock	3,615	8,273	1	33,733			33,734
Compensation expense related to issuance of warrants for common stock and partnership units				537			537
Exercise of warrants for partnership units and common stock	42	2,236		4,152			4,152
Exercise of options for common stock		990		4,005			4,005
Issuance of common stock for ESPP		252		810			810
Issuance of common stock and warrants for cash and securities, net of offering costs		37,185	4	162,348			162,352
Issuance of common stock and warrants for the acquisition of ImmunoTherapy Corporation		2,132		17,167			17,167
Issuance of common stock and warrants for services		536		2,469			2,469
Compensation expense related to issuance of options for common stock				6,842			6,842
Conversion of debt into common stock and partnership units	9	10		88			88
Issuance of common stock in exchange for partnership units	(1,810)	1,633		(0)			
Withdrawal of partnership net assets upon conveyance of technology	(1,856)			(177)			(177)
Common stock subject to rescission, net		(64)		(289)			(289)
Comprehensive income (loss):							
Write-down of short-term securities available-for-sale					17,001		17,001
Realized gain on sale of short-term securities available-for-sale					(3,766)		(3,766)
Unrealized loss on short-term securities available-for-sale					(13,217)		(13,217)
Net loss						(199,189)	(199,189)
Comprehensive loss							(199,171)
BALANCE AT DECEMBER 31, 2006		53,183	5	\$ 231,685	\$ 18	\$ (199,189)	\$ 32,519
Exercise of warrants for common stock		12		29			29
Exercise of options for common stock		39		90			90
Issuance of common stock for ESPP		518		1,450			1,450
Issuance of common stock to vendors							

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Compensation expense related to issuance of options for common stock			313			313
Issuance of common stock for cash and securities, net of offering costs	10,697	1	14,447			14,448
Stock-based compensation			4,719			4,719
Comprehensive income (loss):						
Unrealized gain on short-term securities available- for-sale, net					(18)	(18)
Net loss					(27,168)	(27,168)
Comprehensive loss						(27,186)
BALANCE AT DECEMBER 31, 2007	64,449	6	\$ 252,733	\$	\$ (226,357)	\$ 26,382
Exercise of options for common stock	7		9			9
Issuance of common stock for ESPP	84		72			72
Issuance of common stock and warrants to vendors	324		828			828
Compensation expense to non-employees on issuance of options and warrants to purchase common stock			180			180
Compensation expense on issuance of restricted stock	100		166			166
Stock-based compensation	326		3,656			3,656
Issuance of common stock for acquisition of Ercole	5,812	1	8,391			8,392
Comprehensive income (loss):						
Unrealized gain on short-term securities available- for-sale, net						
Net loss					(23,953)	(23,953)
Comprehensive loss						(23,953)
BALANCE AT DECEMBER 31, 2008	71,102	7	\$ 266,035	\$	\$ (250,310)	\$ 15,732
Exercise of options for common stock	62		76			76
Issuance of common stock for ESPP	124		85			85
Issuance of common stock for cash and securities, net of offering costs	38,520	4	30,518			30,522
Compensation expense on issuance of restricted stock	427		203			203
Stock-based compensation	261		2,171			2,171
Comprehensive income (loss):						
Unrealized gain on short-term securities available- for-sale, net						
Net loss					(25,159)	(25,159)
Comprehensive loss						(25,159)
BALANCE AT DECEMBER 31, 2009	110,496	11	\$ 299,088	\$	\$ (275,469)	\$ 23,630

See accompanying notes to financial statements.

## AVI BioPharma, Inc.

(A Development Stage Company)

## Statements of Cash Flows

(in thousands)	Year ended December 31,			For the Period July 22, 1980 (Inception) through December 31, 2009
	2009	2008	2007	
<b>Cash flows from operating activities:</b>				
Net loss	\$ (25,159)	\$ (23,953)	\$ (27,168)	\$ (275,469)
Adjustments to reconcile net loss to net cash flows used in operating activities:				
Depreciation and amortization	1,379	1,469	2,014	17,682
Loss on disposal of assets	347	584	59	1,305
Realized gain on sale of short-term securities available-for-sale				(3,863)
Write-down of short-term securities available-for-sale				17,001
Impairment charge on property held for sale	128	800		928
Stock-based compensation	2,374	4,830	5,732	22,697
Conversion of interest accrued to common stock				8
Acquired in-process research and development		9,916		29,461
Increase (decrease) on warrant valuation	9,198	(3,161)	(4,956)	(3,450)
(Increase) decrease in:				
Accounts receivable and other assets	2,621	(1,850)	(2,849)	(2,900)
Net increase in accounts payable, accrued employee compensation, and other liabilities	312	(975)	2,491	5,274
Net cash used in operating activities	(8,800)	(12,340)	(24,677)	(191,326)
<b>Cash flows from investing activities:</b>				
Purchase of property and equipment	(931)	(369)	(1,270)	(17,869)
Patent costs	(1,063)	(848)	(857)	(7,243)
Purchase of marketable securities		(11)	(110)	(112,986)
Sale of marketable securities	111		12,813	117,724
Acquisition costs		(11)		(2,389)
Net cash (used in) provided by investing activities	(1,883)	(1,239)	10,576	(22,763)
<b>Cash flows from financing activities:</b>				
Proceeds from sale of common stock, warrants and partnership units, net of offering costs, and exercise of options and warrants	47,840	81	18,745	262,937
Repayments of long-term debt	(74)	(113)		(187)
Buyback of common stock pursuant to rescission offering				(289)
Withdrawal of partnership net assets				(177)
Issuance of convertible debt				80
Net cash (used in) provided by financing activities	47,766	(32)	18,745	262,364
Increase (decrease) in cash and cash equivalents	37,083	(13,611)	4,644	48,275
<b>Cash and cash equivalents:</b>				
Beginning of period	11,192	24,803	20,159	
End of period	\$ 48,275	\$ 11,192	\$ 24,803	\$ 48,275

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SUPPLEMENTAL DISCLOSURE OF CASH  
FLOW INFORMATION:

Cash paid during the year for interest	\$	97	\$	104	\$	104	\$	305
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SUPPLEMENTAL SCHEDULE OF NONCASH  
INVESTING ACTIVITIES AND FINANCING  
ACTIVITIES:

Short-term securities available-for-sale received in connection with the private offering	\$		\$		\$		\$	17,897
Change in unrealized gain (loss) on short-term securities available-for-sale	\$		\$		\$	(18)	\$	
Issuance of common stock and warrants in satisfaction of liabilities	\$		\$		\$		\$	545
Issuance of common stock for building purchase	\$		\$		\$	750	\$	750
Assumption of long-term debt for building purchase	\$		\$		\$	2,200	\$	2,200
Issuance of common stock for Ercole assets	\$		\$	8,075	\$		\$	8,075
Assumption of liabilities for Ercole assets	\$		\$	2,124	\$		\$	2,124

See accompanying notes to financial statements.

**AVI BioPharma, Inc.**

**(A Development Stage Company)**

**NOTES TO FINANCIAL STATEMENTS**

**1. ORGANIZATION AND NATURE OF BUSINESS:**

AVI BioPharma, Inc. (the Company or AVI ) was incorporated in the State of Oregon on July 22, 1980. The mission of the Company is to develop and commercialize improved therapeutic products based upon antisense and cancer immunotherapy technology.

Through May 1993, the financial statements included the combined accounts of the Company and ANTI-GENE DEVELOPMENT GROUP, a limited partnership (AGDG or the Partnership) founded in 1981 and registered in the State of Oregon. Substantially all income generated and proceeds from the Partnership unit sales through that date have been paid to the Company under the terms of research and development contracts entered into by the Partnership and the Company. Significant transactions between the Company and the Partnership through that date have been eliminated.

In March 1993, the Company offered to all partners in the Partnership the opportunity to exchange their partnership units or warrants to purchase partnership units (unit warrants) for common stock or warrants to purchase common stock. Under the terms of the offer, which was completed May 1, 1993, each partner could elect to exchange each unit held or unit warrant held for 1,100 shares of common stock or warrants to purchase 1,100 shares of common stock of the Company, respectively. Total shares and warrants to purchase shares issued in the exchange offer were 1,632,950 and 381,700, respectively.

