AVI BIOPHARMA INC
Form 10-Q
August 09, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from to

Commission file number 001-14895

AVI BIOPHARMA, INC.

(Exact name of registrant as specified in its charter)

Oregon	**93-0797222**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3450 Monte Villa Parkway, Suite 101, Bothell, Washington	**98021**
(Address of principal executive offices)	(Zip Code)

Issuer s telephone number, including area code: (**425) 354-5038**

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 x No o

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 o No x

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 o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock with $0.0001 par value	**111,959,610**
(Class)	(Outstanding as of August 6, 2010)

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

AVI BIOPHARMA, INC.

(A Development Stage Company)

BALANCE SHEETS

(unaudited)

(in thousands, except per share data)

	June 30, 2010	December 31, 2009
Assets		
Current Assets:		
Cash and cash equivalents	$ 36,742	$ 48,275
Accounts receivable	2,153	2,085
Other current assets	1,037	950
Total Current Assets	39,932	51,310
Property held for sale	2,372	2,372
Property and Equipment, net of accumulated depreciation and amortization of $14,393 and $14,026	2,184	2,466
Patent Costs, net of accumulated amortization of $1,829 and $1,762	4,068	3,759
Other assets	111	120
Total Assets	$ 48,667	$ 60,027
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable	$ 2,369	$ 1,381
Accrued employee compensation	1,837	922
Long-term debt, current portion	79	77
Warrant valuation	29,540	27,609
Deferred revenue	3,366	3,428
Other liabilities	77	90
Total Current Liabilities	37,268	33,507
Commitments and Contingencies		
Long-term debt, non-current portion	1,883	1,924
Other long-term liabilities	1,075	966
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; 110,339,777 and 110,495,587 issued and outstanding		11		11
Additional paid-in capital		301,139		299,088
Deficit accumulated during the development stage		(292,709)		(275,469)
Total Shareholders Equity		8,441		23,630
Total Liabilities and Shareholders Equity	$	48,667	$	60,027

See accompanying notes to financial statements.

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AVI BIOPHARMA, INC.

(A Development Stage Company)

STATEMENTS OF OPERATIONS

(unaudited)

(in thousands, except per share amounts)

	Three months ended June 30, 2010	2009	Six months ended June 30, 2010	2009	July 22, 1980 (Inception) through June 30, 2010
Revenues from license fees, grants and research contracts	$ 3,997	$ 2,945	$ 5,201	$ 6,095	$ 65,010
Operating expenses:					
Research and development	6,931	5,804	13,020	10,299	243,452
General and administrative	4,733	2,206	7,577	4,426	81,597
Acquired in-process research and development					29,461
Operating loss	(7,667)	(5,065)	(15,396)	(8,630)	(289,500)
Other non-operating (loss) income:					
Interest (expense) income and other, net	51	(31)	87	(15)	8,410
(Increase) decrease on warrant valuation	(9,040)	(14,572)	(1,931)	(11,950)	1,519
Realized gain on sale of short-term securities available-for-sale					3,863
Write-down of short-term securities available-for-sale					(17,001)
	(8,989)	(14,603)	(1,844)	(11,965)	(3,209)
Net loss and comprehensive loss	$ (16,656)	$ (19,668)	$ (17,240)	$ (20,595)	$ (292,709)
Net loss per share - basic and diluted	$ (0.15)	$ (0.23)	$ (0.16)	$ (0.25)	
Weighted average number of common shares outstanding for computing basic and diluted loss per share (in thousands)	110,383	85,664	110,404	83,235	

See accompanying notes to financial statements.

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AVI BIOPHARMA, INC.

(A Development Stage Company)

STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Six months ended June 30, 2010	2009	For the Period July 22, 1980 (Inception) through June 30, 2010
Cash flows from operating activities:			
Net loss and comprehensive loss	$ (17,240)	$ (20,595)	$ (292,709)
Adjustments to reconcile net loss to net cash flows used in operating activities:			
Depreciation and amortization	698	723	18,380
Loss on disposal of assets	237	221	1,542
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 real estate owned			928
Stock-based compensation	2,031	1,081	24,728
Conversion of interest accrued to common stock			8
Acquired in-process research and development			29,461
Increase (decrease) on warrant valuation	1,931	11,950	(1,519)
(Increase) decrease in:			
Accounts receivable and other current assets	(143)	1,446	(3,043)
Net increase in accounts payable, accrued employee compensation, and other liabilities	1,938	(831)	7,212
Net cash used in operating activities	(10,548)	(6,005)	(201,874)
Cash flows from investing activities:			
Purchase of property and equipment	(340)	(142)	(18,209)
Patent costs	(622)	(555)	(7,865)
Purchase of marketable securities		114	(112,986)
Sale of marketable securities			117,724
Acquisition costs	(3)		(2,392)
Net cash used in investing activities	(965)	(583)	(23,728)
Cash flows from financing activities:			
Proceeds from sale of common stock, warrants, and partnership units, net of offering costs, and exercise of options and warrants	19	15,513	262,956
Repayments of long-term debt	(39)	(37)	(226)
Buyback of common stock pursuant to rescission offering			(289)
Withdrawal of partnership net assets		(43)	(177)
Issuance of convertible debt			80
Net cash provided by (used in) financing activities	(20)	15,433	262,344
Increase (decrease) in cash and cash equivalents	(11,533)	8,845	36,742
Cash and cash equivalents:			

