ARROWHEAD RESEARCH CORP
Form 10-Q
August 11, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008.

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-21898

ARROWHEAD RESEARCH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**46-0408024**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

201 S. Lake Avenue, Suite 703

Pasadena, California 91101

(626) 304-3400

(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 ¨

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 ¨	Accelerated filer x
Non-accelerated filer ¨ Do not check if a smaller reporting company	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 ¨ No x

As of August 7, 2008, 38,956,373 shares of the registrant s common stock, $.001 par value per share, were outstanding.

Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Balance Sheets

As of June 30, 2008 and September 30, 2007

(unaudited)

	(unaudited) June 30, 2008	September 30, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 13,823,480	$ 24,120,097
Trade receivable, net of allowance for doubtful account of $56,031	94,427	273,864
Grant receivable, net of allowance for doubtful account of $0	37,929	
Other receivables	25,000	
Prepaid sponsored research, *Note 8*.	25,006	221,053
Other prepaid research		278,558
Other prepaid expenses	535,325	383,729
Current assets of discontinued operations, *Note 5*.		28,127
TOTAL CURRENT ASSETS	14,541,167	25,305,428
PROPERTY AND EQUIPMENT		
Computers, office equipment and furniture	531,453	515,744
Research equipment	1,863,405	1,429,602
Software	155,315	104,625
Leasehold improvements	121,717	112,983
Property and equipment of discontinued operations		952,503
	2,671,890	3,115,457
Less: Accumulated depreciation and amortization	(1,412,188)	(934,876)
Accumulated depreciation and amortization of discontinued operation		(741,122)
NET PROPERTY AND EQUIPMENT	1,259,702	1,439,459
INTANGIBLE AND OTHER ASSETS		
Rent deposit	137,358	157,534
Patents, *Note 1*.	2,627,930	2,938,513
Minority investment in private company	560,000	
Non-current assets of discontinued operations		12,018
TOTAL OTHER ASSETS	3,325,288	3,108,065
TOTAL ASSETS	$ 19,126,157	$ 29,852,952
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,083,560	$ 1,346,678
Accrued expenses	612,844	530,052
Payroll liabilities	609,051	392,554
Accrued severance	250,000	495,000
Deferred revenue		98,570
Current liabilities of discontinued operations		33,521
TOTAL CURRENT LIABILITIES	2,555,455	2,896,375

LONG-TERM LIABILITIES		
Accrued severance, *Note 8.*	500,000	500,000
Minority interests	2,970,483	152,609
Commitment and contingencies, *Note 8.*		
STOCKHOLDERS EQUITY, *Note 6*.		
Common stock	38,954	38,622
Preferred stock		
Additional paid-in capital	89,899,453	84,672,783
Accumulated deficit during the development stage	(76,838,188)	(58,407,437)
TOTAL STOCKHOLDERS EQUITY	13,100,219	26,303,968
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 19,126,157	$ 29,852,952

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

Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Statements of Operations

(unaudited)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Nine Months Ended June 30, 2008	Nine Months Ended June 30, 2007	May 7, 2003 (Inception) to June 30, 2008
REVENUE, ***Note 1***	**$ 235,372**	**$ 622,599**	**$ 1,362,999**	**$ 629,994**	**$ 3,809,290**
COST OF GOODS SOLD	160,742	347,601	882,766	347,601	1,606,854
GROSS PROFIT ON SALES	**74,630**	**274,998**	**480,233**	**282,393**	**2,202,436**
OPERATING EXPENSES					
Salaries	3,896,950	2,583,712	10,028,895	6,118,938	28,177,348
Consulting	902,031	637,052	2,172,230	1,241,033	5,596,434
General and administrative expenses	1,720,206	1,525,163	4,897,218	3,853,569	16,714,266
Research and development	3,349,423	12,816,916	6,514,896	17,596,583	38,920,347
Patent amortization	102,602	103,991	310,584	311,973	1,299,547
TOTAL OPERATING EXPENSES	9,971,212	17,666,834	23,923,823	29,122,096	90,707,942
OPERATING LOSS	(9,896,582)	(17,391,836)	(23,443,590)	(28,839,703)	(88,505,506)
OTHER INCOME (EXPENSES)					
Gain on sale of stock in subsidiary					2,292,800
Realized and unrealized gain (loss) in marketable securities					382,264
Interest income	115,158	238,239	691,385	879,135	2,971,979
Other income					3,637
TOTAL OTHER INCOME (EXPENSES)	115,158	238,239	691,385	879,135	5,650,680
LOSS BEFORE MINORITY INTERESTS	(9,781,424)	(17,153,597)	(22,752,205)	(27,960,568)	(82,854,826)
Minority interests	1,994,088	4,881,466	4,475,059	6,279,853	13,317,443
LOSS FROM CONTINUING OPERATIONS	(7,787,336)	(12,272,131)	(18,277,146)	(21,680,715)	(69,537,383)
Loss from discontinued operations Nanotechnica, Inc.					(1,342,505)
Loss on disposal of Nanotechnica, Inc. (July 2005 September 2005)					(73,797)
Loss from discontinued operations Aonex Technologies, Inc.	(21,170)	(205,417)	(459,949)	(677,813)	(6,189,247)
Gain on sale of Aonex Technologies, Inc.	306,344		306,344		306,344
GAIN (LOSS) FROM DISCONTINUED OPERATIONS	285,174	(205,417)	(153,605)	(677,813)	(7,299,205)
Provision for income taxes					(1,600)
NET LOSS	$ (7,502,162)	$ (12,477,548)	$ (18,430,751)	$ (22,358,528)	$ (76,838,188)
Income (loss) from continuing operations per share, basic & diluted	$ (0.20)	$ (0.34)	$ (0.47)	$ (0.62)	
Income (loss) from discontinued operations per share, basic & diluted	$ 0.01	$ (0.01)	$ (0.01)	$ (0.02)	

Net income (loss) per share, basic and diluted	$ (0.19)	$ (0.35)	$ (0.48)	$ (0.64)
Weighted average shares outstanding, basic & diluted	38,891,995	36,422,464	38,756,939	34,945,152

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

Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Statement of Stockholders Equity

from inception to June 30, 2008

(unaudited)

