Cyclacel Pharmaceuticals, Inc.
Form 10-Q
August 08, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

OR

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

Commission file number 0-50626

CYCLACEL PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1707622**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 CONNELL DRIVE, SUITE 1500
BERKELEY HEIGHTS, NJ 07922

(Address of principal executive offices)

Registrant s telephone number, including area code: (**908) 517-7330**

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

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

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

(Do not check if a smaller reporting company)

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

As of August 7, 2008 there were 20,433,129 shares of the issuer s common stock outstanding.

CYCLACEL PHARMACEUTICALS, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEETS
(In $000s, except share amounts)

	December 31, 2007	June 30, 2008 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	30,987	31,681
Short-term investments	27,766	8,290
Inventory	213	612
Prepaid expenses and other current assets	4,811	5,231
Total current assets	**63,777**	**45,814**
Property, plant and equipment (net)	3,016	2,782
Deposits and other assets	196	196
Intangible assets (net)	4,305	3,833
Goodwill	4,618	4,593
Total assets	**75,912**	**57,218**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	4,958	2,130
Accrued liabilities	4,015	6,078
Other current liabilities	1,279	1,785
Warrant liability	3,545	656
Current portion of other accrued restructuring charges	905	966
Current portion of equipment financing	10	
Total current liabilities	**14,712**	**11,615**
Other accrued restructuring charges, net of current	2,090	1,588
Other long term payables	1,141	605
Total liabilities	**17,943**	**13,808**
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized at December 31, 2007 and June 30, 2008; 2,046,813 shares issued and outstanding at December 31, 2007 and June 30, 2008. Aggregate preference in liquidation of $20,673,000 at December 31, 2007 and June 30, 2008	2	2
Common stock, $0.001 par value; 100,000,000 shares authorized at December 31, 2007 and June 30, 2008; 20,433,129 shares issued and outstanding at December 31, 2007 and June 30, 2008	20	20

Additional paid-in capital	222,906	223,239
Accumulated other comprehensive loss	(2,630)	(2,726)
Deficit accumulated during the development stage	(162,329)	(177,125)
Total stockholders equity	**57,969**	**43,410**
Total liabilities and stockholders equity	**75,912**	**57,218**

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

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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In $000s, except share and per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,		Period from August 13, 1996 (inception) to June 30,
	2007	2008	2007	2008	2008
Revenues:					
Collaboration and research and development revenue			10		3,000
Product revenue		168		333	333
Grant revenue	31	12	74	24	3,620
Total Revenue	31	180	84	357	6,953
Operating expenses:					
Cost of goods sold		99		195	195
Research and development	4,316	5,803	8,293	11,688	153,233
Selling, general and administrative	2,187	4,104	4,819	7,982	55,477
Restructuring costs			81		1,779
Total operating expenses	6,503	10,006	13,193	19,865	210,684
Operating loss	(6,472)	(9,826)	(13,109)	(19,508)	(203,731)
Other income (expense):					
Costs associated with aborted 2004 IPO					(3,550)
Change in valuation of derivative	(30)		(70)		(308)
Change in valuation of warrants	1,406	680	1,864	2,889	6,094
Interest income	986	267	1,814	897	13,058
Interest expense	(48)	(90)	(100)	(175)	(4,314)
Total other income (expense)	2,314	857	3,508	3,611	10,980
Loss before taxes	(4,158)	(8,969)	(9,601)	(15,897)	(192,751)
Income tax benefit	563	425	1,116	1,101	15,626
Net loss	(3,595)	(8,544)	(8,485)	(14,796)	(177,125)
Dividends on Preferred Ordinary shares					(38,123)
Net loss applicable to common shareholders	(3,595)	(8,544)	(8,485)	(14,796)	(215,248)

Net loss per share diluted	Basic and	$ (0.18)	$ (0.42)	$ (0.44)	$ (0.72)
Weighted average common shares outstanding		**20,410,224**	**20,433,129**	**19,305,425**	**20,433,129**

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

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CYCLACEL PHARMACEUTICALS, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In $000s)
(Unaudited)

	Six Months Ended June 30,		Period from August 13, 1996 (inception) to June 30,
	2007	2008	2008
Cash flows from operating activities:			
Net loss	(8,485)	(14,796)	(177,125)
Adjustments to reconcile net loss to net cash used in operating activities:			
Accretion of deferred consideration payable in common stock related to the acquisition of ALIGN		19	29
Accretion of interest on notes payable, net of amortization of debt premium		39	58
Amortization of investment premiums, net	(131)	(1,057)	(1,930)
Change in valuation of derivative	70		308
Change in valuation of warrants	(1,864)	(2,889)	(6,094)
Depreciation and amortization	478	1,022	11,235
Unrealized foreign exchange (gain) loss	(887)	(268)	2,652
Deferred revenue			(98)
Compensation for warrants issued to non employees			1,215
Shares issued for IP rights			446
Gain on disposal of property, plant and equipment			27
Stock based compensation	1,016	947	14,834
Provision for restructuring	81		1,779
Amortization of issuance costs of Preferred Ordinary C shares			2,517
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(1,322)	(716)	(4,916)
Accounts payable and other current liabilities	(742)	(1,244)	(43)
Net cash used in operating activities	**(11,786)**	**(18,943)**	**(155,106)**
Investing activities:			
Purchase of ALIGN			(3,763)
Purchase of property, plant and equipment	(622)	(322)	(8,764)
Proceeds from sale of property, plant and equipment			26
Purchase of short-term investments	(20,953)	(857)	(154,454)
Redemptions of short-term investments, net of maturities		21,391	151,873
Net cash (used in) provided by investing activities	**(21,575)**	**20,212**	**(15,082)**
Financing activities:			
Payment of capital lease obligations	(89)	(10)	(3,719)

Proceeds from issuance of ordinary and preferred ordinary shares, net of issuance costs			90,858
Proceeds from issuance of common stock and warrants, net of issuance costs	33,359		75,983
Net proceeds from stock options and warrants exercised	163		163
Payment of preferred stock dividend	(614)	(614)	(2,758)
Repayment of government loan			(455)
Government loan received			414
Loan received from Cyclacel Group Plc			9,103
Proceeds of committable loan notes issued from shareholders			8,883
Loans received from shareholders			1,645
Cash and cash equivalents assumed on stock purchase			17,915