Beginning of period	48,275	11,192	
End of period	$ 36,742	$ 20,037	$ 36,742
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for interest	$ 47	$ 48	$ 352
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES AND FINANCING ACTIVITIES:			
Short-term securities available-for-sale received in connection with the private offering	$	$	$ 17,897
Issuance of common stock and warrants in satisfaction of liabilities	$	$	$ 545
Issuance of common stock for building purchase	$	$	$ 750
Assumption of long-term debt for building purchase	$	$	$ 2,200
Issuance of common stock for Ercole assets	$	$	$ 8,075
Assumption of liabilities for Ercole assets	$	$	$ 2,124

See accompanying notes to financial statements.

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AVI BIOPHARMA, INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements reflect the accounts of AVI BioPharma, Inc. (the Company) and its consolidated subsidiaries. The accompanying unaudited condensed consolidated balance sheet data as of December 31, 2009 was derived from audited financial statements not included in this report. The accompanying unaudited condensed consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements.

Management has determined that the Company operates one segment: the development of pharmaceutical products on its own behalf or in collaboration with others.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting only of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2009. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full year.

Estimates and Uncertainties

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

Commitments and Contingencies

As of the date of this report, the Company is not a party to any material legal proceedings with respect to itself, its subsidiaries, or any of its material properties. In the normal course of business, the Company may from time to time be named as a party to various legal claims, actions and complaints, including matters involving employment, intellectual property, effects from the use of therapeutics utilizing its 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.

Note 2. Fair Value Measurements

The Company measures at fair value certain financial assets and liabilities in accordance with 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. There are three levels of inputs that may be used to measure fair-value:

- 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.

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

	Fair Value Measurement as of June 30, 2010			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Cash equivalents	$ 36,742	$ 36,742		
Other current assets	457		$ 457	
Total assets	$ 37,199	$ 36,742	$ 457	$

	Fair Value Measurement as of June 30, 2010			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Warrants	$ 29,540			$ 29,540
Total liabilities	$ 29,540	$	$	$ 29,540

	Fair Value Measurement as of December 31, 2009			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Cash equivalents	$ 48,275	$ 48,275		
Other current assets	455		$ 455	
Total assets	$ 48,730	$ 48,275	$ 455	$

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

A reconciliation of the change in value of the Company s warrants for the three months ended June 30, 2010 is as follows:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) (in thousands)
Balance at March 31, 2010	$ 20,500
Change in value of warrants	9,040
Balance at June 30, 2010	$ 29,540

A reconciliation of the change in value of the Company s warrants for the six months ended June 30, 2010 is as follows:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

		(in thousands)
Balance at December 31, 2009	$	27,609
Change in value of warrants		1,931
Balance at June 30, 2010	$	29,540

See Note 6 Warrants for additional information related to the determination of fair value of the warrants. The carrying amounts reported in the balance sheets for cash, 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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Note 3. Property Held for Sale

The Company has decided to outsource its large scale manufacturing activities. As a result, the Company has listed for sale at a sales price of $2.5 million an industrial property located in Corvallis, Oregon where it had previously intended to manufacture its product candidates and products. Selling and closing expenses are estimated to be $0.1 million. The Company has used a Level 3 fair value measure with the use of an independent appraisal to value this property.

Note 4. U.S. Government Contracts

In the periods presented, substantially all of the revenue generated by the Company was derived from research contracts with the U.S. government. As of June 30, 2010, the Company had contracts with the U.S. government pursuant to which its is entitled to receive up to an aggregate of $83.7 million for development of its product candidates, of which $53.5 million had been billed to the U.S. government and $30.2 million of which relates to development that has not yet been completed and has not been billed. The following is a description of such contracts.

January 2006 Agreements (Ebola and Marburg Host Factors, Dengue, Anthrax and Ricin)

In January 2006, the final version of the 2006 defense appropriations act was enacted, which act included an allocation of $11.0 million to fund the Company s ongoing defense-related programs under certain executed contracts. 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. As of June 30, 2010, the Company has recognized revenue of $9.7 million with respect to these contracts.