Effective May 19, 1993, the Company and the Partnership entered into a Technology Transfer Agreement wherein the Partnership conveyed all intellectual property then within its control to the Company. As part of the conveyance, the Company tendered to the Partnership for liquidation all partnership units received pursuant to the exchange offer and received a 49.37 percent undivided interest in the intellectual property. The Company then purchased the remaining undivided interest in the intellectual property for rights to payments of 4.05 percent of gross revenues in excess of \$200 million, from sales of products, which would, in the absence of the Technology Transfer Agreement, infringe a valid claim under any patent transferred to the Company. The Company also granted to the Partnership a royalty-bearing license to make, use and sell small quantities of product derived from the intellectual property for research purposes only.

In March 2000, the Company and AGDG amended the Technology Transfer Agreement to give to AGDG and Gene Tools LLC, related organizations, exclusive, non royalty-bearing rights to in vitro diagnostic applications of the intellectual property. In consideration for this amendment, Gene Tools paid the Company \$1 million and reduced the royalty that the Company would pay to AGDG under the Technology Transfer Agreement on future sales of therapeutic products from 4.05% to 3.00%.

The remaining net assets of the Partnership, \$177,000 of cash, were no longer combined with those of the Company in May 1993. Under the terms of the Technology Transfer Agreement, the Partnership ceased active sales of partnership units and income generating activities and no longer will enter into research and development contracts with the Company. The Partnership currently exists primarily for the purpose of

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collecting potential future payments from the Company as called for in the Technology Transfer Agreement.

### *Acquisition of Ercole*

On March 20, 2008, the Company acquired all of the stock of Ercole Biotechnology, Inc. ( Ercole ) in exchange for 5,811,721 shares of AVI common stock. The transaction included the assumption of approximately \$1.8 million in liabilities of Ercole. The AVI common stock was valued at approximately \$8.4 million. AVI also issued warrants to purchase AVI stock to settle certain outstanding warrants held in Ercole, which were valued at \$437,000. These warrants are classified as equity. The acquisition was aimed at consolidating AVI's position in directed alternative RNA splicing therapeutics. Ercole and the Company had been collaborating since 2006 to develop drug candidates, including AVI-4658, currently in clinical testing in the United Kingdom for the treatment of Duchenne muscular dystrophy. Ercole has other ongoing discovery research programs.

The total estimated purchase price of \$10.2 million has been allocated as follows:

Accounts Receivable	\$	76,000
Prepaid Expenses	\$	7,000
Fixed Assets	\$	10,000
Patents	\$	190,000
Acquired In-Process Research and Development	\$	9,916,000



The pending patents acquired as part of the Ercole acquisition have an expected expiration date of 2026. Acquired in-process research and development consists of other discovery research programs in areas including beta thalassemia and soluble tumor necrosis factor receptor. As these programs were in development at the time of acquisition, there were significant risks associated with completing these projects, and there were no alternative future uses for these projects, the associated value has been considered acquired in-process research and development.

Ercole has been a development stage company since inception and does not have a product for sale. The Company has retained a limited number of Ercole employees and plans on incorporating in-process technology of Ercole into the Company's processes. The acquisition of Ercole did not meet the definition of a business and it is therefore being accounted for as an asset acquisition.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

### *Basis of Accounting*

The financial statements have been prepared in accordance with U.S. generally accepted accounting principles as outlined in the *FASB Accounting Standards Codification*™.

### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Significant items subject to such estimates and assumptions include the valuation of investments and liability classified warrants, long-lived asset impairment, and revenue recognition.

### *Reclassifications*

Certain prior year amounts have been reclassified to conform to current year presentation. These changes did not have a significant impact on Company's net loss, assets, liabilities, shareholders' equity or cash flows.

### *Cash and Cash Equivalents*

The Company considers all highly liquid investments with an original maturity of three months or less from the date of purchase to be cash equivalents.

*Short-Term Securities Available-For-Sale*

Short-term securities include certificates of deposit, commercial paper and other highly liquid investments with original maturities in excess of 90 days at the time of purchase and less than one year from the balance sheet date. The Company classifies its investment securities as available-for-sale and, accordingly, such investment securities are stated on the balance sheet at their fair market value with unrealized gains (losses) recorded as a separate component of shareholders' equity and comprehensive income (loss). There were no unrealized gains or losses on the Company's investments in marketable securities on its balance sheets as of December 31, 2009 and 2008.

*Accounts Receivable*

Accounts receivable are stated at invoiced amount and do not bear interest as they are due within twelve months. Because a majority of accounts receivable are from the U.S. government and historically no amounts have been written off, an allowance for doubtful accounts receivable is not considered necessary. Amounts included in accounts receivable are as follows:

<b>As of December 31, (in thousands)</b>	<b>2009</b>		<b>2008</b>	
Research contract	\$	2,085	\$	4,971
Accounts receivable	\$	2,085	\$	4,971

*Property and Equipment*

Property and equipment is stated at cost and depreciated over the estimated useful lives of the assets, generally five years, using the straight-line method. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the asset, generally five years, using the straight-line method. Expenditures for repairs and maintenance are expensed as incurred. Expenditures that increase the useful life or value are capitalized.

Amounts included in property held for sale:

As of December 31, (in thousands)	2009	2008
Property held for sale	\$ 2,372	\$

The Company has listed for sale an industrial property located in Corvallis Oregon for a sales price of \$2.5 million. Selling and closing expenses are estimated to be \$0.1 million. The Company has decided to outsource its large scale manufacturing activities and has listed this property for sale with a commercial real estate agent.

Amounts included in property and equipment are as follows:

As of December 31, (in thousands)	2009	2008
Building	\$	\$ 2,500
Lab equipment	5,933	5,676
Office equipment	970	741
Leasehold improvements	9,589	9,191
	16,492	18,108
Less accumulated depreciation	(14,026)	(12,919)
Property and equipment, net	\$ 2,466	\$ 5,189

Depreciation expense was \$1,154,000, \$1,212,000 and \$1,718,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

*Patent Costs*

Patent costs consist primarily of legal and filing fees incurred to file patents on proprietary technology developed by the Company. Patent costs are amortized on a straight-line basis over the shorter of the estimated economic lives or the legal lives of the patents, generally 20 years. Patent amortization was \$225,000, \$257,000 and \$296,000 for the years ended December 31, 2009, 2008 and 2007, respectively. The Company also expensed the remaining net book value of previously capitalized patents that were later abandoned of \$347,000, \$580,000 and \$0, for 2009, 2008 and 2007 respectively. The Company expects to incur amortization expense of approximately \$146,000 per year over the following five fiscal years.

*Revenue Recognition*

The Company records revenue from research contracts and grants as the services are performed and payment is reasonably assured. In 2009, 2008 and 2007, the Company recognized \$17,585,000, \$21,258,000 and \$10,985,000, respectively, in research contracts revenues from government funding for work performed on viral disease projects and other grants and contracts. Revenue associated with research and development arrangements is recognized under the proportional performance method, using the payment received method. To date, revenue from research and development arrangements has not been material.

*Research and Development*

Research and development (R&D) expenses include related salaries, contractor fees, materials, utilities and allocations of corporate costs. R&D expenses also consist of independent R&D costs and costs associated with collaborative development arrangements. In addition, the Company funds R&D at other companies and research institutions under agreements. Research and development costs are expensed as incurred.

*Other Current Assets*

Amounts included in other current assets are as follows:

As of December 31, (in thousands)	2009	2008
Prepaid expenses	\$ 337	\$ 316
Prepaid rents	158	
Restricted cash	284	283
Other current assets	\$ 779	\$ 599

Starting in April 2006, the Company was required to pledge \$150,000 as collateral for company credit cards issued to certain employees. Starting in April 2007, the Company was required to pledge \$125,000 as collateral for payments on long-term debt. The Company classifies these amounts as restricted cash. As of December 31, 2009, restricted cash including accrued interest was \$284,000. The remaining components of other current assets include normally occurring prepaid expenses and rents.

*Stock-based Compensation*

The Company issues stock-based compensation to certain employees, officers and directors. These principles require companies to account for stock options using the fair value method, which results in the recognition of compensation expense over the vesting period of the options. See Note 3.

*Income Taxes*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered and settled. A valuation allowance is recorded to reduce the net deferred tax asset to zero because it is more likely than not that the deferred tax asset will not be realized. The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained upon an examination.

*Fair Value of Financial Instruments*

The Company measures at fair value certain financial assets and liabilities. Generally accepted accounting principles specify a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair-value hierarchy:

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Level 1 Quoted prices for identical instruments in active markets;

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 Valuations derived from valuation techniques in which one or more significant value drivers are unobservable.