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	Six Months Ended June 30,		Period from August 13, 1996 (inception) to June 30,
	2007	2008	2008
Costs associated with stock purchase			(1,951)
Net cash provided by (used in) financing activities	**32,819**	**(624)**	**196,081**
Effect of exchange rate changes on cash and cash equivalents	146	49	5,790
Net (decrease) increase in cash and cash equivalents	(542)	645	25,893
Cash and cash equivalents at beginning of period	44,238	30,987	
Cash and cash equivalents at end of period	**43,842**	**31,681**	**31,683**
Supplemental disclosure of cash flows information:			
Cash received during the period for:			
Interest	1,659	628	11,550
Taxes		296	13,180
Cash paid during the period for:			
Interest	(87)	(119)	(1,800)
Schedule of non-cash transactions:			
Acquisitions of equipment purchased through capital leases			3,470
Issuance of Ordinary shares in connection with license agreements			592
Issuance of Ordinary shares on conversion of bridging loan			1,638
Issuance of Preferred Ordinary C shares on conversion of secured convertible loan notes and accrued interest			8,893
Issuance of Ordinary shares in lieu of cash bonus			164
Issuance of other long term payable on ALIGN acquisition			1,122

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

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CYCLACEL PHARMACEUTICALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Cyclacel Pharmaceuticals, Inc. (Cyclacel or the Company) is a development-stage biopharmaceutical company dedicated to the discovery, development and commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious disorders. Cyclacel s strategy is focused on leading edge therapeutic management of cancer patients based on a portfolio of three products marketed by its ALIGN Pharmaceuticals, LLC (ALIGN) subsidiary and a deep development pipeline. Three orally-available drugs are in clinical development:

- sapacitabine, in two randomized Phase 2 studies for the treatment of elderly acute myeloid leukemia or AML and cutaneous T-cell lymphoma or CTCL;
- seliciclib, in two randomized Phase 2 studies for the treatment of non-small cell lung cancer or NSCLC and nasopharyngeal cancers or NPC and initiating an investigator sponsored Phase 1 combination study with erlotinib (Tarceva®) in patients with advanced solid tumors; and
- CYC116, in Phase 1 in patients with solid tumors.

As a development stage company, substantially all efforts of the Company to date have been devoted to performing research and development, conducting clinical trials, developing and acquiring intellectual properties, raising capital and recruiting and training personnel. The Company was incorporated in the state of Delaware in 1996 and is headquartered in Berkeley Heights, New Jersey, with research facilities located in the United Kingdom.

The condensed consolidated balance sheet as of June 30, 2008, the condensed consolidated statements of operations for the three and six months ended June 30, 2008 and 2007 and the condensed consolidated statements of cash flows for the six months ended June 30, 2008 and 2007, and related disclosures contained in the accompanying notes are unaudited. The condensed consolidated balance sheet as of December 31, 2007 is derived from the audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities and Exchange Commission (the SEC). The condensed consolidated financial statements are presented on the basis of accounting principles that are generally accepted in the United States for interim financial information and in accordance with the rules and regulations of the SEC. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States for a complete set of financial statements. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the condensed consolidated balance sheet as of June 30, 2008, the results of operations for the three and six months ended June 30, 2008 and 2007 and the consolidated statements of cash flows for the six months ended June 30, 2008 and 2007 have been made. The interim results for the six months ended June 30, 2008 are not necessarily indicative of the results to be expected for the year ending December 31, 2008 or for any other year. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the accompanying notes for the year ended December 31, 2007, included in the Company s Annual Report on Form 10-K filed with the SEC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries for the indicated periods. All significant intercompany transactions and balances have been eliminated.

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Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Cyclacel reviews its estimates on an ongoing basis. The estimates were based on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Cyclacel believes the judgments and estimates required by the following accounting policies to be critical in the preparation of the Company s condensed consolidated financial statements.

Cash and Cash Equivalents

Cash equivalents are stated at cost when purchased, which is substantially the same as market value. The Company considers all highly liquid investments with an original maturity of three months or less at the time of initial deposit to be cash equivalents. The objectives of the Company s cash management policy are the safety and preservation of funds, liquidity sufficient to meet Cyclacel s cash flow requirements and attainment of a market rate of return.

Inventory

Cyclacel values inventories at lower of cost or market value. The Company determines cost using the first-in, first-out method. The Company analyzes its inventory levels quarterly and writes-down inventory that becomes obsolete, and its inventory that has a cost basis in excess of its expected net realizable value. Expired inventory is disposed of and the related carrying amounts are written off. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Goodwill

Goodwill represents the difference between the purchase price and the fair value of net tangible and identifiable intangible assets acquired in a business combination. Goodwill acquired in a business combination is not amortized, but instead is tested for impairment at least annually in accordance with the provisions of Statement of Financial Accounting Standards (FAS) FAS No. 142, *Goodwill and Other Intangible Asset* (FAS 142).

The Company last tested goodwill for impairment with respect to Xcyte Therapies, Inc. (Xcyte), on September 30, 2007 and believes that there have been no changes in assumptions or conditions to goodwill since the last impairment analysis.

Intangibles

As part of the acquisition of ALIGN, (see Note 5), the Company acquired rights to a license agreement with Sinclair Pharma PLC (Sinclair) as well as to various customer relationships. The license agreement allows Cyclacel to exclusively sell and distribute Xclair Cream, Numoisyn Liquid and Numoisyn Lozenges in the United States. The Company amortizes the license agreement and customer relationship intangible assets over the remaining life of the contract of approximately seven years. The fair values ascribed to the license agreements and customer relationships on October 5, 2007, the acquisition date, were $3.0 million and $0.5 million, respectively. For the three months ended June 30, 2008, the Company amortized approximately $0.1 million and $17,000 for the license agreement and customer relationships, respectively. For the six months ended June 30, 2008, the Company amortized approximately $0.2 million and $34,000 for the license agreement and customer relationships, respectively. The Company expects to amortize $0.5 million annually for these intangible assets until June 2015.