December 2006 Agreement (Ebola, Marburg and Junín Viruses)

In December 2006, the Company entered into a two-year research contract with Defense Threat Reduction Agency (DTRA), an agency of the U.S. Department of Defense (the DoD), pursuant to which the Company was entitled to $28.0 million to fund its development of antisense therapeutics to treat the effects of Ebola, Marburg and Junín hemorrhagic fever viruses. In May 2009, this contract was amended to extend the term of the contract until November 2009 and to increase funding by $5.9 million to an aggregate of $33.9 million. In June 2009, the contract was amended again to extend the term of the contract to February 2011 and to increase funding by an additional $11.5 million to an aggregate of $45.4 million. As of June 30, 2010, the Company has recognized revenue of $37.8 million with respect to this contract.

May 2009 Agreement (H1N1/Influenza)

In May 2009, the Company entered into a contract with DTRA to develop swine flu drugs. Under this contract, DTRA will pay up to $4.1 million to the Company for the work involving the application of 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 on animals. In March 2010, the contract was amended to include testing against additional influenza strains including H5N1 (avian flu), Tamiflu®-resistant H1N1 (swine flu) and H3N2 (seasonal flu) and funding increased by $4.0 million to an aggregate of $8.1 million. As of June 30, 2010, the Company has recognized revenue of $3.2 million with respect to this contract.

June 2010 Agreement (H1N1/Influenza)

On June 4, 2010, the Company entered into a contract with the DTRA to advance the development of AVI-7100, which was previously designated AVI-7367 and which has been renumbered by the Company, as a medical countermeasure against the pandemic H1N1 influenza virus in cooperation with the Transformational Medical Technologies program (TMT) of the DoD. The contract provides for funding of up to $18 million to advance the development of AVI-7100, including studies enabling an Investigational New Drug (IND) application with the U.S. Food and Drug Administration (FDA), the development of an intranasal delivery formulation, and the funding of a Phase 1 clinical program to obtain human safety data to support potential use under an Emergency Use Authorization. As of June 30, 2010, the Company has recognized revenue of $0.4 million with respect to this contract.

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The following table sets forth the impact on revenue of each of the contracts with the U.S. government on the Company s results of operations for the three and six months ended June 30, 2010 and 2009.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands)		(in thousands)	
January 2006 Agreements *(Ebola and Marburg host factor, Dengue, Anthrax and Ricin)*	$ 147	$ 243	$ 468	$ 1,623
December 2006 Agreement *(Ebola, Marburg and Junín Viruses)*	2,063	1,333	2,608	3,066
May 2009 Agreement *(H1N1)*	1,187	356	1,444	356
June 2010 Agreement *(H1N1)*	433		433	
Other Agreements	167	1,013	248	1,050
Total	$ 3,997	$ 2,945	$ 5,201	$ 6,095

Note 5. Stock Compensation

Valuation Assumptions

Stock-based compensation costs are based on the fair value calculated from the Black-Scholes option-pricing model on the date of grant for stock options. 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 the periods presented were measured on the date of grant using the Black-Scholes option-pricing model, with the following assumptions:

	Three and Six Months Ended June 30,	
	2010	2009
Risk-free interest rate	1.9%-2.8%	1.2%-1.4%
Expected dividend yield	0%	0%
Expected lives	5.3-5.8 years	9.0 years
Expected volatility	83.3%-87.9%	92.0%-92.8%

The risk-free interest rate is estimated using an average of treasury bill interest rates that correlate to the prevailing interest rates at the time of grant. 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 of the Company s common stock. The amounts estimated according to the Black-Scholes option pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

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.

Stock Options

The Company sponsors a 2002 Equity Incentive Plan (the Plan) pursuant to which it may issue options to purchase its common stock to the Company s employees, directors and service providers. In general, stock options granted under the Plan vest over a three year period, with one-third of the underlying shares vesting on each anniversary of grant, and have a ten year term. As of June 30, 2010, 2,425,755 shares of common stock remain available for future grant under the Plan.

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A summary of the Company s stock option compensation activity with respect to the six months ended June 30, 2010 follows:

Stock Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2009	8,932,811	$ 2.79		
Granted	2,641,365	1.43		
Exercised	(16,955)	1.11		
Canceled or expired	(2,195,253)	4.52		
Outstanding at June 30, 2010	9,361,968	2.00	5.97	$ 2,394,171
Vested at June 30, 2010 and expected to vest	9,200,698	2.01	5.91	2,351,800
Exercisable at June 30, 2010	5,469,467	2.47	3.80	1,231,691

The weighted-average fair value per share of stock-based awards, including stock options and restricted stock grants, granted to employees during the six months ended June 30, 2010 and 2009 was $1.03 and $0.87, respectively. During the same periods, the total intrinsic value of stock options exercised was $4,278 and $1,991, respectively, and the total fair value of stock options that vested was $2,288,000 and $973,000, respectively. The total fair value of stock options vested for the three months ended June 30, 2010 and 2009 was $1,629,000 and $456,000, respectively.

Restricted Stock Awards

In the three period ended June 30, 2010, the Company granted a total of 20,000 shares of restricted stock to members of its Board of Directors. These shares vest over a period of approximately one year. During the three and six month periods ended June 30, 2010, the Company recognized compensation expense related to these shares of $3,000.