	Shares	Amount	Additional Paid-in-Capital	Accumulated Deficit during the Development Stage	Totals
Initial Issuance of Stock:					
Common stock & warrants issued for cash @ $0.001 per unit	3,000,000	$ 3,000	$	$	$ 3,000
Common stock & warrants issued for cash @ $1.00 per unit	1,680,000	1,680	1,678,320		1,680,000
Stock issuance cost charged to additional paid-in capital			(168,000)		(168,000)
Net loss for period from inception to September 30, 2003				(95,238)	(95,238)
Balance at September 30, 2003	**4,680,000**	**4,680**	**1,510,320**	**(95,238)**	**1,419,762**
Exercise of stock options @ $0.20 per share	75,000	75	14,925		15,000
Common stock & warrants issued for cash @ $1.00 per unit	475,000	475	474,525		475,000
Common stock & warrants issued for marketable securities @ $1.00 per unit	500,000	500	499,500		500,000
Stock issuance cost charged to additional paid-in capital			(96,500)		(96,500)
Common stock and warrants issued for cash @ $1.50 per unit	6,608,788	6,609	9,906,573		9,913,182
Common stock issued in reverse acquisition	705,529	706	(151,175)		(150,469)
Common stock issued as a gift for $1.09 per share	150,000	163	162,587		162,750
Common stock and warrants issued as stock issuance cost @ $1.50 per unit	356,229	356	533,988		534,344
Stock issuance cost charged to additional paid-in capital			(991,318)		(991,318)
Exercise of stock option @ $0.20 per share	75,000	75	14,925		15,000
Exercise of stock options @ $1.00 per share	6,000	6	5,994		6,000
Stock-based compensation			175,653		175,653
Net loss for the year ended September 30 ,2004				(2,528,954)	(2,528,954)
Balance at September 30, 2004	**13,631,546**	**13,645**	**12,059,997**	**(2,624,192)**	**9,449,450**
Exercise of warrants @ $1.50 per share	13,812,888	13,813	20,705,522		20,719,335
Exercise of stock options @ $1.00 per share	25,000	25	24,975		25,000
Purchase of Insert Therapeutics shares @ $0.28/share	502,260	502	1,999,498		2,000,000
Common stock issued for services	12,500	12	49,988		50,000
Stock-based compensation			508,513		508,513
Change in percentage of ownership in subsidiary			230,087		230,087
Net loss for the year ended September 30 ,2005				(6,854,918)	(6,854,918)
Balance at September 30, 2005	**27,984,194**	**27,997**	**35,578,580**	**(9,479,110)**	**26,127,467**
Exercise of stock options	115,794	116	341,421		341,537
Common stock issued @ $4.88 per share	204,854	205	999,795		1,000,000
Common stock issued @ $3.84 per share to Dr. M. Moskovits as payment for application of patents	15,000	15	57,585		57,600
Common stock issued @ $3.50 per share	5,590,000	5,590	19,539,410		19,545,000
Common stock issued to Caltech as payment for legal fees	25,364	25	149,975		150,000
Purchase of Calando Pharmaceuticals, Inc. @ $5.17/share	208,382	208	1,077,125		1,077,333
Stock-based compensation			1,270,339		1,270,339
Accelerated stock options			99,139		99,139
Net loss for the year ended September 30, 2006				(18,997,209)	(18,997,209)
Balance at September 30, 2006	**34,143,588**	**34,156**	**59,113,369**	**(28,476,319)**	**30,671,206**
Exercise of stock options	186,164	186	434,541		434,727
Common stock issued, net	2,849,446	2,849	15,149,366		15,152,215

Arrowhead's increase in proportionate share of Insert Therapeutics' equity			2,401,394		2,401,394
Common stock issued for purchase of Carbon Nanotechnologies, Inc.	1,431,222	1,431	5,398,569		5,400,000
Stock-based compensation			2,175,544		2,175,544
Net loss for the year ended September 30, 2007				(29,931,118)	(29,931,118)
Balance at September 30, 2007	**38,610,420**	**$ 38,622**	**$ 84,672,783**	**$ (58,407,437)**	**$ 26,303,968**
Exercise of stock options	105,357	106	289,921		290,027
Arrowhead's increase in proportionate share of Uniym's equity			1,720,962		1,720,962
Stock-based compensation			689,590		689,590
Net loss for the three months ended December 31, 2007				(5,233,774)	(5,233,774)
Balance at December 31, 2007	**38,715,777**	**38,728**	**87,373,256**	**(63,641,211)**	**23,770,773**
Common stock issued @ $2.72 per share to Rice University as a gift	50,000	50	135,950		136,000
Stock-based compensation			851,906		851,906
Net loss for the period ended March 31, 2008				(5,694,815)	(5,694,815)
Balance at March 31, 2008	**38,765,777**	**38,778**	**88,361,112**	**(69,336,026)**	**19,063,864**
Common stock issued to purchase shares of Unidym, Inc.	70,547	$ 71	$ 199,929		200,000
Common stock issued to purchase MASA Energy, LLC	105,049	$ 105	$ 309,895		310,000
Stock-based compensation			1,028,517		1,028,517
Net loss for the period ended June 30, 2008				(7,502,162)	(7,502,162)
Balance at June 30, 2008	**38,941,373**	**38,954**	**89,899,453**	**(76,838,188)**	**13,100,219**

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

Arrowhead Research Corporation and Subsidiaries

(A Development Stage Company)

Consolidated Statements of Cash Flows

For the nine months ended June 30, 2008 and 2007 and from inception through June 30, 2008

(Unaudited)

	Nine months ended June 30, 2008	Nine months ended June 30, 2007	Period from May 7, 2003 (Date of inception) to June 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Loss	$ (18,430,752)	$ (22,358,527)	$ (76,838,189)
Realized and unrealized (gain) loss on investment			(382,263)
Gain from sale of subsidiary	(306,344)		(306,344)
Stock issued as gift to Caltech			162,750
Stock issued as gift to Rice University	136,000		136,000
Stock issued for professional services			200,000
Stock issued for in-process research and development	200,000	9,597,005	10,874,338
Stock-based compensation	2,570,013	1,491,827	6,799,201
Depreciation and amortization	849,736	717,689	3,459,396
Gain on sale of stock in subsidiary			(2,292,800)
Minority interests	(4,475,059)	(6,306,201)	(13,317,443)
Decrease/increase in:			
Receivables	114,759	(311,047)	(161,305)
Prepaid research expense	474,605	26,029	(25,007)
Other prepaid expenses	(129,881)	(268,320)	(539,536)
Deposits	20,176	22,282	(139,418)
Accounts payable	(234,055)	607,258	913,282
Accrued expenses	137,838	(221,577)	650,438
Deferred revenue	(98,570)	378,645	
Preferred stock liability		(1,162,000)	
Other liabilities	(29,446)	417,563	1,376,240
NET CASH PROVIDED (USED) IN OPERATING ACTIVITIES	(19,200,980)	(17,369,374)	(69,430,660)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of marketable securities US Treasury Bills			(18,575,915)
Purchase of property and equipment	(508,936)	(563,713)	(3,335,098)
Purchase of MASA Energy, LLC	(250,000)		(250,000)
Cash paid for interest in Nanotechnica			(4,000,000)
Cash paid for interest in Aonex			(5,000,000)
Cash paid for interest in Insert		(5,150,000)	(10,150,000)
Cash paid for interest in Calando			(8,000,000)
Cash paid for interest in Unidym	(5,000,000)		(12,001,000)
Cash paid for interest in Tego	(2,400,000)		(2,501,000)
Cash obtained from interest in Nanotechnica			4,000,000
Cash obtained from interest in Aonex			5,001,250
Cash obtained from interest in Insert		5,150,000	10,529,594
Cash obtained from interest in Calando			8,000,000
Cash obtained from interest in Unidym	5,000,000		12,001,000
Cash obtained from interest in Tego	2,400,000		2,501,000
Proceeds from sale of marketable securities US Treasury Bills			18,888,265
Proceeds from sale of stock in subsidiary	9,013,897	5,136,346	16,575,167
Proceeds from sale of investments			569,913
Proceeds from sale of subsidiary (net)	359,375		359,375
Payment for patents			(303,440)
Restricted cash			50,773
NET CASH USED IN INVESTING ACTIVITIES	8,614,336	4,572,633	14,359,884
CASH FLOWS FROM FINANCING ACTIVITIES:			