The Company's assets measured at fair value on a recurring basis consisted of the following as of December 31, 2009:

(in thousands)	Fair Value Measurement as of December 31, 2009			
	Total	Level 1	Level 2	Level 3
Short-term securities- available- for-sale and restricted cash	\$ 48,730	\$ 48,275	\$ 455	\$
Total	\$ 48,730	\$ 48,275	\$ 455	\$

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The Company's liabilities measured at fair value on a recurring basis consisted of the following as of the date indicated:

(in thousands)	Fair Value Measurement as of December 31, 2009			
	Total	Level 1	Level 2	Level 3
Warrants	\$ 27,609	\$	\$	\$ 27,609
Total	\$ 27,609	\$	\$	\$ 27,609

The Company's assets measured at fair value on a recurring basis consisted of the following as of December 31, 2008:

(in thousands)	Fair Value Measurement as of December 31, 2008			
	Total	Level 1	Level 2	Level 3
Short-term securities- available- for-sale and restricted cash	\$ 11,757	\$ 11,192	\$ 565	\$
Total	\$ 11,757	\$ 11,192	\$ 565	\$

The Company's liabilities measured at fair value on a recurring basis consisted of the following as of the date indicated:

(in thousands)	Fair Value Measurement as of December 31, 2008			
	Total	Level 1	Level 2	Level 3
Warrants	\$ 1,254	\$	\$	\$ 1,254
Total	\$ 1,254	\$	\$	\$ 1,254

A reconciliation of the change in value of the Company's warrants for the year ended December 31, 2009 is as follows:

(in thousands)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
Balance at January 1, 2009	\$	1,254
Change in value of warrants		9,198
Issuances		17,157
Balance at December 31, 2009	\$	27,609

A reconciliation of the change in value of the Company's warrants for the year ended December 31, 2008 is as follows:

(in thousands)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
Balance at January 1, 2008	\$	4,415
Change in value of warrants		(3,161)

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Balance at December 31, 2008	\$	1,254
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The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable, and other current monetary assets and liabilities approximate fair value because of the immediate or short-term maturity of these financial instruments.

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*Warrants*

Certain of the Company's warrants issued in connection with financing arrangements are classified as liabilities in accordance with the generally accepted accounting pronouncements, whereby, the fair market value of these warrants is recorded on the balance sheet at issuance and marked to market at each financial reporting period. The change in the fair value of the warrants is recorded in the Statement of Operations as a non-cash gain (loss) and is estimated using the Black-Scholes option-pricing model with the following assumptions:

<b>Year Ended December 31,</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Risk-free interest rate	0.2%-2.69%	0.3%-3.0%	3.1%-3.5%
Expected dividend yield	0%	0%	0%
Expected lives	0.4-4.7 years	0.2-4.2 years	0.9-5.0 years
Expected volatility	86.0%-102.1%	63.6%-104.8%	58.2%-80.7%
Warrants classified as liabilities	30,203,466	7,994,229	9,607,866
Warrants classified as equity	2,129,530	2,129,530	4,248,545
Market value of stock at beginning of year	\$ 0.66	\$ 1.41	\$ 3.18
Market value of stock at end of year	\$ 1.46	\$ 0.66	\$ 1.41

The risk-free interest rate is estimated using an average of treasury bill interest rates. The expected dividend yield is zero as the Company has not paid any dividends to date and does not expect to pay dividends in the future. The expected lives are based on the remaining contractual lives of the related warrants. The expected volatility is estimated using historical calculated volatility and considers factors such as future events or circumstances that could impact volatility.

For warrants classified as permanent equity, the fair value of the warrants is recorded as additional paid-in capital and no further adjustments are made.

*Comprehensive Income (Loss)*

Comprehensive income (loss) includes charges or credits to equity that did not result from transactions with shareholders. The Company's only component of other comprehensive income (loss) is unrealized gain (loss) on cash equivalents and short-term securities available-for-sale.

*Rent Expense*

The Company's operating lease agreements for its Corvallis, Oregon facility and its Bothell, Washington facility provide for scheduled annual rent increases throughout the lease's term. In accordance with generally accepted accounting principles the Company recognizes the effects of the scheduled rent increases on a straight-line basis over the full term of the leases, which expires in 2020 and 2014.

During the years ended December 31, 2009, 2008 and 2007, the Company recognized \$230,000, \$133,000 and \$155,000, respectively, in additional rent expense from the amortization of future scheduled rent increases.

*Commitments and Contingencies.*

In the normal course of business, the Company may be named as a party to various legal claims, actions and complaints, including matters involving employment, intellectual property, effects from the use of drugs utilizing our technology, or others. It is impossible to predict with certainty whether any resulting liability would have a material adverse effect on the Company's financial position, results of operations or cash flows.

*Financial Instruments.*

The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable, and other current monetary assets and liabilities approximate fair value because of the immediate or short-term maturity of these financial instruments.

*License Arrangements.*

License arrangements may consist of non-refundable upfront license fees, data transfer fees, research reimbursement payments, exclusive licensed rights to patented or patent pending compounds, technology access fees, various performance or sales milestones and future product royalty payments. Some of these arrangements are multiple element arrangements.

The Company defers recognition of non-refundable upfront fees if it has continuing performance obligations without which the technology, right, product or service conveyed in conjunction with the non-refundable fee has no utility to the licensee that is separate and independent of Company performance under the other elements of the arrangement. In addition, if the Company has continuing involvement through research and development services that are required because its know-how and expertise related to the technology is proprietary to the Company, or can only be performed by the Company, then such up-front fees are deferred and recognized over the period of continuing involvement.

Payments related to substantive, performance-based milestones in a research and development arrangement are recognized as revenue upon the achievement of the milestones as specified in the underlying agreements when they represent the culmination of the earnings process.

*Long-Lived Asset Impairment*

Long-lived assets held and used by us and intangible assets with determinable lives are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable in accordance with generally accepted accounting pronouncements. We evaluate recoverability of assets to be held and used by comparing the carrying amount of an asset to future net undiscounted cash flows to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Such reviews assess the fair value of the assets based upon estimates of future cash flows that the assets are expected to generate.

At December 31, 2008, the Company determined that the ongoing decline in the real estate market had adversely impacted the fair value of a building purchased by the Company for \$3.3 million in 2007. Based on an independent third-party appraisal, the Company estimated that the current fair value of the building had declined to approximately \$2.5 million. Accordingly, an impairment charge of \$800,000 was recorded for the year ended December 31, 2008. The Company completed a second third party appraisal in November of 2009, based on this revised estimate the Company believes the property to have a current fair value, net of costs to sell of \$2.4 million. This property was listed for sale in November of 2009. Selling and closing expenses are estimated to be \$0.1 million. The Company has decided to outsource its large scale manufacturing activities and has listed this property for sale with a commercial real estate agent.

In addition, at December 31, 2009, the Company conducted an evaluation of the status of its patents each quarter during 2009. Pursuant to these evaluations, the Company has recorded a write-off of \$347,000, in 2009 for previously capitalized costs related to patents that have expired or were abandoned.

*Government Research Contract Revenue.*

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The Company recognizes revenues from federal research contracts during the period in which the related expenditures are incurred. The Company receives reimbursement of costs incurred, overhead and, in some cases, a fixed fee. The Company presents these revenues and related expenses at gross in the consolidated financial statements in accordance with the generally accepted accounting pronouncements.

### *Recent Accounting Pronouncements*

Recently adopted accounting guidance:

During the first fiscal quarter of 2009, the Financial Accounting Standards Board issued Staff Positions ASC 820 10 65-65-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and the Identifying Transactions That Are Not Orderly*, ASC 320 10 65-65-1, *Recognition and Presentation of Other-Than-Temporary Impairments*, and ASC 825 10 65 65-1, *Interim Disclosures about Fair Value of Financial Instruments*. These Staff Positions were issued to clarify the application of ASC 820 10 65-65-4, *Fair Value Measurements* in the current economic environment, modify the recognition of other-than-temporary impairments of debt securities, and require companies to disclose the fair value of financial instruments in interim periods. The Staff Positions are effective for interim and annual periods ending after September 15, 2009, with early adoption permitted for periods ending after March 15, 2009, if all three Staff Positions or both the fair-value measurement and other-than-temporary impairment Staff Positions are adopted simultaneously. The Company has adopted the Staff Positions in the third quarter of fiscal 2009, and there was no material impact on the Company's Financial Statements or related disclosures.