In the three months ended June 30, 2009, the Company granted 25,000 shares of restricted stock to members of its Board of Directors. These shares vest over a period of one year. During the three and six months ended June 30, 2009, the Company recognized compensation expense related to these shares of $0 and $3,000, respectively.

Also in the three months ended June 30, 2009, the Company granted 100,000 shares of restricted stock to its Chief Business Officer. These shares vest upon the achievement of certain performance milestones. During the three and six months ended June 30, 2009, the Company did not recognize any compensation expense related to these shares as the achievement of the performance milestones was not considered probable and the restricted stock was cancelled.

In the three months ended March 31, 2009, the Company granted 60,000 shares of restricted stock to its Chief Medical Officer. These shares vested over a period of 181 days. During the three and six months ended June 30, 2009 the Company recognized compensation expense related

to these shares of $41,000 and $70,000, respectively.

In the three months ended March 31, 2008, the Company granted 333,000 shares of restricted stock to its former Chief Executive Officer. Of these shares, 100,000 vested immediately and the remaining 233,000 vest over a period of four years. In April 2010, the former Chief Executive Officer tendered his resignation at the request of the Board of Directors and pursuant to the terms of the related separation agreement, 116,500 shares of previously granted restricted stock immediately became fully vested and exercisable at the effective date of the separation agreement. During the three months ended June 30, 2010 and 2009, the Company recognized compensation expense related to these shares of $118,000 and $16,000, respectively. During the six month periods ended June 30, 2010 and 2009, the Company recognized compensation expense related to these shares $134,000 and $35,000, respectively.

	Restricted Stock Awards	Weighted-Average Grant Date Fair Value
	(in thousands)	
Balance as of December 31, 2009	300	$ 1.09
Granted	20	1.30
Vested	(200)	1.09
Forfeited or canceled	(100)	1.10
Balance as of June 30, 2010	20	$ 1.30

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The weighted-average grant-date fair value of restricted stock awards is based on the market price of the Company s common stock on the date of grant. The grant-date fair value of the restricted stock award made during the three and six months ended June 30, 2010 was $1.30. The grant-date fair value of the restricted stock awards made during the three and six month periods ended June 30, 2009 was $1.10 and $1.01, respectively. The total grant-date fair values of restricted stock awards that vested during the six months ended June 30, 2010 and June 30, 2009 were approximately $219,000 and $303,000, respectively.

Stock-based Compensation Expense

The amount of stock-based compensation expense recognized in the three months ended June 30, 2010 and 2009 related to stock options was $1,605,000 and $456,000, respectively. For the six months ended June 30, 2010 and 2009, stock-based compensation expense was $2,031,000 and $1,081,000, respectively. A summary of the stock based compensation expense recognized in the statement of operations is as follows:

	Three Months Ended	
	June 30, 2010	June 30, 2009
	(in thousands)	
Research and development	$ 216	$ 272
General and administrative	1,389	184
Total	$ 1,605	$ 456

The following are the stock-based compensation expense recognized in the Company s statements of operations for the six months ended June 30, 2010 and 2009:

	Six Months Ended	
	June 30, 2010	June 30, 2009
	(in thousands)	
Research and development	$ 415	$ 628
General and administrative	1,616	453
Total	$ 2,031	$ 1,081

As of June 30, 2010, there was $3,150,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements, including stock options and restricted stock, granted under the Plan. These costs are expected to be recognized over a weighted-average period of 2.02 years.

On April 20, 2010, the Company s Chief Executive Officer and President, Leslie Hudson, Ph.D., tendered his resignation at the request of the Board of Directors. Pursuant to the terms of the separation agreement between Dr. Hudson and the Company, unvested options previously granted to Dr. Hudson to purchase 1,166,833 shares of common stock and 116,500 shares of restricted stock immediately became fully vested and exercisable at the effective date of the separation agreement. The Company recorded a charge of stock compensation expense of $1,181,292 as a result of the accelerated vesting of these shares in the second quarter of 2010.

Note 6. Warrants

Warrants issued in connection with the Company s December 2007, January 2009, and August 2009 financings are classified as liabilities as opposed to equity due to their settlement terms. These warrants are non-cash liabilities; the Company is not required to expend any cash to settle these liabilities.