Proceeds from issuance of common stock and warrants, net		290,027		15,570,317		68,894,256
NET CASH PROVIDED BY FINANCING ACTIVITIES		290,027		15,570,317		68,894,256
NET INCREASE (DECREASE) IN CASH		(10,296,617)		2,773,576		13,823,480
CASH AT BEGINNING OF PERIOD		24,120,097		28,020,304		
CASH AT END OF PERIOD	$	13,823,480	$	30,793,880	$	13,823,480
Supplementary disclosures:						
Interest paid	$		$			
Income tax paid	$	4,800	$	4,000		

SUPPLEMENTAL NON-CASH TRANSACTIONS

On March 23, 2005, Arrowhead purchased 7,375,000 shares of Insert Therapeutics, Inc. common stock from two minority stockholders of Insert for 502,260 newly issued shares of Arrowhead Common Stock valued at $2,000,000 based on the closing market price of Arrowhead Common Stock on NASDAQ on the date of the closing.

On March 31, 2006, Arrowhead purchased 964,000 shares of Calando Pharmaceuticals, Inc. common stock from minority stockholders of Calando for $1,928,000 consisting of 208,382 newly issued shares of Arrowhead Common Stock valued at $1,077,333 plus $850,667 in cash. The 208,382 shares of Arrowhead common stock were valued based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to the date of the closing.

On April 20, 2007, Arrowhead purchased the Series E Preferred Stock of Carbon Nanotechnologies, Inc. in exchange for 1,431,222 shares of Arrowhead Common Stock with an estimated fair market value of $5,400,000 based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to March 24, 2007, as set forth in the Agreement and Plan of Merger among Unidym, Carbon Nanotechnologies, Inc., the Company, and others.

On April 23, 2008, Arrowhead purchased 200,000 shares of the Common Stock of Unidym Inc., in exchange for 70,547 shares of Arrowhead Common Stock with an estimated fair market value of $200,000 based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to the date of the closing.

On April 29, 2008, Arrowhead purchased all of the membership units of MASA Energy, LLC for $560,000. The purchase price consisted of 105,049 shares of Arrowhead Common Stock with an estimated fair market value of $310,000 based on the average closing price of Arrowhead s Common Stock on NASDAQ the ten trading days immediately prior to the date of the closing, plus $250,000 in cash.

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

Arrowhead Research Corporation

Notes to Consolidated Financial Statements

June 30, 2008

Unless otherwise noted, (1) the term Arrowhead Research refers to Arrowhead Research Corporation, a Delaware corporation, (2) the terms Arrowhead, the Company, we, us and our refer to the ongoing business operations of Arrowhead and its subsidiaries, whether conducted through Arrowhead Research or a subsidiary of the Company, (3) the term Common Stock refers to Arrowhead Research s Common Stock, (4) the term Warrant refers to warrants to purchase Company Common Stock, and (5) the term stockholder(s) refers to the holders of Common Stock, Warrants and any other security convertible into Common Stock.

NOTE 1. ***ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES***

Nature of Business

Arrowhead is a development stage nanotechnology company commercializing new technologies in the areas of life sciences, electronics and energy. Arrowhead s mission is to build value through the identification, development and commercialization of nanotechnology-related products and applications. The Company works closely with universities to source early stage deals and to generate rights to intellectual property covering promising new nanotechnologies. Arrowhead takes a portfolio approach by operating multiple subsidiaries which allows the pursuit of multiple opportunities and diversifies risk. At June 30, 2008, Arrowhead owned three majority-owned subsidiaries (the Subsidiaries) and minority positions in two other companies (the Minority Positions) focused on developing and commercializing nanotechnology products and applications and has funded a number of prototype development efforts in leading university labs in exchange for the right to license the technology developed in such labs.

Arrowhead owns a majority interest in each of its three operating Subsidiaries, securing substantial participation in any success. Each subsidiary is staffed with its own technical and business team that focuses on its specific technology and markets, while Arrowhead provides financial, strategic and administrative resources. The Company s majority-owned Subsidiaries are focused on developing and commercializing nanotechnology products and applications, including anti-cancer drugs, RNAi therapeutics, carbon-based electronics and fullerene anti-oxidants. The two companies in which Arrowhead owns minority interest are focused on developing advanced nanomaterials for spinal cord injury and wound healing and drug delivery technology. Arrowhead s business plan includes adding to its portfolio through selective acquisition and formation of new companies.

In exchange for the right to license the resultant technology developed in sponsored laboratories, Arrowhead sponsors university research. Arrowhead has worked with some of the most highly-regarded academic institutions in the country, including the California Institute of Technology (Caltech), Stanford University, Duke University and the University of Florida, in critical areas such as stem cell research, carbon electronics and molecular diagnostics.

Arrowhead is incorporated in Delaware and its principal executive offices are located in Pasadena, California.

Arrowhead and its Subsidiaries fund research and operations from cash on hand, government grants and license royalties. Neither Arrowhead nor its Subsidiaries have derived revenue from product sales from its inception until the acquisition of Carbon Nanotechnologies, Inc. (CNI) in April 2007 by its consolidated subsidiary, Unidym, Inc. Since the acquisition, Unidym has manufactured carbon nanotubes for the primary purpose of using them in research and development activities and derives minimal revenues from the sale of carbon nanotubes for research and commercial applications.

Summary of Significant Accounting Policies

Basis of Presentation This report on Form 10-Q for the quarter ended June 30, 2008, should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended September 30, 2007, filed with the SEC on December 14, 2007. The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. Certain prior period amounts have been reclassified to conform to the current period s presentation. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. Operating results for the three-month and nine-month periods ended June 30, 2008 are not necessarily indicative of the results that might be expected for the year ending September 30, 2008.

Principles of Consolidation The consolidated financial statements of the Company include the accounts of Arrowhead and its Subsidiaries. Arrowhead s subsidiaries include Insert Therapeutics, Inc. (Insert) and Calando Pharmaceuticals, Inc. (Calando), which merged in April 2008. The merged entity continues to operate under the name of Calando. Other operating subsidiaries include Unidym, Tego BioSciences Corporation (Tego) and Aonex Technologies, Inc. (Aonex). Aonex was sold in May 2008 and is included in the results as Loss from Discontinued Operations. Nanotechnica, Inc. (Nanotechnica) a majority owned subsidiary dissolved in June 2005, is also included in the results as Loss from Discontinued Operations. All significant intercompany accounts and transactions are eliminated in consolidation, and minority interests are accounted for in the consolidated statements of operations and the balance sheets.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Significant estimates made in preparing these financial statements include valuing of the stock of the Subsidiaries, assumptions to calculate the value of stock options, stock-based compensation expense, allowance for doubtful accounts, deferred tax asset valuation allowance, patents, minority-interest Common Stock and useful lives for depreciable and amortizable assets. Actual results could differ from those estimates.