As part of the acquisition of ALIGN, the Company assumed all rights to the ALIGN trade name, as well as non-compete agreements signed between ALIGN and its senior managers and a beneficial contract pricing arrangement. The Company amortizes the fair values of these assets acquired in the ALIGN acquisition over 2 years, which represents the approximate time period that the non-compete agreements will remain in effect based on the employment contracts of the existing ALIGN management team. The fair value ascribed to the non-compete agreements, trade name and beneficial contract pricing arrangement on October 5, 2007 was $0.4 million, $0.1 million and $0.5 million, respectively. During the three months ended June 30, 2008, the Company amortized approximately $49,000 for the non-compete agreements, $13,000 for the trade name and approximately $59,000 for the beneficial pricing contract. During the six months ended June 30, 2008, the Company amortized approximately $0.1 million for the non-compete agreements, $25,000 for the trade name and $0.1 million for the beneficial pricing contract. The

Company expects to amortize $0.2 million annually for the non-compete agreement, $50,000 for the trade name and $0.2 million for the beneficial pricing contract during 2008 and 2009.

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Impairment of Long-lived Assets

In accordance with the provisions of FAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* (FAS 144), the Company reviews long-lived assets, including property, plant and equipment, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Under FAS 144, an impairment occurs when undiscounted estimated identifiable future cash flows expected to result from the use of the asset and its eventual dispositions are less than its carrying amount. An impairment loss, if any, is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. Through June 30, 2008 there have been no impairments of long-lived assets.

Revenue Recognition

Product sales

The Company recognizes revenue from these product sales when persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the selling price is fixed and determinable; and collectability is reasonably assured.

The Company offers a general right of return on these product sales, and has considered the guidance in FAS No. 48, *Revenue Recognition When Right of Return Exists* (FAS 48) and Staff Accounting Bulletin No. 104 *Revenue Recognition* (SAB 104). Under these pronouncements, the Company accounts for all product sales using the sell-through method. Under the sell-through method, revenue is not recognized upon shipment of product to distributors. Instead, the Company records deferred revenue at gross invoice sales price and deferred cost of sales at the cost at which those goods were held in inventory. The Company recognizes revenue when such inventory is sold through to the end user based upon prescriptions filled. To estimate product sold through to end users, the Company relies on third-party information, including information obtained from third-party market research data, certain distributors with respect to their inventory levels and sell-through to customers.

Collaboration, research and development, and grant revenue

Certain of the Company s revenues are earned from collaborative agreements. The Company recognizes revenue when persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the fee is fixed and determinable; and collectability is reasonably assured. Determination of whether these criteria have been met is based on management s judgments regarding the nature of the research performed, the substance of the milestones met relative to those the Company must still perform, and the collectability of any related fees. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

Research and development revenues, which are earned under agreements with third parties for contract research and development activities, are recorded as the related services are performed. Milestone payments are non-refundable and recognized as revenue when earned, as evidenced by achievement of the specified milestones and the absence of ongoing performance obligations. Any amounts received in advance of performance are recorded as deferred revenue. None of the revenues recognized to date are refundable if the relevant research effort is not successful.

Grant revenues from government agencies and private research foundations are recognized as the related qualified research and development costs are incurred, up to the limit of the prior approval funding amounts. Grant revenues are not refundable.

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Clinical Trials Accounting

Data management and monitoring of all of the Company s clinical trials are performed by contract research organizations (CROs) or clinical research associates (CRAs) in accordance with the Company s standard operating procedures. Typically, CROs and some CRAs bill monthly for services performed, and others bill based upon milestones achieved. For outstanding amounts, the Company accrues unbilled clinical trial expenses based on estimates of the level of services performed each period. Costs of setting up clinical trial sites for participation in the trials are expensed immediately as research and development expenses. Clinical trial site costs related to patient enrollment are accrued as patients are entered into the trial and any initial payment made to the clinical trial site is accrued upon execution of the clinical trial agreements and expensed as research and development expenses.

Research and Development Expenditures

Research and development expenses consist primarily of clinical trial costs associated with the Company s product candidates, milestones, compensation and other expenses for research and development personnel, supplies and development materials, costs for consultants and related contract research, facility costs, amortization of purchased technology and depreciation. Expenditures relating to research and development are expensed as incurred.

Segments

The Company has determined that it has one reportable segment.

Supplemental Financial Information:

Loss per Share

Basic and diluted loss per share is computed by dividing loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted weighted average shares outstanding excludes shares underlying stock options; convertible preferred stock; make-whole dividend payments of common stock on convertible preferred stock and common stock warrants, since the effects would be anti-dilutive. Accordingly, basic and diluted loss per share is the same. Such excluded shares are summarized as follows:

	June 30, 2007	**June 30, 2008**
Stock options	1,663,473	2,815,318
Convertible preferred stock	870,980	870,980
Make-whole dividend payments of common stock on convertible preferred stock	190,608	
Common stock warrants	3,634,703	3,809,703
Total shares excluded from calculation	6,359,764	7,496,001

Other Comprehensive Loss

In accordance with Financial Accounting Standards Board Statement (FASB), FAS No. 130, *Reporting Comprehensive Income* , or (FAS 130) all components of comprehensive income (loss), including net income (loss), are reported in the financial statements in the period in which they are recognized. Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Net income (loss) and other comprehensive income (loss), including foreign currency translation adjustments and changes in the fair value of available-for-sale securities, are reported, net of any related tax effect, to arrive at comprehensive income (loss).

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Short-term Investments

The following is a summary of short-term investments at December 31, 2007 and June 30, 2008:

	December 31, 2007			
	Gross amortized cost $000	Gross unrealized gains $000	Gross unrealized losses $000	Fair value $000
Federal agency obligations & municipal bonds	9,354			9,354
Corporate bonds & commercial paper	18,390	24	(2)	18,412
	27,744	24	(2)	27,766

	June 30, 2008			
	Gross amortized cost $000	Gross unrealized gains $000	Gross unrealized losses $000	Fair value $000
Federal agency obligations & municipal bonds	599	3		602
Corporate bonds	7,665	23		7,688
	8,264	26		8,290

For investments that are in an unrealized loss position, the Company has evaluated the nature of the investments, the duration of the impairments and concluded that the impairments are not other-than-temporary.

At June 30, 2008, all investments have contractual maturities due within one year. At December 31, 2007, investments of $1.5 million had maturities greater than one year.