In April 2009, the FASB issued FASB Staff Position ASC 320 10 65-65-1, *Recognition and Presentation of Other-Than-Temporary Impairments*, which requires the Company to disclose information for interim and annual periods that enables users of its financial statements to understand the types of available-for-sale and held-to-maturity debt and equity securities held, including information about investments in an unrealized loss position for which an other-than-temporary impairment has or has not been recognized. The provisions of this pronouncement were adopted in the second quarter of 2009. There was no material impact on the Company's financial statements.

In April 2009, the FASB issued FSP ASC 825 10 65 65-1, *Interim Disclosures about Fair Value of Financial Instruments*, which requires publicly traded companies to include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. The provisions of these pronouncements were adopted in the second quarter of 2009. There was no material impact on the Company's financial statements.

**Recent accounting guidance not yet adopted:**

In January 2010, the FASB issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. The guidance will become effective for us with the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for us with the reporting period beginning July 1, 2011. Other than requiring additional disclosures, adoption of this new guidance will not have a material impact on our financial statements.

**3. STOCK-BASED COMPENSATION:**

Stock-based compensation costs are generally based on the fair value calculated from the Black-Scholes option-pricing model on the date of grant for stock options and on the date of enrollment for the Plan. The fair value of stock grants is amortized as compensation expense on a straight-line basis over the vesting period of the grants. Stock options granted to employees are service-based and typically vest over three years.

The fair market values of stock options granted during 2009, 2008 and 2007 were measured on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions:

<b>Year Ended December 31,</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Risk-free interest rate	1.2%-1.8%	1.1%-3.4%	4.4%-5.1%
Expected dividend yield	0%	0%	0%
Expected lives	3.6-9.1 Years	3.6-9.1 Years	3.7-9.1 Years
Expected volatility	92.0%-94.4%	81.0%-90.7%	84.1%-90.6%

The risk-free interest rate is estimated using an average of treasury bill interest rates. The expected dividend yield is zero as the Company has not paid any dividends to date and does not expect to pay dividends in the future. The expected lives are estimated using expected and historical exercise behavior. The expected volatility is estimated using historical calculated volatility.

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The Company is required to estimate potential forfeiture of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures is adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up in the period of change and impact the amount of stock compensation expense to be recognized in future periods.

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A summary of the Company's stock option activity with respect to the years ended December 31, 2009, 2008 and 2007 is presented in the following table:

For the Year Ended December 31,	2009		2008		2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding at beginning of year	7,540,873	\$ 3.34	6,304,453	\$ 4.60	5,571,470	\$ 5.12
Granted	2,727,000	1.10	2,743,607	1.27	1,263,548	2.80
Exercised	(62,711)	1.68	(6,761)	1.31	(11,639)	2.49
Canceled	(1,272,351)	2.72	(1,500,426)	4.82	(518,926)	5.88
Options outstanding at end of year	8,932,811	2.79	7,540,873	3.34	6,304,453	4.60
Exercisable at end of year	5,119,227	\$ 3.94	4,779,603	\$ 4.18	4,497,526	\$ 4.76
Vested at December 31, 2009 and expected to vest	8,856,539	\$ 2.80				

The following table summarizes information about stock options outstanding at December 31, 2009:

Range of Exercise Prices	Number of Shares	Outstanding Options		Exercisable Options	
		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number of Shares	Weighted Average Exercise Price
\$0.60-\$1.09	2,013,950	\$ 0.96	8.54	200,617	\$ 1.06
\$1.10-\$1.39	1,895,430	\$ 1.24	8.64	447,181	\$ 1.28
\$1.42-\$2.53	1,969,357	\$ 2.18	6.29	1,569,524	\$ 2.30
\$2.55-\$5.75	2,106,291	\$ 4.49	3.08	1,954,122	\$ 4.60
\$5.88-\$7.35	947,783	\$ 7.21	4.26	947,783	\$ 7.21
Total	8,932,811	\$ 2.79	6.33	5,119,227	\$ 3.94

The weighted average fair value per share of stock-based payments granted to employees during 2009, 2008 and 2007 was \$1.09, \$1.04 and \$2.27, respectively. During 2009, 2008 and 2007, the total intrinsic value of stock options exercised was \$105,301, \$1,831 and \$4,937, and the total fair value of stock options that vested was \$1,740,000, \$3,040,000 and \$3,661,000, respectively.

As of December 31, 2009, there was \$2,278,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. These costs are expected to be recognized over a weighted-average period of 2.3 years.

During the year ended December 31, 2009, \$76,000 was received for the exercise of stock options. The Company is obligated to issue shares from the 2002 Equity Incentive Plan upon the exercise of stock options. The Company does not currently expect to repurchase shares from any source to satisfy its obligations under the Plan. The Company may issue options to purchase up to an additional 681,995 shares of Common Stock at December 31, 2009 under stock option plans.

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The following are the stock-based compensation costs recognized in the Company's statements of operations:

(in thousands)

	Year Ended December 31, 2009		Year Ended December 31, 2008		Year Ended December 31, 2007	
Research and development	\$	1,192	\$	1,689	\$	1,878
General and administrative		1,182		3,141		3,854
Total	\$	2,374	\$	4,830	\$	5,732

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On March 27, 2007, in connection with his resignation, the Company entered into a Separation and Release Agreement with AVI's former Chairman and Chief Executive Officer. Pursuant to this agreement, he may exercise his previously granted options until the earlier of the termination date specified in the respective stock option grant agreements or March 28, 2010. This modification of these stock options in the first quarter of 2007 increased compensation costs by \$1,057,000.

In the first quarter of 2008, the Company granted 333,000 shares of restricted stock to its new Chief Executive Officer. These shares vest over a period of four years. The Company recognized compensation expense related to these shares of for the years ended December 31, 2009 and 2008, of \$63,000 and \$166,000.

In the third quarter of 2008, the Company's President and Chief Operating Officer resigned. In accordance with his existing employment agreement, he may exercise his previously granted options until the earlier of the termination date specified in the respective stock option grant agreements or March 18, 2010. This acceleration of the vesting of these stock options resulted in additional compensation costs of \$382,000 for the year ended December 31, 2008. As of December 31, 2009, these options were outstanding.

In the second quarter of 2009, the Company granted a total of 25,000 shares of restricted stock to members of its Board of Directors. These shares vest over a period of one year. During year ended December 31, 2009, the Company recognized compensation expense related to these shares of \$58,000.

Also in the second quarter of 2009, the Company granted 100,000 shares of restricted stock to its Vice President of Business Development. These shares vest upon the achievement of certain performance milestones. During the year ended December 31, 2009, the Company did not recognize any compensation expense related to these shares since the performance milestones was not achieved and these shares were canceled.

In the first quarter of 2009, the Company granted 60,000 shares of restricted stock to its Chief Medical Officer. These shares vest over a period of 181 days. During the year ended December 31, 2009 the Company recognized compensation expense related to these shares of \$82,000.

The Company records the fair value of stock options granted to non-employees in exchange for services in accordance with generally accepted accounting principles. The fair value of the options granted is expensed when the measurement date is known. The performance for services was satisfied on the grant date for stock options granted to non-employees.

The total fair value of the options granted to non-employees during the years ended December 31, 2009, 2008 and 2007 was \$141,000, \$180,000 and \$313,000 respectively, which was expensed to general and administration.

#### **4. NET LOSS PER SHARE:**

Basic EPS is calculated using the weighted average number of common shares outstanding for the period and diluted EPS is computed using the weighted average number of common shares and dilutive common equivalent shares outstanding. Given that the Company is in a loss position, there is no difference between basic EPS and diluted EPS since the common stock equivalents would be antidilutive.

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Year Ended December 31, (in thousands)	2009	2008	2007
Net loss	\$ (25,159)	\$ (23,953)	\$ (27,168)
Weighted average number of shares of common stock and common stock equivalents outstanding:			
Weighted average number of common shares outstanding for computing basic earnings per share	93,090	69,491	53,942
Dilutive effect of warrants and stock options after application of the treasury stock method	*	*	*
Weighted average number of common shares outstanding for computing diluted earnings per share	93,090	69,491	53,942
Net loss per share - basic and diluted	\$ (0.27)	\$ (0.34)	\$ (0.50)

\* Warrants and stock options to purchase 41,266,000, 17,665,000 and 20,161,000 shares of common stock as of December 31, 2009, 2008 and 2007, respectively, were excluded from the earnings per share calculation as their effect would have been antidilutive.

## 5. LIQUIDITY:

Since its inception in 1980 through December 31, 2009, the Company has incurred losses of approximately \$275.5 million, substantially all of which resulted from expenditures related to research and development, general and administrative charges and acquired in-process research and development resulting from two acquisitions. The Company has not generated any material revenue from product sales to date, and there can be no assurance that revenues from product sales will be achieved. Moreover, even if the Company does achieve revenues from product sales, the Company expects to incur operating losses over the next several years.