Cash and Cash Equivalents For purposes relating to the statement of cash flows, the Company considers all liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Credit Risk The Company extends credit to its customers in the normal course of business and generally does not require collateral or other security. The Company performs ongoing credit evaluations of its customers financial condition and historically has not incurred significant credit losses.

Concentration of Credit Risk The Company maintains checking accounts for Arrowhead and separate accounts for each Subsidiary at either of two financial institutions. These accounts are insured by the Federal Deposit Insurance Corporation (FDIC) for up to $100,000. The Company has three wealth management accounts at the same financial institution that invest in higher yield money market accounts and in government securities. At June 30, 2008, the Company had uninsured cash deposits totaling $14,075,847. The Company has not experienced any losses in such accounts and management believes it has placed its cash on deposit with financial institutions that are financially stable.

Property and Equipment Property and equipment are recorded at cost. Depreciation of property and equipment is recorded on the straight-line method over the respective useful lives of the assets ranging from 3 to 7 years. Leasehold improvements are amortized over the initial term of the leases.

Intellectual Property At June 30, 2008, intellectual property consisted of patents and patent applications licensed or purchased in the gross amount of $570,983. A portion of the consideration paid for Insert has been allocated to the patents held by Insert. The Calando (formerly Insert) patents, in the gross amount of $3,301,190, are being amortized over the life of these patents. The accumulated amortization of patents totaled $1,244,243 at June 30, 2008. Patents are being amortized over 3 years to 20 years unless a patent is determined to have no foreseeable commercial value and is written down to $1. The weighted average original amortization period is 13 years. The weighted average remaining amortization period is 10 years.

Revenue Recognition Revenue from product sales is recognized when the related goods are shipped and all significant obligations of the Company have been satisfied. The Company recognizes license fee revenue on a straight-line basis over the term of the license. Development fees, milestone fees, collaboration fees and grant revenues are recognized upon the completion and payment of services or achievement of the mutually agreed milestones.

The Company generated revenues of $235,000 and $623,000 for the three months ended June 30, 2008 and 2007, respectively, and revenues of $1,363,000 and $630,000 for the nine months ended June 30, 2008 and 2007, respectively. The revenue for the three months ended June 30, 2008 consists of $85,000 from license fees from Unidym technology, $144,000 from the sale and delivery of carbon nanotubes to third parties and $6,000 for shipping charges. The revenue for the first nine months of fiscal 2008 consists of $748,000 from grants to fund research for the development of carbon nanotube applications, $507,000 from the sale and delivery of carbon nanotubes to third parties and $23,000 for shipping charges. The $630,000 of revenue in the prior year s nine month period consisted of $409,000 from grants to fund research for the development of carbon nanotube applications, $207,000 from the sale and delivery of carbon nanotubes to third parties and $7,000 for shipping charges and $7,000 of revenue from a National Institute of Health grant at Calando.

Cost of Goods Sold The Company includes direct materials, production labor and direct plant production cost (excluding depreciation) in cost of goods sold.

Research and Development Costs and expenses that can be identified as research and development are charged to expense as incurred in accordance with Financial Accounting Standards Board (FASB) statement No. 2, Accounting for Research and Development Costs .

Earnings (Loss) per Share Basic earnings (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) per share are computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Dilutive potential common shares primarily consist of stock options issued to employees, directors and consultants and warrants of the Company.

Recently Issued Accounting Standards Management does not believe that any recently issued, but not yet effective, accounting standards, if currently adopted, would have a material effect on the accompanying financial statements.

NOTE 2. ***BASIS OF CONSOLIDATION***

The consolidated financial statements for the three-month and nine-month periods ended June 30, 2008 and 2007, respectively, include the accounts of Arrowhead and its Subsidiaries Calando, Unidym and Tego. Aonex is included in the Loss from discontinued operations. All significant intercompany accounts and transactions are eliminated in consolidation and minority interests were accounted for in the consolidated statements of operations and the balance sheets.

NOTE 3. ***ALLOWANCE FOR DOUBTFUL ACCOUNTS***

The Company accrues an allowance for doubtful accounts based on estimates of uncollectible revenues by analyzing historical collections, accounts receivable aging and other factors. Accounts receivable are written off when all collection attempts have failed. The allowance for doubtful accounts applicable to Unidym as of June 30, 2008 was $56,031.

NOTE 4. ***INVESTMENT IN SUBSIDIARIES AND AFFILIATES***

Calando Pharmaceuticals, Inc. (formerly known as Insert Therapeutics, Inc.)

On April 17, 2008, Calando merged with and into Insert, with Insert as the surviving company. Following the common-control merger, Insert changed its name to Calando. Insert and Calando effectuated the merger (the Calando Merger) of Calando with and into Insert pursuant to the Agreement and Plan of Reorganization dated January 14, 2008 (the Calando Merger Agreement).

Prior to the merger, Arrowhead had financed the operations of Insert and Calando through a series of working capital loans. At the time of the merger, Arrowhead had a series of 6% simple-interest working capital loans outstanding to Insert totaling $1,600,000. Arrowhead also had a series of 6% simple-interest working capital loans outstanding to Calando totaling $4,450,000. As part of the merger, an Agreement to Provide Additional Capital, dated as of March 31, 2006, between Calando and the Company was amended and terminated to accelerate the payment of the remaining $6,000,000 payable thereunder, against receipt of the repayment of the principal and interest on all loans extended by the Company to either Insert or Calando ($6,187,663 principal and interest as of the date of the merger).

Among other things, the Calando Merger was conditioned upon the recapitalization of Insert and Calando to eliminate the preferred stock of each company. In the Insert recapitalization, immediately before the effective time of the Calando Merger, each share of Insert Series B Preferred Stock, Series C Preferred Stock and Series C-2 Preferred Stock was converted into one share of common stock, par value $0.0001 per share, of Insert (the Insert Common Stock). All warrants outstanding for the purchase of Insert Series D Preferred Stock became exercisable for a like number of shares of Insert Common Stock. In the Calando recapitalization, immediately before the effective time of the Calando Merger, each share of Calando Series A Preferred Stock was be converted into one share of Calando common stock, par value $0.0001 per share (the Calando Common Stock).

At the time of the Calando Merger, each issued and outstanding share of Calando Common Stock was canceled and automatically converted into the right to receive shares of Insert Common Stock based on the relative enterprise valuation of Insert to Calando of 1 to 1.5, or a Calando Merger share exchange ratio of 5.974126 shares of Insert Common Stock issued for each share of Calando Common Stock. Outstanding options to acquire Calando Common Stock were converted into an option to acquire approximately 5.974126 shares of Insert Common Stock.

Insert and Calando made representations, warranties and covenants to one another in the Calando Merger Agreement, which expired at the effective time of the Calando Merger. Consummation of the Calando Merger was conditioned upon, among other things: (i) the representations and warranties of each party to the Calando Merger Agreement being true in all material respects as of the closing; (ii) the performance or satisfaction in all material respects of all covenants and conditions of each party to the Calando Merger Agreement; (iii) the completion of the recapitalization of Insert and Calando; (iv) the approval by a majority of Insert s and Calando s stockholders (excluding the Company); and (v) the satisfaction of certain other customary closing conditions.