Fair value measurements

On January 1, 2008, the Company adopted FAS No. 157, *Fair Value Measurements* (FAS 157), for our financial assets and liabilities. The Company s adoption of FAS 157 did not materially affect the Company s financial position, results of operations or liquidity. In accordance with FASB Staff Position No. FAS 157-2, *Effective Date of FAS 157* , the Company elected to defer until January 1, 2009 the adoption of FAS 157 for all non-financial assets and non-financial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. As defined in FAS No. 157, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, FAS No. 157 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as considers counterparty credit risk in its assessment of fair value.

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Financial assets and liabilities carried at fair value as of June 30, 2008 are classified in the table below in one of the three categories described above:

	Level 1 **$000**	Level 2 **$ 000**	Level 3 **$000**	Total **$ 000**
U.S. Government Agency Securities		602		602
Municipal Notes				
Corporate Bonds		7,688		7,688
Total assets at fair value		**8,290**		**8,290**
Warrants		(656)		(656)
Total liabilities at fair value		**(656)**		**(656)**

Prepaid expenses and other current assets:

Prepaid expenses and other current assets consist of the following:

	December 31, 2007	**June 30, 2008**
	($000s)	
Research and development tax credit receivable	2,467	3,277
Prepayments	1,741	1,776
Other current assets	603	178
Total prepaid expenses and other current assets	4,811	5,231

Accrued Liabilities and Other Current Liabilities:

Accrued liabilities consist of the following:

	December 31, 2007	**June 30, 2008**
	($000s)	
Accrued research and development	3,681	5,276
Other accrued liabilities	334	802
Total accrued liabilities	4,015	6,078

Other current liabilities consist of the following:

	December 31, 2007	**June 30, 2008**
	($000s)	
Payroll	308	145
Preferred stock dividends declared	307	307
Deferred consideration payable in common stock	250	260
Other short term payables		575
Other current liabilities	414	498

Total other current liabilities	1,279	1,785

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3. STOCK BASED COMPENSATION

At the Company s annual shareholder meeting on May 14, 2008, the stockholders approved and amended the number of shares reserved under the 2006 Equity Incentive Plan (2006 Plan) to 5,200,000 shares of the Company s common stock (up from 3,000,000 shares). The shares reserved under the 2006 Plan have a maximum maturity of 10 years and generally exercisable over a four-year period from the date of grant.

A summary of activity for the options under the Company s 2006 Plan for the six months ended June 30, 2008 is as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in $000s)
Options outstanding at December 31, 2007	2,592,246	$ 6.39	9.1	
Granted	290,000	$ 4.08		
Exercised				
Expired				
Cancelled / forfeited	(66,928)	$ 6.19		
Options outstanding at June 30, 2008	2,815,318	$ 6.15	8.73	
Unvested at June 30, 2008	1,716,674	$ 5.73	9.16	
Vested and exercisable at June 30, 2008	1,098,644	$ 6.79	8.07	

The Company accounts for all share-based payment transactions under FASB, Statement No. 123R, *Share-Based Payment* (FAS 123R). FAS 123R requires the Company to measure all share-based payment awards, including those with employees, granted, modified, repurchased or cancelled after, or that were unvested as of, January 1, 2006 at fair value. Under FAS 123R, the fair value of stock options and other equity-based compensation must be recognized as compensation cost in the financial statements over the requisite service period of each award.

The Company used the Black-Scholes option-pricing model with the following assumptions for stock option grants to employees and directors for the six months ended June 30, 2007 and 2008:

	For the six months ended June 30,	
	2007	2008
Expected term	4.25 6 Yrs	4.25 6 Yrs
Risk free interest rate	4.56 5.07%	2.75 3.76%
Expected volatility	70 80%	65 70%
Expected dividend yield over expected term		
Resulting weighted average grant fair value	$4.54	$2.24

The expected term assumption was estimated using past history of early exercise behavior and expectations about future behavior.

The expected volatility assumption was based on the historical volatility of the Company s common stock since the merger with Xcyte on March 27, 2006 together with an analysis of the historical volatilities of a peer group of similar biotechnology companies.

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The weighted average risk-free interest rate represents interest rate for treasury constant maturities published by the Federal Reserve Board. If the term of available treasury constant maturity instruments is not equal to the expected term of an employee option, the Company uses the weighted average of the two Federal Reserve securities closest to the expected term of the employee option.

Dividend yield has been assumed to be zero as (a) the Company has never declared or paid any dividends and (b) does not currently anticipate paying any cash dividends on its outstanding shares of common stock in the foreseeable future.

There were no exercises of stock options during the three and six months ended June 30, 2008. The Company received $0.2 million from the exercise of 25,508 stock options during the second quarter of 2007. As the Company presently has tax loss carry forwards from prior periods and expects to incur tax losses in 2008, the Company is not able to benefit from the deduction for exercised stock options in the current reporting period.

Cash used to settle equity instruments granted under share-based payment arrangements amounted to $0 during all periods presented.

In accordance with the terms of a retirement agreement with a former employee, the Company agreed to extend the period during which he would be entitled to exercise vested stock options to purchase Cyclacel s common stock from 30 (thirty) days following the effective date of his retirement, January 8, 2008, to 36 (thirty six) months following such effective date. The Company recorded a one time compensation expense related to the modification of the exercise period of $0.1 million for the three months ended March 31, 2008.

The following table summarizes the components of the Company s stock based compensation for the three and six months ended June 30, 2007 and 2008:

	For the three months ended June 30,		For the six months ended June 30,	
	2007	2008	2007	2008
	($000s)		($000s)	
Research and development	212	129	502	420
General and administrative	261	266	514	527
Stock-based compensation costs before income taxes	473	395	1,016	947

4. COMMITMENTS AND CONTINGENCIES

In 2005, the Company recorded an accrued restructuring liability associated with abandoning the facility in Bothell, Washington. The lease term on this space expires December 2010. The restructuring liability was computed as the present value of the difference between the remaining lease payments due less the estimate of net sublease income and expenses. The accrual balance was adjusted in 2006 to reflect a change in estimate due to continued deterioration in the local real estate market. As of June 30, 2008, the accrued restructuring liability was $2.6 million. This represents the Company s best estimate of the fair value of the liability. Subsequent changes in the liability due to accretion, or changes in estimates of sublease assumptions, etc. will be recognized as adjustments to restructuring charges in future periods.

The Company records payments of rent related to the Bothell facility as a reduction in the amount of the accrued restructuring liability. Accretion expense is recognized due to the passage of time, which is also reflected as a restructuring charge. Based on our current projections of estimated sublease income and a discount rate of 7.8%, the Company expects to record additional accretion expense of approximately $0.3 million over the remaining term of the lease.