The Company believes it has sufficient cash to fund operations at least through the following twelve months, exclusive of future receipts from billings on existing government contracts. For 2010, the Company expects expenditures for operations, net of government funding, including collaborative efforts and research and development activities to be approximately \$23 to \$27 million. The Company believes it will continue to receive funding from government and other sources to pursue the development of its product candidates, and has assumed certain revenues from these awards in providing this guidance. Should the Company not continue to receive funding from its current contracts or receive additional funding, or should the timing be delayed, it may have a significant negative impact on the Company's guidance.

Our cash, cash equivalents and short-term securities were \$48.4 million at December 31, 2009, compared with \$11.5 million at December 31, 2008, respectively. The increase of \$36.9 million was due primarily to net proceeds of \$47.8 million from the sale of common stock and issuance of stock warrants from two separate equity financing transactions that closed in January and August of 2009. The cash from financing activities was partially offset by cash used in operations of \$8.8 million, costs of \$2.0 million related to acquisitions of patents and fixed assets and debt repayments of \$0.1 million.

In January 2009, we raised net proceeds of \$15.5 million in financing through the sale of 14,224,202 shares of common stock pursuant to a registered direct offering to a select group of institutional investors. The investors also received warrants to purchase 14,224,202 shares of the Company's common stock at an exercise price of \$1.16 per share. These warrants are exercisable starting July 30, 2009 and expire on July 30, 2014. In addition, the placement agent used for the equity financing received a warrant for the purchase of an additional 426,726 common shares at \$1.45 per share. This warrant is exercisable starting January 30, 2009 and expires on January 30, 2014. All of these warrants have been classified as liabilities as discussed in Note 7, as they require the issuance of registered shares. These warrants are non-cash liabilities; the Company is not required to expend any cash to settle these liabilities.

On August 25, 2009, the Company closed a registered equity financing for net proceeds of \$32.3 million with several institutional investors. The Company sold 24,295,775 shares of common stock at \$1.42 per share, and also issued warrants for the purchase of 9,718,310 common shares at an exercise price of \$1.78 per share. These warrants are exercisable starting February 25, 2010 and expire on August 25, 2014. All of these warrants have been classified as liabilities as discussed in Note 7, as they require the issuance of registered shares. These warrants are non-cash liabilities; the Company is not required to expend any cash to settle these liabilities.

The Company currently has a total of \$61.7 million of contracted development studies. As of December 31, 2009, \$48.4 million has been billed to the government. The Company has \$13.3 in development contracts remaining that have not yet been completed and have not been billed. The Company expects to complete the remaining contract activity and receive the contracted revenue in 2010 and early 2011.

In December 2006, the Company announced the execution of a two-year \$28 million research contract with the Defense Threat Reduction Agency (DTRA), an agency of the United States Department of Defense (DoD). The contract is directed toward funding the Company's development of antisense therapeutics to treat the effects of Ebola, Marburg and Junin hemorrhagic viruses, which are seen by DoD as potential

biological warfare and bioterrorism agents. In May 2009, the Company received an amendment from DTRA to extend the contract performance period to November 29, 2009 and a cost modification of an additional \$5.9 million, increasing the total contract amount to \$33.9 million. In September 2009, the Company received a second amendment from DTRA to extend the contract performance period to February 28, 2011 and a cost modification of an additional \$11.5 million, increasing the total contract amount to \$45.4 million. During the twelve month period ended December 31, 2009, 2008 and 2007, the Company recognized \$10.4 million, \$16.8 million and \$8.0 million, respectively, in research contract revenue from this contract. To date, the Company has recognized revenues of \$35.2 million from this contract. Funding of the remainder of the contract is anticipated in 2010 and 2011.

In January 2006, the Company announced that the final version of the 2006 defense appropriations act had been approved, which included an allocation of \$11.0 million to fund the Company's ongoing defense-related programs. Net of government administrative costs, it is anticipated that the Company will receive up to \$9.8 million under this allocation. The Company's technology is expected to be used to continue developing RNA based drugs against Ebola and Marburg viruses. The Company has received signed contracts for all of these projects. The Company expects that funding under these signed contracts will be completed over the next 12 months. During the twelve month period ended December 31, 2009, 2008 and 2007, the Company recognized \$2.3 million, \$4.2 million and \$2.7 million, respectively, in research contract revenue from this contract. To date, the Company has recognized revenues of \$9.2 million on these contracts. Funding of the remainder of these contracts is anticipated in 2010.

In May 2009, the Company entered into a contract with DTRA to develop H1N1 drugs. Under this contract, DTRA will pay up to \$4.1 million to the Company for the work to be performed by the Company. The work will involve the application of analogs based on the Company's proprietary PMO and PMO*plus* antisense chemistry and the Company plans to conduct preclinical development of at least one drug candidate and demonstrate it is effective by testing it in virus infected animals. During the twelve month period ended December 31, 2009, the Company recognized \$1.7 million in revenue under this contract.

In July 2009, the Company entered into a lease agreement with BMR-3450 Monte Villa Parkway LLC relating to the lease of 19,108 square feet of laboratory and office space in Bothell, Washington. The Company began occupying this space in August 2009, and has moved its headquarters and R&D functions to this new location. The term of the lease is approximately 63 months, although the Company has a one-time option to terminate the lease after 3 years time upon payment of a termination fee. The Company will commence paying base rent of approximately \$43,000 per month after approximately 3 months. The amount of base rent is subject to an annual increase of 3%.

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 complex regulatory environment in which the Company operates. There can be no assurance that the Company will ever achieve significant revenues or profitable operations.

## 6. LONG-TERM DEBT

The Company has two loans outstanding which are collateralized by a parcel of real property purchased in April 2007 in Corvallis, Oregon. These loans bear interest at 4.75% and mature in February 2027. At December 31, 2009, these loans had unpaid principal balances of \$1,275,000 and \$726,000, for a total indebtedness of \$2,001,000. The Company incurred interest expense on these loans of \$97,000, \$104,000 and \$104,000, respectively, for the years ended December 31, 2009, 2008 and 2007.

The following table sets forth the expected future principal payments on these loans:

(in thousands)

<b>Year ending December 31,</b>		
2010	\$	77
2011		81
2012		85
2013		90
2014		92
Thereafter		1,576
<b>Total scheduled loan principal payments</b>	<b>\$</b>	<b>2,001</b>

## 7. SHAREHOLDERS EQUITY AND WARRANT LIABILITY:

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In December 2007, the Company closed a private equity financing for net proceeds of \$14,448,250 with several institutional investors. The Company sold 10,696,616 shares of common stock at \$1.90 per share. These investors also received warrants for the purchase of 5,348,308 common shares at \$2.45 per share. These warrants are exercisable starting June 19, 2008 and expire on December 18, 2012.

On January 30, 2009, the Company closed a registered equity financing for net proceeds of \$15.5 million with several institutional investors. The Company sold 14,224,202 shares of common stock at \$1.16 per share, and also issued warrants for the purchase of 14,224,202 common shares at \$1.16 per share and a fair value at the date of issue of \$8.2 million. These warrants are exercisable starting July 30, 2009 and expire on July 30, 2014. In connection with the equity financing, the placement agent received a warrant for the purchase of an additional 426,726 common shares at \$1.45 per share. This warrant is exercisable starting January 30, 2009 and expires on January 30, 2014. All of these warrants have been classified as liabilities as they require the issuance of registered shares. These warrants are non-cash liabilities; The Company does not expect to expend any cash to settle these liabilities.

On August 25, 2009, the Company closed a registered equity financing for net proceeds of \$32.3 million with several institutional investors. The Company sold 24,295,775 shares of common stock at \$1.42 per share, and also issued warrants for the purchase of 9,718,310 common shares at \$1.78 per share and a fair value at the date of issue of \$9.0 million. These warrants are exercisable starting February 25, 2010 and expire on August 25, 2014. All of these warrants have been classified as liabilities as, as they require the issuance of registered shares. These warrants are non-cash liabilities; The Company does not expect to expend any cash to settle these liabilities.