As a result of the Calando Merger, the following agreements to which the Company was a party terminated: (i) Insert s Right of First Refusal and Co-Sale Agreement, relating to Insert, dated as of June 4, 2004, (ii) Insert s Voting Agreement, dated as of June 4, 2004, (iii) Calando s Amended and Restated Investors Rights Agreement, dated as of March 31, 2006, (iv) Calando s Amended and Restated Voting Agreement, dated as of March 31, 2006, and (v) Calando s Right of First Refusal and Co-Sale Agreement, dated as of March 31, 2006. Upon the effective date, the license agreement between Insert and Calando, dated as of March 14, 2005, pursuant to which Insert granted Calando worldwide exclusive rights to Insert s intellectual property related technologies, and a broad patent application covering methods and uses for the therapeutic use of RNAi, including its linear cyclodextrin polymers, was terminated.

With the Calando Merger, Insert entered into an Amended and Restated Investors Rights Agreement (the Restated Investors Rights Agreement), restating Insert Investors Rights Agreement, dated as of June 4, 2004, as amended by Amendment No. 1 to Investors Rights Agreement, dated as of March 30, 2005, and as further amended by Amendment No. 2 to Investors Rights Agreement, dated as of October 25, 2006.

Following the Calando Merger, the Company owns 67.8% of the outstanding shares of the combined company (62.5% on a fully diluted basis).

As of June 30, 2008, Arrowhead had a series of 6% simple-interest working capital loans outstanding to Calando totaling $1,987,663 plus accrued interest of $20,941 payable upon demand.

Unidym, Inc. (formerly NanoPolaris, Inc.)

On April 4, 2005, Arrowhead founded NanoPolaris, Inc. (NanoPolaris) as a wholly-owned subsidiary of Arrowhead. NanoPolaris was initially capitalized with $1,000.

On June 13, 2006, NanoPolaris acquired substantially all of the net assets and the name Unidym from Unidym s founding scientist. Unidym was a developer of carbon nanotube-based electronics. The net assets acquired included Unidym s intellectual property, prototypes and equipment, for a purchase price consisting of $25,000 in cash, the assumption of $75,000 of liabilities and shares of NanoPolaris common stock, with an estimated value of $154,350. At the time of the purchase, the shares issued for the purchase represented 11.9% (10% on a fully diluted basis) of NanoPolaris outstanding voting stock. Concurrently with the purchase, Arrowhead agreed to provide up to $4,000,000 in additional capital contributions over the next two years. In August 2006, NanoPolaris changed its name to Unidym, Inc.

On April 20, 2007, a wholly owned subsidiary of Unidym merged with CNI, a Texas-based company involved in the development, manufacture and marketing of carbon nanotubes (the CNI Merger). The combined company operates under the Unidym name, has an expansive portfolio of carbon nanotube-related patents and is one of the largest manufacturers of carbon nanotubes in the world.

In connection with the CNI Merger, Arrowhead agreed to accelerate the $4,000,000 capital contribution to Unidym and made payment on April 23, 2007. In aggregate consideration for the acceleration of the additional capital to Unidym and the transfer from Arrowhead to Unidym of rights and obligations under two sponsored research agreements, Unidym issued 448,000 shares of Unidym common stock to Arrowhead.

Prior to the CNI Merger, certain shareholders of CNI assumed all of CNI s outstanding debt, a total of $5,400,000, in exchange for 1,080,000 shares of Series E Preferred Stock of CNI. On the date of the CNI Merger, Arrowhead purchased the Series E Preferred Stock in exchange for 1,431,222 shares of Arrowhead Common Stock with an estimated fair market value of $5,400,000. The CNI Series E Preferred Stock was exchanged in the merger for 2,784,252 shares of newly authorized Unidym Series B Preferred Stock. The 2,889,000 shares of Unidym Series A Preferred Stock owned by Arrowhead were exchanged for 2,889,000 shares of Unidym Series B Preferred Stock.

In exchange for all the outstanding shares of CNI common stock, Unidym issued 5,000,000 shares of newly authorized Unidym Series A Convertible Preferred Stock with an estimated total value of $4,200,000. The Series A Preferred Stock is convertible into 8,400,482 shares of Unidym common stock under certain conditions. Unidym also assumed CNI s 2007 Restricted Stock Unit Plan subject to which 1,104,010 shares of Unidym common stock are issuable on the later of June 30, 2008, or an initial public offering by Unidym and a warrant to purchase 64,000 shares of Unidym common stock.

The consolidated statement of operations includes the results of the merged companies since April 21, 2007.

Prior to the CNI Merger, Arrowhead owned 88.1% of the outstanding voting securities of Unidym. Immediately following the CNI Merger, Arrowhead s ownership of the outstanding voting securities was 60.1%. If all options were awarded and exercised, all common stock subject to restricted stock units was issued and all preferred stock was converted, Arrowhead s interest would have been 42.1% immediately following the CNI Merger.

In December 2007, Unidym completed a private financing with strategic and financial investors, pursuant to which Unidym issued and sold an aggregate of 5,764,778 shares of its Series C Preferred Stock for $1.80 per share. The private placement generated net cash proceeds of $10,013,897, including $3,000,000 invested by Arrowhead.

Immediately following the private financing, in December 2007, Arrowhead s ownership of the outstanding, voting securities was 51.2%. If at that point in time all options were awarded and exercised, all common stock subject to restricted stock units was issued and all preferred stock was converted, Arrowhead s interest would have been 39.2%.

On April 23, 2008, the Company entered into a stock purchase agreement whereby the Company purchased from a Unidym stockholder and director 550,000 shares of Unidym common stock in exchange for $350,000 in cash and restricted Company common stock valued at $200,000. As part of the agreement, the director resigned from his seat on the Unidym board and the Chief Executive Officer of the Company was appointed to the Unidym board.

At June 30, 2008, the Company owned 53.3% if the outstanding voting stock of Unidym and 37.5% on a fully diluted basis.

On March 13, 2008, the Unidym s wholly owned subsidiary, Unidym Acquisition LLC that merged with CNI was itself merged into Unidym and ceased to exist.

On June 12, 2008 and June 16, 2008, Unidym entered into subscription agreements with Entegris, Inc. and Arrowhead Research Corporation, respectively, pursuant to which Unidym issued and sold an aggregate of 2,222,222 shares of its Series C Preferred Stock for aggregate cash proceeds of $4,000,000 in a private financing transaction. Entegris investment was made in connection with its expanded customer relationship with Unidym for carbon nanotubes. The Company purchased 1,111,111 shares of Series C Preferred Stock for a purchase price of $2,000,000. After giving effect to the Shares issued in this private placement, Arrowhead retains majority ownership of Unidym.

In addition to other licensing agreements on March 14, 2008, Unidym sub-licensed certain of its intellectual property to Ensysce BioSciences Inc. (Ensysce) that will focus on research into the medical therapeutic applications of carbon nanotubes. Ensysce is both funded and effectively controlled by a related party to Unidym who also serves as a director of Unidym. Terms of the licensing arrangement between Unidym and Ensysce include a $25,000 up-front sub-licensing fee, ongoing royalties, and an initial 50% equity position for Unidym in Ensysce. Unidym also provides contract services to Ensysce, including supplies of research grade nanotubes, back-office and accounting support. Ensysce is accounted for on the equity basis.