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In connection with the abandonment of the Bothell facility and the related sale of assets in late 2005, the Company has been subjected to a State sales tax audit by the Department of Revenue of the State of Washington. As a result of the potential State sales tax assessment, the Company recorded a liability of $0.3 million during 2006. There has been no change in the Company s assessment of the liability during the three months ended June 30, 2008.

5. ACQUISITIONS

Acquisition of ALIGN

On October 5, 2007, the Company purchased certain net assets of ALIGN Pharmaceuticals, LLC or ALIGN. As part of the acquisition, the Company acquired the Sellers exclusive rights to sell and distribute three products in the United States used primarily to manage the effects of radiation or chemotherapy in cancer patients: Xclair Cream, Numoisyn Liquid and Numoisyn Lozenges. The acquired business provides Cyclacel with the foundation to build a commercial organization focused on cancer that is complementary to Cyclacel s oncology/hematology products in development and is part of Cyclacel s strategy to build a diversified biopharmaceutical business.

As consideration for the asset purchase and pursuant and subject to the terms of the agreement, the Company paid $3.3 million in cash to the Sellers and have paid an additional $0.5 million approximately 190 business days from the closing date of the asset acquisition. In addition, the Company may be required to issue to the Sellers a maximum number of 138,132 shares of common stock. This is reduced from the original number of shares of 184,176 as a result of the Sellers not meeting certain operational and financial milestones. Issuance is contingent upon the achievement of certain operational and financial milestones and subject to satisfaction of any outstanding indemnification obligations by the Sellers. Cyclacel will issue the shares of its common stock only to the extent that the milestones are achieved. The Company is also committed, as part of securing long term supply arrangements, to make future payments of approximately $0.6 million in 2009 and $0.7 million in 2010. The present value of these commitments has been reported as other short term payables and other long term payables on the condensed consolidated balance sheets.

For the three months ended June 30, 2008, goodwill was reduced by $9,000 as a royalty rebate of $48,000 was recognized, offset by an increase in the product returns provision by $39,000. For the six months ended June 30, 2008, goodwill has reduced by $25,000 as a result of adjustments to product returns provision and recognizing the royalty rebate.

The transaction was accounted for as a business combination and the consolidated results of operations of Cyclacel include the results of operations of ALIGN from October 5, 2007. The assets and certain agreed liabilities of ALIGN have been recorded, as of the closing date, at their estimated fair values.

Acquisition Purchase Price

The preliminary purchase price paid to acquire the Sellers assets was calculated as follows (in thousands):

Cash and equity	$	3,571
Acquisition costs		432
Total purchase price	$	4,003

Acquisition Preliminary Purchase Price Allocation

As part of the acquisition, the following net assets were acquired (in thousands):

Current assets	$	199
Property, plant and equipment		10
Intangible assets		4,495
Current liabilities		(1,423)
Non-current liabilities		(1,122)
Goodwill		1,844
	$	4,003

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Pro Forma Results of Operations

The results of operations of ALIGN are included in Cyclacel s condensed consolidated financial statements from the date of the business combination transaction as of October 5, 2007. The following table presents pro forma results of operations and gives effect to the business combination transaction as if the business combination was consummated at January 1, 2007. The unaudited pro forma results of operations are not necessarily indicative of what would have occurred had the business combination been completed at the beginning of the retrospective periods or of the results that may occur in the future.

	For the three months ended June 30, 2007 (000s)	For the six months ended June 30, 2007 (000s)
Revenue	234	536
Loss before taxes	(5,977)	(11,485)
Net loss applicable to ordinary shareholders	(5,414)	(10,369)
Net loss per share-basic and diluted	$ (0.27)	$ (0.54)
Weighted average shares	20,410,224	19,305,425

Acquisition of Xcyte Therapies Inc.

On March 27, 2006, Xcyte Therapies Inc. (Xcyte) completed a Stock Purchase Agreement (the Stock Purchase Agreement) with Cyclacel Group plc (Group), a public company organized under the laws of England and Wales in which Xcyte agreed to purchase from Group all of the capital stock of Cyclacel Limited (Limited), a private limited company organized under the laws of England and Wales and a wholly-owned subsidiary of Group (the Stock Purchase). For more information please see the Company s Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the SEC.

6. STOCKHOLDERS EQUITY

Preferred stock

On November 3, 2004, the Company completed a public offering of 2,990,000 shares of its 6% convertible exchangeable preferred stock (the Preferred Stock) at $10.00 per share, including the shares sold to the underwriters pursuant to the over-allotment option granted in connection with the offering. Net proceeds from the offering, after deducting underwriting discounts and offering-related expenses, totaled $27.5 million.

Dividends on the Preferred Stock are cumulative from the date of original issue at the annual rate of 6% of the liquidation preference of the Preferred Stock, payable quarterly on the first day of February, May, August and November, commencing February 1, 2005. Any dividends must be declared by the Company s board of directors and must come from funds that are legally available for dividend payments. The Preferred Stock has a liquidation preference of $10 per share, plus accrued and unpaid dividends. In January, April, July and October 2007, the Company s Board of Directors declared quarterly dividends in the amount of $0.15 per share of preferred stock, which were paid on the first business day in February, May, August and November 2007, respectively. Each quarterly dividend distribution totaled $0.3 million and was paid to holders of record as of the close of business on January 22, April 20, July 20 and October 19, 2007, respectively. In December 2007 and April 2008 the Company s Board of Directors declared quarterly dividends in the amount of $0.15 per share of Preferred Stock, which were paid on the first business day in February and May 2008, respectively. Each quarterly dividend distribution totaled $0.3 million and was paid to holders of record as of the close of business on January 18 and April 18, 2008, respectively. On July 8, 2008 a dividend was declared and subsequently paid on August 1, 2008.

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The Preferred Stock is convertible at the option of the holder at any time into the Company s common stock at a conversion rate of approximately 0.42553 shares of common stock for each share of Preferred Stock, based on a conversion price of approximately $23.50. The Company has reserved 870,980 shares of common stock for issuance upon conversion of the remaining shares of Preferred Stock outstanding as of June 30, 2008. In each of the three month periods ended June 30, 2007 and 2008, no shares of preferred stock were converted into common stock.