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The Company has two stock option plans, the 2002 Equity Incentive Plan and the 1997 Stock Option Plan (the Plans). The 2002 Plan provides for the issuance of incentive stock options to employees and nonqualified stock options, stock appreciation rights and bonus rights to employees, directors of the Company and consultants. The 1997 Plan provides for the assumption of the ImmunoTherapy Options under the Merger Agreement. The Company has reserved 11,828,111 shares of common stock for issuance under the Plans. Options issued under the Plans generally vest ratably over three years and expire five to ten years from the date of grant. At December 31, 2009, 8,932,811 options were outstanding at a weighted-average exercise price of \$2.79 under equity compensations plans approved by security holders. At December 31, 2009, 681,955 options were available for issuance under equity compensation plans approved by security holders. See Note 3 Stock-Based Compensation for a summary of the status of the Company's stock option plans and changes for the years ended December 31, 2009, 2008 and 2007.

The Company has also issued warrants for the purchase of common stock in conjunction with financing and compensation arrangements. A summary of the status and activity with respect to the Company's warrants is presented in the following table:

For the Year Ended December 31,	2009		2008		2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Warrants outstanding at beginning of year	10,123,759	\$ 8.54	13,856,411	\$ 8.12	8,508,103	\$ 11.68
Granted	24,369,238	1.41	445,985	1.77	5,348,308	2.45
Exercised						
Expired	(2,160,001)	5.00	(4,178,637)	6.42		
Warrants outstanding at end of year	32,332,996	3.40	10,123,759	8.54	13,856,411	8.12
Exercisable at end of year	20,948,808	\$ 1.60	8,457,881	\$ 3.21	6,842,225	\$ 5.85

The following table summarizes information about warrants outstanding at December 31, 2009:

Exercise Price	Outstanding Warrants at December 31, 2009	Weighted Average Remaining Contractual Life (Years)	Exercisable Warrants
\$ 0.0003	16,667	No expiration date	16,667
0.1679	238,228	2.87	238,228
1.14	1,000	No expiration date	1,000
1.16	14,224,202	4.58	14,224,202
1.45	426,726	4.08	426,726
1.78	9,718,310	4.67	0
2.45	5,348,308	2.97	5,348,308
3.61	207,757	0.37	207,757
5.00	485,920	0.37	485,920
35.63	1,665,878	0.25	
	32,332,996		20,948,808

The warrants issued in 2009 and 2007 do not require net cash settlement. However, because the warrants require settlement in registered shares, the Company has recorded the warrants as liabilities on the accompanying balance sheet. There is no effect on cash flows from these warrants, as the mark-to-market adjustment is reflected as a non-cash charge within the Company's Statements of Operations. There were 30,203,466, 9,607,866, and 4,259,558 outstanding warrants classified as liabilities at December 31, 2009, 2008, and 2007, respectively.

**8. SIGNIFICANT AGREEMENTS:**

On January 27, 2007, the Company announced that it had entered into a definitive License Agreement with Chiron Corporation ( Chiron ) granting the Company a nonexclusive license to Chiron's patents and patent applications for the research, development, and commercialization of antisense therapeutics against hepatitis C virus, in exchange for the payment of certain milestone and royalty payments to Chiron. In lieu of the first milestone payment due under the License Agreement, the Company and Chiron also entered into a separate agreement under which the Company issued to Chiron 89,012 shares of the Company's common stock with a market

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value of \$500,000 and which was expensed to research and development. There may be future payments made to Chiron by the Company based on milestones in the License Agreement.

On March 13, 2007, the Company announced that it had entered into agreements with Cook Group Inc. ( Cook ) for Cook's development and commercialization of products for vascular and cardiovascular diseases. In November 2009, we announced that we believe Cook discontinued development of our drug candidate, AVI-5126, on its cobalt-chromium stent because of an unexpectedly high rate of restenosis.

Effective January 1, 2006, the Company extended the lease on its facility located at 4575 SW Research Way, Suite 200, Corvallis, OR 97333. This lease now expires on December 31, 2020. As of December 31, 2005, the Company had an accrued rent payable of \$615,163 related to back rent payments. During the first half of 2006 the Company issued 31,154 shares of the Company's common stock with a market value of \$175,000, paid cash and sold fixed assets to Research Way Investments to pay off the accrued rent payable related to back rent payments.

In January 2006, the Company issued 30,000 shares of the Company's common stock with a market value of \$200,000 to the Oregon State University Foundation to secure access to certain university research facilities, which was expensed to research and development.

On January 8, 2007, the Company announced that it had entered into a cross-license agreement with Eleos Inc. for the development of antisense drugs targeting p53, a well-studied human protein that controls cellular response to genetic damage. Under the terms of the agreement, the Company granted Eleos Inc. an exclusive license to the Company's NEUGENE® third-generation antisense chemistry to treat cancer with p53-related drugs. In return, Eleos Inc. granted an exclusive license to its patents to the Company for treatment of most viral diseases with drugs that target p53. The companies are sharing rights in other medical fields where targeting p53 may be therapeutically useful. Each company will make milestone payments and royalty payments to the other on development and sales of products that utilize technology licensed under the agreement. In addition, Eleos Inc. made an upfront payment of \$500,000 to the Company. The Company recognized \$125,000 in license fees for each of the years ended December 31, 2009, 2008 and 2007; the remaining \$125,000 has been classified as deferred revenue.

On March 27, 2007, in connection with the resignation of AVI's former Chairman and Chief Executive Officer, the Company entered into a Separation and Release Agreement, pursuant to which the former Chairman and CEO is entitled to receive his base compensation for 18 months (\$562,500 in the aggregate) and medical insurance for the same 18 month period and may exercise his previously granted options until the earlier of the termination date of the respective stock option grant agreements or March 28, 2010. The Company recognized \$1,619,872 in total compensation expense to general and administrative in 2007, including \$562,500 in cash compensation and \$1,057,372 in stock-based compensation.

On April 19, 2007, the Company entered into a real property purchase agreement with WKL Investments Airport, LLC ( WKL ) to purchase a parcel of real property, including improvements situated on the land and intangibles related to the land, for \$3,300,000. The Company paid the purchase price as follows: \$350,000 in cash, assumption of two loans secured by the property in the amount of \$2,200,000, and issuance of 270,758 shares of AVI common stock (at \$2.77 per share or \$750,000 in the aggregate).

On October 15, 2007, the Company and Charley's Fund, Inc. announced that the Company had been awarded a \$2.45 million research grant from Charley's Fund, a nonprofit organization that funds drug development and discovery initiatives specific to Duchenne muscular dystrophy (DMD). This award will support a new product development program using proprietary exon skipping technologies developed by the Company to overcome the effects of certain genetic errors in the dystrophin gene. The award will allow AVI to accelerate its development of new therapeutics for DMD. Through December 31, 2009, the Company had received \$2.0 million from Charley's Fund, and recorded the advances as Deferred Revenue, to be recognized upon the attainment of certain milestones as specified in the agreement. In September 2009, the Company

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amended the agreement with Charley's Fund. The Amendment pertains to certain provisions of the Sponsored Research Agreement by and between the Company and Charley's Fund entered into effective October 12, 2007 (the "Agreement"). Under the terms of the Amendment, the Company was awarded up to an additional \$3 million in sponsored research funds, for a total of \$5 million from Charley's Fund to support a new product development program using proprietary exon skipping technologies developed by the Company to overcome the effects of certain genetic errors in the dystrophin gene. Revenue associated with this research and development arrangement is recognized under the proportional performance method, using the payment received method. For the years ended December 31, 2009, 2008 and 2007, the Company recognized \$0, \$23,000 and \$38,000, respectively, in revenues from Charley's Fund.

On September 18, 2008, the Company's President and Chief Operating Officer resigned. In accordance with his employment agreement, he is entitled to receive severance payments totaling \$630,000. Of this amount, one-third (\$210,000) was paid on the effective date of his termination, and the remaining \$420,000 was paid in monthly installments of \$35,000 over the following 12 months. The Company recognized compensation expense of \$630,000 in 2008 pursuant to his resignation, of which \$280,000 was classified as a deferred liability as of December 31, 2008. In 2009 the Company recognized \$315,000 of compensation expense. In addition, in accordance with his employment agreement, he may exercise his previously granted stock options until the earlier of the

termination date specified in the respective stock option grant agreements or March 18, 2010. This acceleration of the vesting of these stock options resulted in additional compensation costs of \$382,419 for the year ended December 31, 2008.

In July 2009, the Company entered into a lease agreement with BMR-3450 Monte Villa Parkway LLC relating to the lease of 19,108 square feet of laboratory and office space in Bothell, Washington. The Company began occupying this space in August 2009, and has moved its headquarters and R&D functions to this new location. The term of the lease is approximately 63 months, although the Company has a one-time option to terminate the lease after 3 years time upon payment of a termination fee. The Company will commence paying base rent of approximately \$43,000 per month after approximately 3 months. The amount of base rent is subject to an annual increase of 3%.