Tego BioSciences Corporation

On April 20, 2007, Tego, a newly formed, wholly-owned Subsidiary of Arrowhead, acquired the assets of C Sixty, Inc., a Texas-based company developing pharmaceuticals based on the unique biochemical properties of modified fullerenes, for $1,000. On July 3, 2007, Arrowhead capitalized Tego with a purchase of 5,000,000 shares of Tego Series A Preferred Stock for $100,000. The Company is evaluating opportunities for Tego s technology.

On October 25, 2007, Arrowhead provided $2.4 million in additional capital to Tego, in exchange for 15 million shares of Series A-2 Preferred Stock. The $2.4 million is to be used for developing and commercializing pharmaceuticals based on modified fullerenes. Arrowhead owns 100% of the outstanding voting securities of Tego and 83% of the voting securities on a fully diluted basis after taking into account stock options and warrants.

Along with the on-going studies with the National Cancer Institute and university laboratories, Tego has initiated a number of pre-clinical studies to better understand the chemistry and the pharmacology as well as the efficacy and potency of its proprietary fullerene based compounds. The studies include applications in the areas of magnetic resonance imaging contrast agents and ophthalmic therapeutics.

Minority Positions in Private Companies

Nanotope, Inc.

Through the acquisition of Masa Energy LLC, a Delaware limited liability company with no other assets or operations, in April 2008, the Company acquired a 5.78% minority position in Nanotope, Inc. (Nanotope) and a 6.13% minority position in Leonardo Biosystems, Inc. (LBS)

On July 23, 2008, the Company acquired shares of Series B Preferred Stock of Nanotope and committed to acquire shares for another $1 million on or before September 17, 2008, bringing the Company s ownership to approximately 23% of Nanotope. See note 13, Subsequent Events.

Nanotope is developing advanced nanomaterials for the treatment of spinal cord injuries and wound healing. Nanotope is based on technology developed in the laboratories of Dr. Samuel Stupp at Northwestern University. Nanotope s lead product is a compound that, when injected or applied at a wound site, self-assembles to form a scaffold of nanofibers on which cells can grow and differentiate to heal the wound.

Leonardo Biosystems, Inc.

LBS is developing a drug-delivery platform technology is based on novel methods of designing spheroid porous silicon microparticles that selectively accumulate in the tumor vasculature. The microparticles are designed to be loaded with drug associated nanoparticles. LBS is based on technology developed in the University of Texas laboratory of Dr. Mauro Ferrari.

NOTE 5. DISCONTINUED OPERATIONS AONEX

On May 5, 2008, Aonex entered into an Agreement and Plan of Merger (the Aonex Merger Agreement) by and among AmberWave Systems Corporation, a Delaware corporation in the business of research, development and licensing of advanced technologies for semiconductor manufacturing (Amberwave) and Aonex Acquisition Corporation, a California corporation and wholly-owned subsidiary of the Amberwave formed for the purpose of acquiring Aonex s business (Acquiror). On May 6, 2008, the merger was consummated and the outstanding Company loans to Aonex of $1,298,000 were converted to equity.

At the effective time of the Aonex Merger all of the issued and outstanding shares of Aonex capital stock automatically converted into the right to receive an aggregate amount equal to (a) $450,000 minus (b) the sum of the of Aonex transaction expenses and $15,625.31. In addition, the stockholders of Aonex are entitled to receive future payments as follows:

(i) Upon Acquiror s completion of a successful laminate substrate production at its facilities, Acquiror will pay the stockholders of Aonex capital stock (Aonex Stockholders) an additional amount equal to $500,000;

(ii) For each agreement the Acquiror enters into with a customer during the 24 month period following the closing of the Merger (each a Customer Agreement), the Acquiror will pay Aonex Stockholders an additional amount equal to $500,000 (with the aggregate amount not to exceed $2 million), subject to the satisfaction of certain procedural requirements set forth in the Aonex Merger Agreement;

(iii) During the 42-month period beginning on the closing of the Aonex Merger, the Acquiror will pay Aonex Stockholders, on a quarterly basis, the sum of: (A) 20% of the cash gross margin contribution received by the Acquiror or its subsidiaries from its customers during such period for the sale of specified products, services or devices employing Aonex s intellectual property assets, and (B) 35% of the revenues from the licensing or sale of Aonex s intellectual property assets received by the Acquiror from its customers during such period; provided however, that (1) the aggregate payments under this subsection do not exceed $7 million and (2) certain procedural requirements set forth in the Aonex Merger Agreement are satisfied; and

(iv) During the ten-year period following the Aonex Merger, the Acquiror will pay Aonex Stockholders royalty payments, payable on a quarterly basis, equal to one-half of one percent of the revenues associated with the sale of any product incorporating the Aonex s intellectual property assets for solar applications or the license of Aonex s intellectual property assets for solar applications; subject to the satisfaction of certain procedural requirements set forth in the Aonex Merger Agreement.

Notwithstanding the above, the aggregate Earn-out Payments made by the Acquiror (other than those payments under subsection (iv) above) to Aonex Stockholders shall not exceed $7.95 million.

Arrowhead has preference to the first $6,298,000 in future payments after which any additional payments will be split 64% to Arrowhead and 36% to the holders of the common stock of Aonex.

NOTE 6. STOCKHOLDERS EQUITY

The Company had a total of 75,000,000 authorized shares at June 30, 2008, consisting of 70,000,000 authorized shares of Common Stock, par value $0.001, and 5,000,000 shares of authorized Preferred Stock.

At June 30, 2008, 38,941,373 shares of Common Stock were outstanding. At June 30, 2008, 1,559,000 shares and 4,738,310 shares were reserved for issuance upon exercise of options granted under Arrowhead s 2000 Stock Option Plan and 2004 Equity Incentive Plan, respectively. On December 3, 2007, an inducement grant of options to purchase 2,000,000 shares of Common Stock was made outside of Arrowhead s equity incentive plans to the Company s newly hired CEO. Arrowhead s Compensation Committee is negotiating the final terms of this grant to be memorialized in a Stock Option Agreement. Through June 30, 2008, options to purchase 1,559,000 shares were outstanding under the 2000 Stock Option Plan and options to purchase 4,432,680 shares were outstanding under the 2004 Equity Incentive Plan.

On January 24, 2006, the Company completed a private placement of 5,590,000 shares of restricted Common Stock at $3.50 per share that generated $19.6 million in total proceeds. The purchasers received warrants, exercisable after July 25, 2006, to purchase an additional 1,397,500 shares of restricted Common Stock at $5.04 per share. The warrants may be called by the Company any time after July 25, 2006, if the closing price of the Company s Common Stock is $6.50 or above for the previous 30 trading days.

On May 29, 2007, the Company completed a private placement of 2,849,466 shares of restricted Common Stock at $5.78 per share that generated $15.2 million in net proceeds. The purchasers received warrants to purchase an additional 712,362 shares of Common Stock at $7.06 per share. The warrants may be called by the Company any time after May 29, 2008, if the closing price of the Company s Common Stock is $8.47 or above for the previous 20 trading days.