The Company may automatically convert the Preferred Stock into common stock if the closing price of the Company s common stock has exceeded $35.30, which is 150% of the conversion price of the Preferred Stock, for at least 20 trading days during any 30-day trading period, ending within five trading days prior to notice of automatic conversion.

The Company and the holders elected not to automatically convert some or all of the Preferred Stock into common stock prior to November 3, 2007. If they had done so, the Company would have made an additional payment on the Preferred Stock equal to the aggregate amount of dividends that would have been payable on the Preferred Stock through November 3, 2007, less any dividends already paid on the Preferred Stock. This additional payment would have been payable in cash or, at the Company s option, in shares of the Company s common stock, or a combination of cash and shares of common stock. As of June 30, 2008, the Company issued 81,927 shares of common stock to converting holders in satisfaction of this additional payment. During the three months ended June 30, 2008, no shares of the Company s common stock were issued.

In accordance with FAS 133, *Accounting for Derivative Instruments* (FAS 133), the Company was required to separate and account for, as an embedded derivative, the dividend make-whole payment feature of the Preferred Stock. As an embedded derivative instrument, the dividend make-whole payment feature was measured at fair value and reflected as a liability. Changes in the fair value of the derivative were recognized in the condensed consolidated statement of operations as a component of other income (expense). The derivative liability was reduced to $0 as of November 2, 2007, the last date of possible conversion. During the three and six months ended June 30, 2007, the Company recorded a charge of $30,000 and $0.1 million, respectively, on the consolidated statement of operations as other expense.

The Company may elect to redeem the Preferred Stock at declining redemption prices on or after November 6, 2007.

The Preferred Stock is exchangeable, in whole but not in part, at the option of the Company on any dividend payment date beginning on November 1, 2005 (the Exchange Date) for the Company s 6% Convertible Subordinated Debentures (Debentures) at the rate of $10 principal amount of Debentures for each share of Preferred Stock. The Debentures, if issued, will mature 25 years after the Exchange Date and have terms substantially similar to those of the Preferred Stock.

The Preferred Stock has no maturity date and no voting rights prior to conversion into common stock, except under limited circumstances.

Common Stock and warrants

February 2007 Registered Direct Offering

On February 16, 2007, the Company raised $36.0 million in gross proceeds, before deducting placement agent fees and offering expenses of $2.6 million, in a registered direct offering through the sale of shares of the Company s common stock and warrants. The Company entered into subscription agreements with these investors pursuant to which it sold approximately 4.2 million units, each unit consisting of one share of common stock and a seven-year warrant to purchase 0.25 shares of common stock, at a purchase price of $8.47125 per unit. The purchase price for the shares and the exercise price for the warrants was $8.44 per share, the closing bid price for the Company s common stock on February 12, 2007. Investors paid $0.125 per warrant. The Company issued 4,249,668 shares of common stock and warrants to purchase 1,062,412 shares of common stock.

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The warrants issued to the investors are being accounted for as a liability in accordance with Emerging Issues Task Force (EITF) 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* (EITF 00-19). At the date of the transaction, the fair value of the warrants of $6.8 million was determined utilizing the Black-Scholes option pricing model utilizing the following assumptions: risk free interest rate 4.58%, expected volatility 85%, expected dividend yield 0%, and a remaining contractual life of 6.88 years. The value of the warrant shares is being marked to market each reporting period as a derivative gain or loss on the consolidated statement of operations until exercised or expiration. At December 31, 2007, the fair value of the warrants was $3.5 million. At June 30, 2008, the fair value of the warrants was $0.7 million. For the three months ended June 30, 2007 and 2008, the Company recognized the change in the value of warrants of approximately $1.4 million and $0.7 million, respectively, as a gain on the consolidated statement of operations. For the six months ended June 30, 2007 and 2008, the Company recognized the change in the value of warrants of approximately $1.9 million and $2.9 million, respectively, as a gain on the consolidated statement of operations. Since the date of the transaction, the Company recognized the change in the value of warrants of approximately $6.1 million.

December 2007 Committed Equity Financing Facility

On December 10, 2007, Cyclacel entered into a Committed Equity Financing Facility or CEFF, with Kingsbridge Capital Limited or Kingsbridge, a private investment group, in which Kingsbridge committed to purchase the lesser of 4,084,590 shares of common stock or $60 million of common stock from Cyclacel capital during the next three years. Under the terms of the agreement, Cyclacel will determine the exact timing and amount of any CEFF financings, subject to certain conditions. All amounts drawn down under the CEFF will be settled via the issuance of registered shares of Cyclacel s common stock. Cyclacel may access capital under the CEFF in tranches of either (a) 2% of Cyclacel s market capitalization at the time of the draw down or (b) the lesser of (i) 3% of Cyclacel s market capitalization at the time of the draw down and (ii) an alternative draw down amount based on the product of (A) the average trading volume of the 30-day trading period preceding the draw down excluding the five highest and five lowest trading days during such period, (B) the volume-weighted average trading price (VWAP) on the trading day prior to the notice of draw down, (C) the number of days during the draw down period and (D) 85%, subject to certain conditions. Each tranche will be issued and priced over an eight-day pricing period. Kingsbridge will purchase shares of common stock pursuant to the CEFF at discounts ranging from 6% to 10% depending on the average market price of the common stock during the eight-day pricing period, provided that the minimum acceptable purchase price for any shares to be issued to Kingsbridge during the eight-day period is determined by the higher of $2.50 or 90% of Cyclacel s common stock closing price the day before the commencement of each draw down.

In connection with the CEFF, Cyclacel issued a warrant to Kingsbridge to purchase up to 175,000 shares of common stock at an exercise price of $7.17 per share which represents a 30% premium over the average of the closing bid prices of Cyclacel s common stock during the 5 trading days preceding the signing of the agreement. The warrant will become exercisable six months from the date of the agreement and will remain exercisable, subject to certain exceptions, for a period of five years thereafter. As of June 30, 2008, the warrants issued to the investors have been classified as equity in accordance with EITF 00-19. The transaction date fair value of the warrants of $0.6 million was determined utilizing the Black-Scholes option pricing model utilizing the following assumptions: risk free interest rate 3.605%, expected volatility 70%, expected dividend yield 0%, and a remaining contractual life of 5.5 years.