## 9. INCOME TAXES:

As of December 31, 2009 the Company has federal and state net operating loss carryforwards of approximately \$211,108,000 and \$225,611,000, respectively, available to reduce future taxable income, which expire 2009 through 2028. Of these amounts, approximately \$2,007,000 and \$2,046,000, respectively, relate to federal and state net operating losses assumed as part of the Ercole acquisition. Utilization of the Ercole net operating losses is limited to approximately \$425,000 per year. In addition, the Internal Revenue Code rules under Section 382 and related state laws could limit the future use of the remaining net operating losses based on ownership changes and the value of the Company's stock. Approximately \$3,930,000 of the Company's carryforwards were generated as a result of deductions related to exercises of stock options. When utilized, this portion of the Company's carryforwards, as tax affected, will be accounted for as a direct increase to contributed capital rather than as a reduction of the year's provision for income taxes. The principal differences between net operating loss carryforwards for tax purposes and the accumulated deficit result from depreciation, amortization, investment write-downs, treatment of research and development costs, limitations on the length of time that net operating losses may be carried forward, and differences in the recognition of stock-based compensation.

The Company had net deferred tax assets of \$110,539,000 and \$102,881,000 at December 31, 2009 and 2008, respectively, primarily from net operating loss carryforwards and research and development credit carryforwards. A valuation allowance was recorded to reduce the net deferred tax asset to zero because it is more likely than not that the deferred tax asset will not be realized. The net change in the valuation allowance for deferred tax assets was an increase of approximately \$7,658,000 and \$8,250,000 for the years ended December 31, 2009 and 2008, respectively, mainly due to the increase in the net operating loss carryforwards, research and development tax credits, and a decrease in the asset related to short term securities due to the expiration of the capital loss carryforward period as of December 31, 2009.

Deferred tax assets assumed as part of the Ercole acquisition total approximately \$1,407,000 and primarily relate to accrual to cash adjustment, net operating losses, and research & development credits. A valuation allowance was recorded to reduce the net deferred tax assets to zero because it is more likely than not that the deferred tax asset will not be realized. When such deferred tax assets are utilized or at such time when the valuation allowance is lifted, this portion of the Company's deferred tax assets, as tax affected, will be accounted for as a direct increase to equity rather than as a reduction of that year's provision for income taxes.

An analysis of the deferred tax assets (liabilities) is as follows:

December 31, (in thousands)	2009	2008
Net operating loss carryforwards	\$ 83,057	\$ 75,509
Difference in depreciation and amortization	2,544	2,276

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Capital loss carryforward	8	8
Research and development tax credits	18,436	20,404
stock compensation	4,197	3,326
Stock options for consulting services	1,012	957
Deferred Rent	378	244
Deferred Revenue	805	
Other	102	157
	110,539	102,881
Valuation allowance	(110,539)	(102,881)
	\$	\$

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The Company's policy is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accrual for interest or penalties on its balance sheet at December 31, 2009 and at December 31, 2008, and has not recognized interest and/or penalties in the statement of operations for the years ended December 31, 2009, 2008 or 2007.

**10. COMMITMENTS AND CONTINGENCIES:**

*Lease Obligations*

The Company leases office and laboratory facilities under various noncancelable operating leases through December 2020. Rent expense under these leases was \$1,467,000, \$1,429,000 and \$1,388,000 for the years ended December 31, 2009, 2008 and 2007, respectively, and \$12,837,000 for the period from July 22, 1980 through December 31, 2009.

At December 31, 2009, the aggregate non-cancelable future minimum payments under these leases are as follows:

(in thousands)

<b>Year ending December 31,</b>		
2010	\$	2,073
2011		2,175
2012		2,230
2013		2,036
2014		2,033
Thereafter		9,135
<b>Total minimum lease payments</b>	<b>\$</b>	<b>19,682</b>

*Royalty Obligations*

The Company has license agreements for which it is obligated to pay the licensors a minimum annual royalty. Royalty payments under these agreements were \$75,000, \$75,000 and \$125,000 for the years ended December 31, 2009, 2008 and 2007, respectively, and \$1,259,000 for the period from July 22, 1980 through December 31, 2009.

At December 31, 2009, the aggregate future minimum royalty payments under these agreements are as follows:

( in thousands)

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Year ending December 31,		
2010	\$	100
2011		80
2012		80
2013		80
2014		55
Thereafter		715
Total minimum royalty payments	\$	1,110

*Litigation*

In the ordinary course of business, the Company defends its patents as deemed necessary. There are no material asserted claims as of 12/31/09.

**11. FINANCIAL INFORMATION BY QUARTER (UNAUDITED):**

2009 for quarter ended (in thousands)	December 31	September 30	June 30	March 31
Revenues from grants and research contracts	\$ 5,141	\$ 6,349	\$ 2,945	\$ 3,150
Operating expenses:				
Research and development	6,624	7,473	5,804	4,495
General and administrative	2,470	1,800	2,206	2,220
Operating loss	(3,953)	(2,924)	(5,065)	(3,565)
Other income (loss):				
Interest income, net	(312)	(127)	(31)	16
Increase (decrease) on warrant valuation	7,791	(5,039)	(14,572)	2,622
Net income (loss)	\$ 3,526	\$ (8,090)	\$ (19,668)	\$ (927)
Net income (loss) per share basic	\$ 0.03	\$ (0.08)	\$ (0.23)	\$ (0.01)
Net income (loss) per share diluted	\$ 0.03	\$ (0.08)	\$ (0.23)	\$ (0.01)
Shares used in per share calculations basic	110,266	95,261	85,664	80,759
Shares used in per share calculations diluted	125,647	95,261	85,664	80,759

2008 for quarter ended (in thousands)	December 31	September 30	June 30	March 31
Revenues from grants and research contracts	\$ 5,479	\$ 5,171	\$ 4,983	\$ 5,625
Operating expenses:				
Research and development	5,070	7,680	7,678	6,903
General and administrative	3,303	3,429	2,184	2,553
Acquired in process research and development				9,916
Operating loss	(2,894)	(5,938)	(4,879)	(13,747)
Other income (loss):				
Interest income, net	36	60	81	167
Increase (decrease) on warrant valuation	1,718	(169)	3,047	(1,435)
Net income (loss)	\$ (1,140)	\$ (6,047)	\$ (1,751)	\$ (15,015)
Net income (loss) per share basic	\$ (0.01)	\$ (0.08)	\$ (0.02)	\$ (0.23)
Net income (loss) per share diluted	\$ (0.01)	\$ (0.08)	\$ (0.02)	\$ (0.23)
Shares used in per share calculations basic	71,074	71,151	70,986	65,189
Shares used in per share calculations diluted	71,074	71,151	70,986	65,189

**12. SUBSEQUENT EVENTS (UNAUDITED):**

- On March 18, 2010, Michael Casey announced to the Board of Directors his decision to not stand for re-election at the end of his term as a director of the Company. On March 24, 2010, Dr. Christopher Henney announced to the Board of Directors his decision to not stand for re-election at the end of his term as a director of the Company. Both decisions were based solely on personal reasons, and was not the result of any disagreement with the Company on any matter relating to the Company's operations, policies, or practices. Both will remain a director through the end of his current term which ends following the 2010 Annual Meeting of the Company's shareholders.

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- On March 25, 2010, AVI BioPharma, Inc. ( AVI or the Company ) entered into an amendment to its contract with the U.S. Defense Threat Reduction Agency ( DTRA ) to develop, in cooperation with the Transformational Medical Technologies Initiative ( TMTI ) of the U.S. Department of Defense, one or more of AVI s nucleotide-based drug candidates targeting the pandemic H1N1 influenza virus (swine flu) and demonstrate efficacy in an appropriate preclinical model. The material terms of the original contract between DTRA and the Company were previously disclosed by the Company in the Company s Current Report on Form 8-K filed with the U.S. Securities and Exchange Commission on May 11, 2009.

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Under the contract entered into by the Company in May 2009, DTRA agreed to pay up to \$5.1 million to the Company for the work to be performed by the Company, which amount was ultimately finalized at \$4.1 million. The amendment entered into on March 25, 2010 provides up to \$4.0 million in additional DTRA funding to support continued preclinical development of AVI's lead influenza drug candidate, AVI-7367, against H1N1 as well as its expanded preclinical evaluation against H5N1 (avian flu) and drug resistant H1N1 and H3N2 flu strains. AVI's lead influenza drug candidate utilizes AVI's proprietary PMO *plus* chemistry.