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

Exercise prices	**Number of Warrants**	**Weighted Average Remaining Life in Years**	**Weighted Average Exercise Price**
$5.04	1,397,500	7.6	$5.04
$7.06	712,362	8.9	$7.06

On January 30, 2008, Arrowhead s Form S-3 Registration Statement, originally filed on December 20, 2007, was declared effective. The prospectus allows Arrowhead to issue, from time to time in one or more offerings, shares of Common Stock and warrants to purchase common stock for an aggregate dollar amount of up to $50 million.

It is the Company s intent to use the net proceeds from the sale of the securities and received upon exercise of the warrants for general corporate purposes, which may include one or more of the following: working capital, research and clinical development activities, potential future acquisitions of companies and/or technologies, and capital expenditures.

NOTE 7. *LEASES*

The Company leases the following facilities:

	Lab/Office Space	**Monthly Rent**	**Lease Commencement**	**Lease Term**
Arrowhead				
Pasadena(1)	7,388 sq ft	$ 17,362	March 1, 2006	62 Months
New York	130 sq ft	$ 3,600	September 1, 2007	12 Months
Calando	4,354 sq ft	$ 12,173	June 1, 2006	36 Months
Unidym				
Menlo Park, CA	7,000 sq ft	$ 14,345	February 1, 2007	36 Months
Houston, TX	8,017 sq ft	$ 13,362		Month to Month
Springfield, MO	1,900 sq ft	$ 2,533	December 1, 2007	24 Months

(1) Arrowhead leases corporate office space in Pasadena, which it occupied beginning March 1, 2006. The lease agreement provides Arrowhead with two months free rent, which was recorded as a deferred liability and is being amortized over the life of the lease.

The Company has no plans to own any real estate and expects that all facility leases will be operating leases.

At June 30, 2008, the future minimum commitments remaining under leases were as follows:

Twelve months ending September 30	**Facilities Leases**	**Equipment Leases**
2008 (3 months)	$ 152,426	$ 4,642
2009	$ 521,656	$ 14,382
2010	$ 283,353	$ 9,210

2011	$ 129,290	$ 2,268
2012 and thereafter	$ 0	$ 0

Facility and equipment rent expense for the three months ended June 30, 2008 and 2007 was $295,336 and $261,194 respectively. Facility and equipment rent expense for the nine months ended June 30, 2008 and 2007 was $821,082 and $626,167 respectively. From inception to date, rent expense has totaled $2,634,513.

NOTE 8. ***COMMITMENTS AND CONTINGENCIES SUBSIDIARIES AND SPONSORED RESEARCH***

Subsidiaries

As of June 30, 2008, Arrowhead held a majority interest of each of the following three operating Subsidiaries:

Subsidiary	% Outstanding Voting Securities[2]	Technology/Product Focus
Calando Pharmaceuticals, Inc. (1) *founded June 4, 2004*	67.8%	Developing nano-engineered RNAi therapeutics and drug delivery system in anti-cancer clinical trials
Unidym, Inc. (formerly NanoPolaris) *founded April 4, 2005*	53.5%	Developing carbon nanotube products for the electronic industry
Tego BioSciences Corporation *founded April 20, 2007*	100.0%	Developing pharmaceutical products based on the unique biochemical properties of modified fullerenes

(1) On April 17, 2008, Calando merged with Insert. Following the Calando Merger, Insert Therapeutics, Inc. changed its name to Calando Pharmaceuticals, Inc.

(2) Each Subsidiary has an option plan to help motivate and retain employees. Calando has 4,335,473 outstanding warrants, primarily issued in connection with a financing event that closed in October 2006. As of June 30, 2008, assuming all options in each Subsidiary plan were awarded and exercised and all warrants were exercised, the Company would own approximately 62.5% of Calando, 37.5% of Unidym and 83% of Tego.

Sponsored Research

By funding university research, Arrowhead has the opportunity to ascertain the technical success at low research cost and, if warranted, continue cost effective development by leveraging the already existing resources available to university scientists, such as laboratories and equipment and a culture that encourages the exchange of ideas. Moreover, the cultivation of relationships in the academic community provides an additional window into other promising technologies. The Company normally obtains the exclusive license to the technology developed by the research it sponsors. If such technology has commercial potential, the Company can form a majority-owned subsidiary to develop the technology and provide stock in the subsidiary to the scientist and the university, in order to give them an economic interest in the success of the subsidiary. Should the related technology prove to be too difficult or too expensive to commercialize, Arrowhead may terminate the license agreement and return the licensed intellectual property to the university.

Sponsored Research for the three months ended June 30, 2008 and 2007, was $142,559 and $368,782, respectively. Sponsored Research for the nine months ended June 30, 2008 and 2007, was $678,531 and $682,565, respectively.

Sponsored Research Agreement University of Florida

The terms of the sponsored research agreement with the University of Florida (UF) are summarized in the following table:

Research Project	Period Covered	Total Estimated Project Cost	Annual Cost	Amount Paid as of June 30, 2008	Prepaid Amt as of June 30, 2008
Development of flexible electronic devices Thin film transistors (Dr. Andrew Rinzler)	Jul. 1, 2006 - Jun. 30, 2008 (2 years)	$ 647,533	$ 323,767	$ 647,533	$ 0

In connection with the merger between Unidym and CNI, the rights and obligations under the sponsored research agreement with UF were transferred to Unidym.

Sponsored Research Agreement Duke University

The terms of the new sponsored research agreement between Unidym and Duke University (Duke) are summarized in the following table:

Research Project	Period Covered	Total Estimated Project Cost	Annual Cost	Amount Paid as of June 30, 2008	Prepaid Amt as of June 30, 2008
Electrical Conductivity of Carbon Nanotubes (Dr. Jie Liu)	Dec. 1, 2007 - Nov. 30, 2010 (3 years)	$ 574,124	$ 191,375	$ 136,641	$ 25,006

The first payment of $136,641, for the above sponsored research project was made in May 2008.

The agreement described below concluded in November 2007 and was one of the sponsored research obligations transferred from Arrowhead to Unidym at the time of the CNI merger.

Research Project	Period Covered	Total Estimated Project Cost	Annual Cost	Amount Paid as of June 30, 2008	Prepaid Amt as of June 30, 2008
CVD Growth of Well-Aligned Individual Single Walled Carbon Nanotubes (Dr. Jie Liu)	Dec. 1, 2005 - Nov. 30, 2007 (2 years)	$ 677,651	$ 338,826	$ 677,651	$ 0

Sponsored Research Agreements California Institute of Technology

The terms of the sponsored research agreements between Arrowhead and the California Institute of Technology (Caltech) are summarized in the following table:

Research Project	Period Covered	Total Estimated Project Cost	Annual Cost	Amount Paid as of June 30, 2008	Prepaid Amt as of June 30, 2008
Drug Discovery & Diagnostics (Dr. C. Patrick Collier)	Oct. 1, 2003 - Sept. 30, 2008 (5 years)	$ 1,393,806	$ 292,540	$ 1,152,266	$ 0

Gene Regulatory Networks (Dr. Eric H. Davidson)	Jan. 1, 2007 - Dec. 31, 2009 (3 years)	$ 765,000	$ 255,000	$ 404,800	$ 0

After fiscal 2007 year end, Arrowhead issued notices to terminate both sponsored research agreements with Caltech. The Company was responsible for any outstanding commitments that could not be canceled. The total cost to terminate the agreements and to settle the outstanding obligations was $201,000.