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Common Stock Warrants

The following table summarizes information about warrants outstanding at June 30, 2008:

Issued in Connection With	Expiration Date	Common Shares Issuable	Weighted Average Exercise Price
Acquisition of Xcyte March 2006	2008	431	$ 15.29
Acquisition of Xcyte March 2006	2009	431	15.29
March 2006 stock issuance	2014	2,571,429	7.00
February 2007 stock issuance	2014	1,062,412	8.44
December 2007 CEFF	2012	175,000	7.17
Total		3,809,703	$ 7.41

Exercise of Stock Options

There were no stock option exercises during the six months ended June 30, 2008. During the three months ended June 30, 2007, 25,508 shares of the Company s common stock were issued from the exercise of stock options resulting in proceeds of $0.2 million.

7. INCOME TAXES

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

The Company applies FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48) in accounting for uncertainty in income taxes recognized in a company s financial statements. FIN 48 prescribes a minimum probability threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods as well as disclosure and transition.

Credit is taken in the accounting period for research and development tax credits, which will be claimed from H. M. Revenue & Customs, the United Kingdom s taxation and customs authority, in respect of qualifying research and development costs incurred in the same accounting period.

8. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. FAS 159 was effective on January 1, 2008 and the adoption of FAS 159 did not have a material impact on the Company s condensed consolidated financial statements.

In December 2007, FASB ratified the consensus reached by Emerging Issues Task Force (EITF) Issue 07-1, *Accounting for Collaborative Arrangements* or (EITF 07-1). EITF 07-1 requires collaborators to present the results of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable Generally Accepted Accounting Principles or, in the absence of other applicable GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. Further, EITF 07-1 clarified that the determination of whether transactions within a collaborative arrangement are part of a vendor-customer (or analogous) relationship subject to EITF 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products). EITF 07-1 was effective on January 1, 2008. The adoption of EITF 07-1 did not have a material impact on the Company s consolidated financial statements.

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In November 2007, the FASB issued FAS No. 141 (revised 2007), Business Combination (FAS 141(R)) and FAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS 160). FAS 141(R) will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. FAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. FAS 141(R) and FAS 160 are effective for both public and private companies for fiscal years beginning on or after December 15, 2008 (January 1, 2009 for the Company). FAS 141(R) will be applied prospectively. FAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of FAS 160 will be applied prospectively. Early adoption is prohibited for both standards. The Company believes that the adoption of FAS 141(R) and FAS 160 will not have a material impact on its consolidated financial statements.

In June 2007, FASB ratified the consensus reached by the EITF on EITF Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* or (EITF 07-3). EITF 07-3 addresses the diversity that exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under EITF 07-3, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-3 is effective for the Company beginning on January 1, 2008 and must be adopted on a prospective basis. Given a review of our current contracts and arrangements the adoption of EITF 07-3 did not have a material effect on the Company s consolidated financial statements.

On March 19, 2008, FASB issued FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (FAS 161). FAS 161 requires enhanced financial disclosure about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity s financial position, financial performance, and cash flows. FAS 161 achieves these improvements by requiring disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also provides more information about an entity s liquidity by requiring disclosure of derivative features that are credit risk-related. Finally, it requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company believes that the adoption of FAS 161 will not have a material impact on its consolidated financial statements.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including, without limitation, Management s Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). We intend the forward-looking statements to be covered by the safe harbor for forward-looking statements in such sections of the Exchange Act. The forward-looking information is based on various factors and was derived using numerous assumptions. All statements, other than statements of historical fact, that address activities, events or developments that we intend, expect, project, believe or anticipate will or may occur in the future are forward-looking statements. Such statements are based upon certain assumptions and assessments made by our management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. These forward-looking statements are usually accompanied by words such as believe, anticipate, plan, seek, expect, intend and similar expressions.

Forward-looking statements necessarily involve risks and uncertainties, and our actual results could differ materially from those anticipated in the forward looking statements due to a number of factors, including those set forth in Part I, Item 1A Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2007, as updated and supplemented by Part II, Item 1A Risk Factors of this Quarterly Report on Form 10-Q, and elsewhere in this report. These factors as well as other cautionary statements made in this Quarterly Report on Form 10-Q, should be read and understood as being applicable to all related forward-looking statements wherever they appear herein. The forward-looking statements contained in this Quarterly Report on Form 10-Q represent our judgment as of the date hereof. We encourage you to read those descriptions carefully. We caution you not to place undue reliance on the forward-looking statements contained in this report. These statements, like all statements in this report, speak only as of the date of this report (unless an earlier date is indicated) and we undertake no obligation to update or revise the statements except as required by law. Such forward-looking statements are not guarantees of future performance and actual results will likely differ, perhaps materially, from those suggested by such forward-looking statements. In this report, Cyclacel, the Company, we, us, and our refer to Cyclacel Pharmaceuticals, Inc.

Overview

We are a development stage biopharmaceutical company dedicated to the discovery, development and commercialization of novel, mechanism-targeted drugs to treat human cancers and other serious disorders. Our strategy is focused on leading edge therapeutic management of cancer patients based on a portfolio of three products marketed by ALIGN Pharmaceuticals, LLC ALIGN , our subsidiary, and a deep development pipeline.

We market directly in the United States Xclair™ Cream for radiation dermatitis and Numoisyn™ Liquid and Numoisyn™ Lozenges for xerostomia. We have three orally-available drugs that are in clinical development:

- sapacitabine in two randomized Phase 2 studies for the treatment of elderly acute myeloid leukemia, or AML and cutaneous T-cell lymphoma, or CTCL;

- seliciclib in two randomized Phase 2 studies for the treatment of non-small cell lung cancer, or NSCLC and nasopharyngeal cancers, or NPC and initiating an investigator sponsored Phase 1 study in combination with erlotinib (Tarceva®) in patients with advanced solid tumors including NSCLC; and

- CYC116 in a Phase 1 study in patients with solid tumors. Our area of expertise is in cell cycle biology, or the processes by which cells divide and multiply.