The fair market value of these warrants was recorded on the balance sheet at issuance and the warrants are marked to market at each financial reporting period, with changes in the fair value recorded as a gain or loss in the statement of operations. The fair value of the warrants is determined using the Black-Scholes option-pricing model, which requires the use of significant judgment and estimates for the inputs used in the model. The following reflects the weighted-average assumptions for each of the periods indicated:

	Three and Six Months Ended June 30,	
	2010	**2009**
Risk-free interest rate	0.1%-2.6%	0.2%-2.4%
Expected dividend yield	0%	0%
Expected lives	0.1-4.4 years	0.1-5.0 years
Expected volatility	62.3%-95.8%	83.2%-140.6%
Shares underlying warrants classified as liabilities	29,717,546	22,645,157

	Three and Six Months Ended June 30,	
	2010	**2009**
Market value of stock at beginning of year	$ 1.58	$ 0.66
Market value of stock at end of period	1.61	1.58
Weighted average exercise price	1.59	4.18

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The risk-free interest rate is estimated using an average of treasury bill interest rates that correlate to the prevailing interest rates at the time of issuance. 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 volatility of the Company s common stock, taking into account factors such as future events or circumstances that could impact volatility. The amounts estimated according to the Black-Scholes option pricing model may not be indicative of the actual values realized upon the exercise of these warrants by the holders.

All other warrants issued by the Company other than the warrants issued in connection with its December 2007, January and August 2009 financings are classified as permanent equity in accordance with GAAP; the fair value of the warrants was recorded as additional paid-in capital and no further adjustments are made. For the three months ended June 30, 2010 and 2009, 255,895 and 2,129,530 shares, respectively, were underlying such warrants.

A summary of the Company s warrant activity with respect to the six months ended June 30, 2010 is as follows:

Warrants	Shares	Weighted Average Exercisable Price	Weighted Average Remaining Contractual Term
Outstanding at January 1, 2010	32,332,996	$ 3.40	
Granted			
Canceled or expired	(2,359,555)	26.50	
Outstanding at June 30, 2010	29,973,441	1.59	3.81

Note 7. Earnings Per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding. Diluted net loss per share is computed by dividing net loss by the weighted-average number of common shares and dilutive common stock equivalent shares outstanding. Given that the Company was in a loss position for each of the periods presented, there is no difference between basic and diluted net loss per share since the effect of common stock equivalents would be anti-dilutive and are therefore excluded from the diluted net loss per share calculation.

	Three Months Ended June 30,	
	2010	2009
	(in thousands, except per-share data)	
Net loss	$ (16,656)	$ (19,668)
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	110,383	85,664
Dilutive effect of warrants and stock options after application of the treasury stock method	*	*
	110,383	85,664

Weighted-average number of common shares outstanding for computing diluted earnings per share				
Net loss per share - basic and diluted	$	(0.15)	$	(0.23)

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	Six Months Ended June 30,	
	2010	2009
	(in thousands, except per-share data)	
Net loss	$ (17,240)	$ (20,595)
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	110,404	83,235
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	110,404	83,235
Net loss per share - basic and diluted	$ (0.16)	$ (0.25)

* Warrants and stock options to purchase 39,335,409 and 33,838,997 shares of common stock as of June 30, 2010 and 2009, respectively, were excluded from the net loss per share calculation as their effect would have been anti-dilutive.

Note 8. Liquidity

Since its inception in 1980 through June 30, 2010 the Company has incurred losses of approximately $292.7 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 revenue from product sales will be achieved. Moreover, even if the Company does achieve revenue from product sales, the Company expects to incur operating losses over the next several years.

At June 30, 2010, cash, cash equivalents and short-term investments were $37.2 million, compared to $48.7 million at December 31, 2009. The Company s principal sources of liquidity have been revenue from its U.S. government research contracts and equity financings. The Company s principal uses of cash have been research and development expenses, general and administrative expenses and other working capital requirements.

In the periods presented, substantially all of the revenue generated by the Company was derived from research contracts with the U.S. government. As of June 30, 2010, the Company had contracts with the U.S. government pursuant to which its is entitled to receive up to an aggregate of $83.7 million for development of its product candidates, of which $53.5 million had been billed to the U.S. government and $30.2 million of which relates to development that has not yet been completed and has not been billed. See Note 4 U.S. Government Contracts for additional information.

In January 2009, the Company sold approximately 14.2 million shares of its common stock and also issued warrants to purchase approximately 14.2 million shares of its common stock in an offering registered under the Securities Act of 1933 (the Securities Act). The offering generated net proceeds of approximately $15.5 million.

In August 2009, the Company sold approximately 24.3 million shares of its common stock and also issued warrants to purchase approximately 9.7 million shares of its common stock in an offering registered under the Securities Act. The offering generated net proceeds of approximately $32.3 million. The warrants issued to the investors in the offering have an exercise price of $1.78 per share and are exercisable at any time on or before August 25, 2014. See Note 9 Equity Financing for more information.

Note 9. Equity Financing

In January 2009, the Company sold approximately 14.2 million shares of its common stock and also issued warrants to purchase approximately 14.2 million shares of its common stock in an offering registered under the Securities Act. The offering generated net proceeds of approximately $15.4 million. The warrants issued to the investors in the offering have an exercise price of $1.16 per share and are exercisable at any time on or before July 30, 2014. In connection with the offering, the Company also issued to the placement agent a warrant to purchase approximately 427,000 shares of the Company s common stock at an exercise price of $1.45 per share. The warrant issued to the placement agent is exercisable on or before January 30, 2014.