In January and July of 2007, Insert made contributions of $50,000 each to Caltech for laboratory research in the field of synthetic polymers for use primarily in drug delivery applications. Caltech has granted Calando (formerly known as Insert) an exclusive license to the patent rights and improvements in the field of synthetic polymers for drug delivery.

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Sponsored Research Agreement Stanford University

Arrowhead has exclusively licensed intellectual property from Stanford University (Stanford) for a nanotech device designed to control the behavior of stem cells. Arrowhead funded additional research involving the device at Stanford to develop and commercialize the technology.

Research Project	Period Covered	Total Estimated Project Cost	Annual Cost	Amount Paid as of June 30, 2008	Prepaid Amt as of June 30, 2008
Microchip-based Biological Signal Delivery (Dr. Nicholas Melosh)	Jun. 1, 2005 - May 31, 2007 (2 years)	$ 600,000	$ 300,000	$ 600,000	$ 0

All payments under this agreement had been made and the agreement had been concluded.

Employment Agreements

On May 24, 2007, the Company entered into a Severance Agreement with each of R. Bruce Stewart, the Company s Chairman and Chief Executive Officer at that time, and Joseph T. Kingsley, the Company s Interim President and Chief Financial Officer at that time, to provide for payments to the officers in the event of their retirement or the termination of their employment. The agreements provide that the executives will be entitled to receive severance payments and payments for any accrued and unused vacation time in the event that (i) the executive dies or voluntarily retires from the Company, (ii) the executive voluntarily terminates his employment other than for cause or (iii) the Company terminates the executive s employment other than for cause (each, a Termination Event). Upon the occurrence of a Termination Event, Mr. Stewart is entitled to receive as severance, during each of the first three years following the Termination Event, payments equal to his highest annual salary while employed by the Company, payable in equal monthly installments. Upon the occurrence of a Termination Event, Mr. Kingsley was entitled to receive as severance, during the first year following the Termination Event, payments equal, in the aggregate, to 100% of his highest annual salary while employed by the Company, payable in equal monthly installments, which payments would be reduced by any payments received by Mr. Kingsley or his estate from the Company s Long Term Disability Plan. Each agreement also provides that, if any payment to the executive is subject to excise tax under Section 4999 of the Internal Revenue Code of 1986, as amended (the Code), the Company will pay to the executive an amount sufficient, on an after-tax basis, to put the executive in the same position he would have been in if the excise tax was not imposed. The timing of payments under the agreements is also subject to adjustment to avoid any adverse tax treatment under Section 409A of the Code.

Mr. Kingsley stepped down from his positions as Interim President on December 1, 2007 and as Chief Financial Officer of the Company on January 14, 2008 and remained an employee of the Company. On March 10, 2008, the Company entered into an Employment Agreement with Mr. Kingsley. Under the Agreement, Mr. Kingsley will serve as Assistant to the President from January 14, 2008 through January 13, 2009 and he will be paid his previous base salary. Mr. Kingsley s previously granted stock options ceased vesting as of January 14, 2008 and all remaining unvested stock options were cancelled. The exercise period for the Executive s vested stock options was extended by the Employment Agreement from 90 days after retirement to one year after he terminates employment with the Company. As a condition to the Employment Agreement, the Severance Agreement between the Company and Mr. Kingsley, entered into on May 24, 2007 was terminated in its entirety.

As of June 30, 2008, the Company had accrued $750,000 related to the Stewart Severance Agreement.

On June 11, 2008, the Company, entered into an Employment Agreement and a Stock Option Agreement (together with the Employment Agreement with Dr. Christopher Anzalone, the Company s Chief Executive Officer and President as well as a Director of the Company. Dr. Anzalone commenced employment with the Company on December 1, 2007.

Dr. Anzalone will be paid an annual base salary of $400,000 and is eligible to receive bonuses based on the performance of the Company and individual performance objectives. Dr. Anzalone was also granted an option to purchase 2,000,000 shares of Arrowhead common stock with an exercise price of $3.92 per share, which is equal to the closing price of Arrowhead s common stock on NASDAQ Global Market on the date of grant, December 3, 2007. The option will vest as follows: 250,000 shares vest on the six month anniversary of Dr. Anzalone s date of hire and the balance of the shares vest in 42 equal installments on the first of each successive month. These options are governed by the Stock Option Agreement and were granted outside of the Company s current equity incentive plans.

Dr. Anzalone will also be reimbursed up to $100,000 in relocation expenses and the Company agreed to provide supplemental life insurance to bring his life insurance benefit up to $2,000,000. If the Company terminates Dr. Anzalone s employment without cause, the Company will pay Dr. Anzalone his base salary and benefits for twelve months.

Facility Lease Agreement

As of June 30, 2008 the facility lease for Unidym s Houston location has expired and is now operating on a month to month basis. The facility s landlord is unwilling to enter into a new facility lease with Unidym and believes it can achieve a better return on its investment by having a new tenant occupy both the administrative and manufacturing areas that it currently leases to Unidym. Unidym also employs, on a contract basis, certain technicians from the landlord to assist in Unidym s manufacturing and research and development activities. Unidym does not believe that the relocation of the facility or the replacement of the landlord s technicians results in any adverse long term impact to Unidym, although, the relocation of the facility will eventually result in relocation related expenses which are unknown at this time but could be significant. On August 6, 2008, Unidym entered into a lease for a facility in Houston, Texas. See Note 13, Subsequent Events.

NOTE 9. *STOCK OPTIONS*

Stock-Based Compensation Arrowhead has two plans that provide for equity-based compensation. Under the 2000 Stock Option Plan, 1,559,000 shares of Arrowhead s Common Stock are reserved for issuance upon exercise of non-qualified stock options. No further grants can be made under the 2000 Stock Option Plan. The 2004 Equity Incentive Plan reserves 4,738,310 shares for the grant of stock options, stock appreciation rights, restricted stock awards and performance unit/share awards by the Board of Directors to employees, consultants and others expected to provide significant services to Arrowhead. As of June 30, 2008, there were options granted and outstanding to purchase 1,559,000 and 4,432,680 shares of common stock under the 2000 Stock Option Plan and the 2004 Equity Incentive Plan, respectively. During the three months ended June 30, 2008, options to purchase 810,000 shares of Common Stock were granted under the 2004 Equity Incentive Plan.

On December 3, 2007, an inducement grant of an option to purchase two million shares of Common Stock was made outside of Arrowhead s equity incentive plans to Dr. Christopher Anzalone, the Company s new Chief Executive Officer. The option vests over 48 months with the first 41,667 shares vesting six months from the date of original grant. The option price is $3.92 per share, the closing price of Arrowhead s stock on the date of grant. The estimated fair value at the date of grant was $4,692,207.