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We focus primarily on the discovery and development of orally available anticancer agents that target the cell cycle with the aim of slowing the progression or shrinking the size of tumors, and enhancing the quality of life and improving survival rates of cancer patients. We are generating several families of anticancer drugs that act on the cell cycle including nucleoside analogues, cyclin dependent kinase or CDK inhibitors and Aurora kinase/Vascular Endothelial Factor Receptor 2 or AK/VEGFR2 inhibitors. Although a number of pharmaceutical and biotechnology companies are currently attempting to develop nucleoside analogues, CDK inhibitor and AK inhibitor drugs, we believe that our drug candidates are differentiated in that they are orally available and interact with unique target profiles and mechanisms. For example, we believe that our sapacitabine is the only orally available nucleoside analogue presently being tested in Phase 2 trials in AML, seliciclib is the only orally available CDK inhibitor currently in Phase 2 trials and CYC116 is the only AK inhibitor in clinical trials that also interacts with VEGFR2.

Our corporate headquarters is located in Berkeley Heights, New Jersey, with research facilities located in the United Kingdom. From our inception in 1996 through June 30, 2008, we have devoted substantially all our efforts and resources to our research and development activities. We have incurred significant net losses since inception. As of June 30, 2008, our accumulated deficit during the development stage was $177.1 million. We expect to continue incurring substantial losses for the next several years as we continue to develop our clinical, pre-clinical and other drugs currently in development and build our commercialization capability. Our operating expenses are primarily comprised of research and development expenses and selling, general and administrative costs.

As of June 30, 2008, we have not generated significant product revenue but have financed our operations and internal growth through private placements, licensing revenue, interest on investments, government grants and research and development tax credits. Our revenue has consisted of collaboration and grant revenue. Beginning in 2008, our revenue now includes product sales following the ALIGN acquisition.

Acquisition of ALIGN Pharmaceuticals, LLC and ALIGN Holdings, LLC

On October 5, 2007, the Company purchased certain net assets of ALIGN. As part of the asset acquisitions, we acquired the Sellers exclusive rights to sell and distribute three products in the United States used primarily to manage the effects of radiation or chemotherapy in cancer patients: Xclair Cream, Numoisyn Liquid and Numoisyn Lozenges. The acquired business provides us with the foundation to build a commercial organization focused on cancer that is complementary to our oncology/hematology products in development and is part of our strategy to build a diversified biopharmaceutical business.

As consideration for the asset purchase and pursuant and subject to the terms of the agreement, the Company paid $3.3 million in cash to the Sellers and have paid an additional $0.5 million approximately 190 business days from the closing date of the asset acquisition. In addition, we may be required to issue to the Sellers a maximum number of 138,132 shares of common stock. This is reduced from the original number of shares of 184,176 as a result of the Sellers not meeting certain operational and financial milestones. Issuance is contingent upon the achievement of certain operational and financial milestones and subject to satisfaction of any outstanding indemnification obligations by the Sellers. We will issue the shares of our common stock only to the extent that the milestones are achieved. We are also committed, as part of securing long term supply arrangements, to make future payments of approximately $0.6 million in 2009 and $0.7 million in 2010. The present value of these commitments has been reported as other short term payables and other long term payables on the consolidated balance sheet as of June 30, 2008.

For the three months ended June 30, 2008, goodwill was reduced by $9,000 due to a decrease of recognizing a royalty rebate of $48,000 offset by an increase in the product returns provision of $39,000. For the six months ended June 30, 2008, goodwill was reduced by $25,000 as a result of adjustments to product returns provision and recognizing the royalty rebate.

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Results of Operations

The results of operations and balance sheet data for the three months ended June 30, 2008 reflect the operations of the Company and its subsidiary companies, including ALIGN. However, the results of operations for the comparable periods in 2007 do not reflect the results of ALIGN and, therefore, may not be comparable to the results of the current period.

Three Months Ended June 30, 2007 and 2008

Revenues

The following table summarizes the components of our revenues for the three months ended June 30, 2007 and 2008:

	Three months ended June 30,			
	2007	**2008**	**Difference**	**Difference**
		($000s)		**%**
Product revenue		168	168	100
Grant revenue	31	12	(19)	(61)
Total revenue	31	180	149	481

Grant revenue is recognized as we incur and pay for qualifying costs and services under the applicable grant. Grant revenue is primarily derived from various United Kingdom government grant awards.

Product revenue is derived as a result of the asset acquisition of ALIGN on October 5, 2007. During the three months ended June 30, 2008, we recorded sales of $0.2 million. We anticipate that product revenue will continue to grow as we penetrate the market place and gain market share.

Cost of goods sold

	Three months ended June 30,			
	2007	**2008**	**Difference**	**Difference**
		($000s)		**%**
Cost of goods sold		99	99	100

Total cost of sales represented 59% of product revenue for the three months ended June 30, 2008.

During the three months ended June 30, 2008, we recorded cost of goods sold of $0.1 million related to the sale of ALIGN products.

The future

We expect cost of goods sold as a percentage of the product revenue to reduce in the foreseeable future if the level of turnover increases.

Research and development expenses

To date, we have focused on drug discovery and development programs, with particular emphasis on orally available anticancer agents. Research and development expense represents costs incurred to discover and develop novel small molecule therapeutics, including clinical trial costs for sapacitabine, seliciclib and CYC116, to advance product candidates through clinical trials, to develop in-house research and preclinical study capabilities and to advance our biomarker program and technology platforms. We expense all research and development costs as they are incurred. Research and development expenses primarily include:

- payroll and related-expense, including consultants and contract research;
- clinical trial and regulator-related costs;

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pre-clinical studies;

screening and identification of drug candidates;

laboratory supplies and materials;

technology license costs;

rent and facility expenses for our laboratories; and

scientific consulting fees.

The following table provides information with respect to our research and development expenditure for the three months ended June 30, 2007 and 2008:

	Three months ended June 30,			
	2007	**2008**	**Difference**	**Difference**
		($000s)		**%**
Sapacitabine	953	2,293	1,340	141
Seliciclib	745	782	37	5
CYC116	412	501	89	22
Other research and development costs	2,206	2,227	21	1
Total research and development expenses	4,316	5,803	1,487	34

Total research and development expenses represented 66% and 58% of our operating expenses for the three months ended June 30, 2007 and 2008, respectively.

Research and development expenditure increased by $1.5 million to $5.8 million for the three months ended June 30, 2008 from $4.3 million for the three months ended June 30, 2007. Sapacitabine costs increased by $1.3 million primarily due to the commencement of a Phase 2 trial in elderly AML in December 2007, and costs related to preclinical and product scale-up.