In August 2009, the Company sold approximately 24.3 million shares of its common stock and also issued warrants to purchase approximately 9.7 million shares of its common stock in an offering registered under the Securities Act. The offering generated net proceeds of approximately $32.3 million. The warrants issued to the investors in the offering have an exercise price of $1.78 per share and are exercisable at any time on or before August 25, 2014. The warrants issued in connection with the January and August 2009 offerings are classified as a liability due to their settlement terms. These warrants are non-cash liabilities; the Company is not required to expend any cash to settle these liabilities. Accordingly, the fair value of the warrants is recorded on the consolidated balance sheet as a liability, and such fair value is adjusted at each financial reporting period with the adjustment to fair value reflected in the consolidated statement of operations as described in greater detail in Note 6 Warrants .

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Note 10. Income Taxes

The Company has not recognized any liability for unrecognized tax benefits. There are no unrecognized tax benefits included in the balance sheet that would, if recognized, affect the effective tax rate.

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 June 30, 2010 or December 31, 2009, and has not recognized interest and/or penalties in the statement of operations for the three and six months ended June 30, 2010.

At December 31, 2009, the Company had net deferred tax assets of approximately $111 million. The deferred tax assets are primarily composed of U.S. federal and state tax net operating loss carryforwards, U.S. federal and state research and development credit carryforwards, share-based compensation expense and intangibles. Due to uncertainties surrounding its ability to generate future taxable income to realize these assets, a full valuation allowance has been established to offset its net deferred tax asset. Additionally, the Internal Revenue Code rules could limit the future use of its net operating loss and research and development credit carryforwards to offset future taxable income based on ownership changes and the value of the Company s stock.

Note 11. Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (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 became effective for the Company 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 the Company with the reporting period beginning July 1, 2011. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the Company s financial statements.

In April 2010, the FASB issued guidance on applying the milestone method of revenue recognition for milestone payments for achieving specific performance measures when those payments are related to uncertain future events. The scope of this guidance is limited to transactions involving research or development. Under the guidance, the milestone method is a valid application of the proportional performance model for revenue recognition if the milestones are substantive and there is substantive uncertainty about whether the milestone will be achieved. The guidance is effective on a prospective basis to milestones achieved in fiscal years, and interim periods within those years, beginning after June 15, 2010, with early adoption permitted. The Company is still evaluating the impact of this guidance to determine the potential effects on the Company s financial statements.

Note 12. Subsequent Events

On July 14, 2010, the Company was awarded a new contract with the U.S. Department of Defense Chemical and Biological Defense Program through the U.S. Army Space and Missile Defense Command for the advanced development of the Company s hemorrhagic fever virus therapeutic candidates, AVI-6002 and AVI-6003, for Ebola and Marburg viruses, respectively. The contract is funded as part of the TMT program, which was instigated to develop innovative platform-based solutions countering biological threats. The contract is structured into four segments with potential funding of up to approximately $291 million. Activity under the first segment is to begin immediately and provides for funding to the Company of up to approximately $80 million. Activities under the first segment include Phase 1 studies in healthy volunteers as well as preclinical studies, and are scheduled over an 18-month period.

After completion of the first segment, and each successive segment, TMT has the option to proceed to the next segment for either or both AVI-6002 and AVI-6003. If TMT exercises its options for all four segments, contract activities would include all clinical and licensure activities necessary to obtain FDA regulatory approval of each therapeutic candidate and would provide for a total funding award to the Company of up to approximately $291 million over a period of approximately six years. The contract was granted in response to proposals the Company submitted to a request for proposal issued in November 2009 and initially submitted by the Company in January 2010. Under an earlier contract, the Company completed development activities that culminated in the opening of IND applications for both AVI-6002 and AVI-6003.

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

This section should be read in conjunction with our condensed consolidated financial statements and related notes included in Part I, Item 1 of this report and the section contained in our annual report on Form 10-K for the year ended December 31, 2009 under the caption Part II-Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations . This discussion contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and

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Section 21E of the Exchange Act. Forward-looking statements are identified by such words as believe, expect, anticipate and words of similar import and are based on current expectations that involve risks and uncertainties, such as our plans, objectives, expectations and intentions. All statements other than historical or current facts, including, without limitation, statements about our business strategy, plans and objectives of management and our future prospects, are forward-looking statements. Such forward-looking statements involve risks and uncertainties, including, but not limited to, expectations regarding future expenses, funding from government and other sources, the results of research and development efforts, the adequacy of funds to support or future operations, the results of pre-clinical and clinical testing, the effect of regulation by FDA and other agencies, the impact of competitive products, product development, commercialization and technological difficulties. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in this report in Part II, Item 1A Risk Factors, and elsewhere in this report. These statements, like all statements in this report, speak only as of their date, and we undertake no obligation to update or revise these statements in light of future developments.