- On April 14, 2010, at the 2010 American Academy of Neurology Annual Meeting, AVI BioPharma, Inc. ( AVI or the Company ) presented the poster entitled *AVI-5038: Initial Efficacy and Safety Evaluation in Cynomolgus Monkeys*.

AVI-5038 is AVI's lead pre-clinical PPMO, or peptide-conjugated phosphorodiamidate morpholino oligomer, drug candidate for the potential treatment of Duchenne muscular dystrophy (DMD) and is intended to cause a skip of exon 50 in the gene coding for the protein dystrophin. PPMOs are one of a series of different chemical analogs being developed from AVI's core PMO, or phosphorodiamidate morpholino oligomer, chemistry.

The American Academy of Neurology poster includes previously reported data of a preclinical study in which cynomolgus monkeys were dosed intravenously for four weeks with AVI-5038 given up to 9mg/kg. In that study, the candidate drug appeared to be well tolerated with findings generally limited to the kidney, and included basophilic granule accumulation and evidence of tubular degeneration/regeneration that was dose dependent. Clinical chemistry and urinalysis did not detect a change in kidney function. Significant levels of exon skipping were detected by RT-PCR in the diaphragm, heart and quadriceps after four weeks of dosing at 9mg/kg.

A preliminary summary of the findings from an ongoing 12-week preclinical study in which cynomolgus monkeys were dosed intravenously with AVI-5038 at doses of 1.5, 6 and 15mg/kg was also presented. Significant toxicological findings were observed following bolus intravenous administration at 6 and 15mg/kg. The preliminary results suggest that the toxicities seen in this study are also dose dependent and primarily involve the kidney. The in life portion of the study is complete, but the collection and analysis of data from the study is still ongoing. The Company believes that the data set is not yet sufficient to determine the ultimate impact these findings might have on the future development of AVI-5038.

PPMOs are chemically distinct from PMOs. AVI-4658 is AVI's lead PMO drug candidate for the potential treatment of DMD by skipping exon 51. AVI-4658 is currently being evaluated in an ongoing Phase 1b/2 clinical trial at two sites in the United Kingdom and has been generally well tolerated to date in all patients dosed up to 20mg/kg for 12 weeks.

- On April 20, 2010, the Company entered into a Settlement Agreement with George W. Haywood ( Mr. Haywood ), Cheryl Haywood ( Ms. Haywood ), Rockall Emerging Markets Master Fund Limited (the Fund ), Meldrum Asset Management, LLC ( Meldrum ), Con Egan ( Mr. Egan ) and Conor O Driscoll ( Mr. O Driscoll ) ( Mr. Haywood , Ms. Haywood , the Fund , Meldrum , Mr. Egan and Mr. O Driscoll Shareholder Party and, collectively, the Shareholder Group ). The Shareholder Group had previously requested that the Company call a special shareholders meeting to (1) remove certain members of the Company's board of directors ( Board ) and (2) elect new directors to the Board to fill vacancies left by removal of directors. The Settlement Agreement memorializes certain actions taken by the Board of Directors, including, among other things, (i) requesting the resignation of Leslie Hudson as the Company's Chief Executive Officer and President, and as a director, (ii) amending the Company's Bylaws to reduce the size of the Board and to clarify that a nominee appointed by the Board to fill a vacancy would serve the remainder of the term of such seat, (iii) appointing J. David Boyle II, the Company's current Senior Vice President and Chief Financial Officer, as the Company's Interim Chief Executive Officer and President, (iv) appointing Anthony R. Chase to serve as a director of the Company to fill the vacancy created by Dr. Hudson's resignation from the Board, (v) appointing Mr. Chase to the Nominating and Corporate Governance Committee and (vi) accepting the resignation of one of the Company's directors, K. Michael Forrest, to facilitate the reduction in Board size as a result of the Bylaw amendment.

- As the Board of Directors requested that Leslie Hudson, PhD, the Company's Chief Executive Officer and President, tender his resignation as the Company's Chief Executive Officer and President, such resignation is being treated as an involuntary termination of his employment without Cause for purposes of Section 13(d) of the Employment Agreement dated February 8, 2008 between the Company and Dr. Hudson (the Employment Agreement). In connection with his resignation, on April 20, 2010, the Company entered into a separation agreement with Dr. Hudson (the Separation Agreement), the terms of which were previously negotiated pursuant to the Employment Agreement. Pursuant to the terms of the Separation Agreement, Dr. Hudson will receive total cash severance payments of \$1,412,170.00 (the Cash Severance Payments), calculated by reference to two (2) times the sum of: (i) his annual base salary in effect as of the Separation Date (\$494,400), (ii) the average of his last two annual bonuses (\$188,669), and (iii) the annual cost of Pfizer retiree healthcare coverage for him and his spouse (\$23,016). The Cash Severance Payments will be made to Dr. Hudson in twenty-four (24) equal monthly

installments, less required deductions and withholdings, over the twenty-four (24) month period following the effective date of the Separation Agreement. In addition, as of the effective date of the Separation Agreement, all previously granted options to Dr. Hudson became fully vested and exercisable until October 20, 2010 and all shares of restricted stock granted to Dr. Hudson not released for the Company's repurchase option were released from such repurchase option. The aggregate number of unvested shares subject to previously granted options that became fully vested and exercisable as of April 20, 2010 was one million one hundred sixty-six thousand eight hundred thirty-three (1,166,833). The following table identifies the options held by Dr. Hudson as of April 20, 2010, and how many shares were vested and unvested under each option granted to Dr. Hudson immediately prior to the acceleration of all unvested options provided for in Dr. Hudson's Employment Agreement and Separation Agreement:

<b>Date of Option Grant</b>	<b>Number of Shares Subject to the Option</b>	<b>Exercise Price</b>	<b>Number of Options Vested as of April 20, 2010</b>	<b>Number of Unvested Options Accelerated as of April, 20, 2010</b>	<b>Termination of Exercise Period</b>
February 8, 2008	667,000	\$ 1.09	333,500	333,500	October 20, 2010
February 10, 2009	350,000	\$ 0.92	116,667	233,333	October 20, 2010
February 9, 2010	600,000	\$ 1.45	0	600,000	October 20, 2010
<b>Total</b>	<b>1,617,000</b>		<b>450,167</b>	<b>1,166,833</b>	<b>October 20, 2010</b>

An additional one hundred sixteen thousand five hundred (116,500) shares of restricted stock were released from the Company's repurchase option as of April 20, 2010.

- On April 20, 2010, the Board of Directors appointed J. David Boyle II, 56, the Company's current Senior Vice President and Chief Financial Officer as its Interim Chief Executive Officer and President, to serve at the pleasure of the Board of Directors. Mr. Boyle will continue in his position as Chief Financial Officer. As a result of this interim appointment, Mr. Boyle's salary has been increased by \$3,000 per month while serving as the Interim Chief Executive Officer and President, his bonus target percentage for 2010 has been increased to forty percent (40%), and he has been granted a fully vested option on April 20, 2010 to acquire 50,000 shares of the Company's common stock at an exercise price of \$1.24.

- On April 20, 2010, the Board of Directors appointed Anthony R. Chase as a Group II Director to fill the vacancy on the Board left by the resignation of Leslie Hudson. The Board also designated Mr. Chase as an independent member of the Board. The Shareholder Group submitted Mr. Chase's name for consideration by the Company's Nominating and Corporate Governance Committee and the Board. Mr. Chase was granted an option pursuant to the Company's 2002 Equity Incentive Plan to acquire 60,000 shares of the Company's Common Stock, at an exercise price of \$1.24, with a four-year vesting period commencing on the grant date of April 20, 2010 (the Grant Date), 1/4th of the shares vest and become exercisable on the earlier of one year after the Grant Date or the commencement of the next succeeding annual meeting of shareholders; 1/4th of the shares vest and become exercisable on the earlier of two years after the Grant Date or the commencement of the next succeeding annual meeting of shareholders, 1/4th of the shares vest and become exercisable on the earlier of three years after the Grant Date or the commencement of the next succeeding annual meeting of shareholders and 1/4th of the shares vest and become exercisable on the earlier of four years after the Grant Date or the commencement of the next succeeding annual meeting of shareholders. Mr. Chase will hold office for the remainder of the term of a Group II director and until such director's successor shall have been elected and qualified.