In this report, we, our, us, AVI, and Company refers to AVI BioPharma, Inc.

Overview

We are a biopharmaceutical company focused on the discovery and development of novel RNA-based therapeutics for rare and infectious diseases, as well as other select disease targets. Applying pioneering technologies developed and optimized by AVI, we are able to target a broad range of diseases and disorders through distinct RNA-based mechanisms of action. Unlike other RNA-based approaches, our technologies can be used to directly target both messenger RNA (mRNA) and precursor messenger RNA (pre-mRNA) to either down-regulate (inhibit) or up-regulate (promote) the expression of targeted genes or proteins. We believe that these broad capabilities represent highly competitive RNA-based technology platforms and a strong intellectual property position, both of which are the result of advances across several areas of science, including over 20 years of research and development work in chemistry and biology. Our patent estate includes 205 patents (foreign and domestic) issued to or licensed by us and 184 patent applications (domestic and foreign).

We are leveraging our discovery and development capabilities to build a pipeline of RNA-based therapeutic drug candidates to develop independently and in collaboration with larger pharmaceutical and biotechnology partners. Current applications of our RNA technology platform include genetic diseases (Duchenne Muscular Dystrophy, or DMD), infectious diseases (including Ebola, Marburg and H1N1 Influenza viruses), and other early discovery targets. Several of our antiviral programs, including Ebola, Marburg, Junín and H1N1, have been or are currently funded by the U.S. government as described in greater detail below. Some of our other programs have received funding from non-government sources.

On June 4, 2010, we entered into a new contract with the U.S. Defense Threat Reduction Agency, or DTRA, and agency of the U.S. Department of Defense, or DoD, to advance the development of AVI-7100, as a medical countermeasure against the pandemic H1N1 influenza virus (swine flu) in cooperation with the Transformational Medical Technologies program, or TMT, of the DoD. The contract provides for funding of up to $18 million to advance the development of AVI-7100, including studies enabling an Investigational New Drug, or IND, application with the U.S. Food and Drug Administration, or FDA, the development of an intranasal delivery formulation, and the funding of a Phase 1 clinical program to obtain human safety data to support potential use under an Emergency Use Authorization.

On July 14, 2010, we were awarded a new contract with the U.S. Department of Defense Chemical and Biological Defense Program through the U.S. Army Space and Missile Defense Command for the advanced development of our hemorrhagic fever virus therapeutic candidates,

AVI-6002 and AVI-6003, for Ebola and Marburg viruses, respectively. The contract is funded as part of the TMT program, which was instigated to develop innovative platform-based solutions countering biological threats. The contract is structured into four segments with potential funding of up to approximately $291 million. Activity under the first segment is to begin immediately and provides us funding of up to approximately $80 million. After completion of the first segment, and each successive segment, TMT has the option to proceed to the next segment for either or both AVI-6002 and AVI-6003. If TMT exercises its options for all four segments, contract activities would include all clinical and licensure activities necessary to obtain FDA regulatory approval of each therapeutic candidate and would provide for a total funding award to us of up to approximately $291 million. The contract was granted in response to proposals we submitted to a request for proposal, or RFP, issued in November 2009 and initially submitted by us in January 2010. Under an earlier contract, we completed development activities that culminated in the opening of IND applications for both AVI-6002 and AVI-6003.

On April 20, 2010, our chief executive officer and president, Leslie Hudson, Ph.D., tendered his resignation at the request of our Board of Directors. Pursuant to his separation agreement, Dr. Hudson will receive total cash severance payments of $1,412,170 (comprised of two 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 24 equal monthly installments, less required

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deductions and withholdings following the effective date of the separation agreement. In addition, as of the effective date of the separation agreement, unvested options to purchase 1,166,833 shares of our common stock and 116,500 shares of restricted stock previously granted to Dr. Hudson became fully vested and exercisable, which resulted in a charge to stock compensation expense of $1,181,292 in the second quarter of 2010.

As previously disclosed, on April 20, 2010, we entered into a settlement agreement with a shareholder group that had sought a special meeting of our shareholders to replace certain members of our Board of Directors. Pursuant to such settlement agreement, among other things, (i) our Board of Directors sought Dr. Hudson s resignation and appointed J. David Boyle II, our Chief Financial Officer, as interim Chief Executive Officer and President, (ii) our bylaws were amended to reduce the size of our Board of Directors, (iii) Dr. Hudson and K. Michael Forrest resigned as directors to facilitate the reduction in the size of the Board of Directors, and (iv) Anthony R. Chase was appointed to fill the vacancy created by Dr. Hudson s resignation. In addition, for a period of one year, the shareholder group agreed not to engage in the solicitation of any proxy relating to the voting of our common stock and not to take certain actions relating to our Board of Directors or the management of our company. Furthermore, for a period of six months, members of the shareholder group also agreed not to acquire beneficial ownership of additional shares of our common stock if such acquisition would cause their beneficial ownership to exceed certain thresholds as set forth in the settlement agreement.

At our 2010 annual meeting of shareholders, Chris Garabedian and Hans Wigzell were elected to our Board of Directors, replacing Christopher Henney and Michael D. Casey who did not stand for reelection.

From our inception in 1980, we have devoted our resources primarily to fund our research and development efforts. As the result of recent new U.S. government research contracts for H1N1/ Influenza, Ebola and Marburg, we expect future revenues and research and development cost to increase. We have been unprofitable since inception and, other than limited interest, license fees, grants and research contracts, we have had no material revenue from the sale of products or other sources, other than from government grants and research contracts, and we do not expect material revenue for the foreseeable future. We expect to continue to incur losses for the foreseeable future as we continue our research and development efforts and enter additional collaborative efforts. As of June 30, 2010, our accumulated deficit was $292.7 million.

Government Contracts

In the periods presented, substantially all of the revenue generated by our company was derived from research contracts with the U.S. government. As of June 30, 2010, we had contracts with the U.S. government pursuant to which we are entitled to receive up to an aggregate of $83.7 million for development of its product candidates, of which $53.5 million had been billed to the U.S. government and $30.2 million of which relates to development that has not yet been completed and has not been billed. The following is a description of such contracts.

January 2006 Agreement (Ebola and Marburg Host Factors, Dengue, Anthrax and Ricin)

In January 2006, the final version of the 2006 defense appropriations act was enacted, which act included an allocation of $11.0 million to fund our ongoing defense-related programs under certain executed contracts. Net of government administrative costs, it is anticipated that we will receive up to $9.8 million under this allocation. Our technology is expected to be used to continue developing RNA based drugs against Ebola and Marburg viruses. We have received signed contracts for all of these projects. As of June 30, 2010, we have recognized revenue of $9.7

million with respect to these contracts and expect to receive the remaining funding under these contracts in 2010.

December 2006 Agreement (Ebola, Marburg and Junín Viruses)

In December 2006, we entered into a two-year research contract with the DTRA pursuant to which we were entitled to $28 million to fund our development of antisense therapeutics to treat the effects of Ebola, Marburg and Junín hemorrhagic viruses. In May 2009, this contract was amended to extend the term of the contract until November 2009 and to increase funding by $5.9 million to an aggregate of $33.9 million. In June 2009, the contract was amended again to extend the term of the contract to February 2011 and to increase funding by an additional $11.5 million to an aggregate of $45.4 million. As of June 30, 2010, we have recognized revenue of $37.8 million with respect to this contract and expect to receive the remaining funding under this contract in 2010 and 2011.

May 2009 Agreement (H1N1/Influenza)

In May 2009, we entered into a contract with the DTRA to develop swine flu drugs. Under this contract, DTRA will pay up to $4.1 million to our company for the work involving the application of our proprietary PMO and PMO*plus* antisense chemistry and we

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plan to conduct preclinical development of at least one drug candidate and demonstrate it is effective by testing it on animals. In March 2010, the contract was amended to include testing against additional influenza strains including H5N1 (avian flu), Tamiflu® resistant H1N1 (swine flu) and H3N2 (seasonal flu) and funding increased by $4.0 million to an aggregate of $8.1 million. As of June 30, 2010, we have recognized revenue of $3.2 million with respect to this contract and expect to receive the remaining funding under this contract in 2010.

June 2010 Agreement (H1N1/Influenza)

On June 4, 2010, we entered into a contract with the DTRA to advance the development of AVI-7100, which was previously designated AVI-7367 and which has been renumbered by us, as a medical countermeasure against the pandemic H1N1 influenza virus in cooperation with the TMT. The contract provides for funding of up to $18 million to advance the development of AVI-7100, including studies enabling an IND application with the FDA, the study of an intranasal delivery formulation, and the funding of a Phase 1 clinical trial to obtain human safety data to support potential use under an Emergency Use Authorization. As of June 30, 2010, we have recognized revenue of $0.4 million with respect to this contract and expect to receive the remaining funding under this contract in 2010 and 2011.

The following table sets forth the impact on revenue of each of the contracts with the U.S. government on our results of operations for the three and six months ended June 30, 2010 and 2009.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands)		(in thousands)	
January 2006 Agreements *(Ebola and Marburg Host factors, Dengue, Anthrax and Ricin)*	$ 147	$ 243	$ 468	$ 1,623
December 2006 Agreement *(Ebola, Marburg and Junín Viruses)*	2,063	1,333	2,608	3,066
May 2009 Agreement *(H1N1)*	1,187	356	1,444	356
June 2010 Agreement *(H1N1)*	433		433	
Other Agreements	167	1,013	248	1,050
Total	$ 3,997	$ 2,945	$ 5,201	$ 6,095

Key Financial Metrics