

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended June 30, 2000

or

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

For the transition period from _____ to _____
Commission file number 000-26422

DISCOVERY LABORATORIES, INC.

(Exact name of small business issuer as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

94-3171943

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

350 South Main Street, Suite 307

Doylestown, Pennsylvania

(Address of principal executive offices)

18901

(Zip Code)

Registrants' telephone number, including area code: (215) 340-4699

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

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

Common Stock, par value \$.001 per share

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

As of August 10, 2000, 20,840,353 shares of Common Stock, par value \$.001 per share, were outstanding.

Documents incorporated by reference: None.

Transitional Small Business Disclosure Format: Yes No

Page 1

DISCOVERY LABORATORIES, INC.

Table of Contents

Page

PART I - FINANCIAL INFORMATION

| | |
|---|--------|
| Item 1. Financial Statements (unaudited) | |
| CONSOLIDATED BALANCE SHEETS -- | |
| As of June 30, 2000 (unaudited) and December 31, 1999..... | Page 3 |
| CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited) -- | |
| For the Three and Six Months Ended June 30, 2000 and | |
| June 30, 1999 and for the Period from May 18, 1993 (Inception) | |
| through June 30, 2000..... | Page 4 |
| CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY | |
| (unaudited)-- For the Six Months Ended June 30, 2000..... | Page 5 |
| CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)-- | |
| For the Six Months Ended June 30, 2000 and June 30, 1999 | |
| and for the Period from May 18, 1993 (Inception) | |
| through June 30, 2000..... | Page 6 |
| Notes to Financial Statements..... | Page 7 |
| Item 2. Management's Discussion and Analysis of Financial Condition | |
| and Results of Operations..... | Page 7 |

PART II - OTHER INFORMATION

| | |
|--|---------|
| Item 1. Legal Proceedings..... | Page 10 |
| Item 2. Change in Securities..... | Page 10 |
| Item 3. Defaults Upon Senior Securities..... | Page 10 |
| Item 4. Submission of Matters to a Vote of Security Holders..... | Page 10 |
| Item 5. Other Information..... | Page 10 |
| Item 6. Exhibits and Reports on Form 8-K..... | Page 10 |
| Signatures..... | Page 12 |

DISCOVERY LABORATORIES, INC. AND SUBSIDIARY
(a development stage company)

Consolidated Balance Sheets

| | June 30, 2000 | December 31, 1999 |
|---|----------------------|----------------------|
| | ----- (Unaudited) | ----- |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 11,813,000 | \$ 3,547,000 |
| Marketable securities | \$ 10,038,000 | |
| Inventory | 575,000 | 575,000 |
| Prepaid expenses and other current assets | 233,000 | 66,000 |
| | ----- | ----- |
| Total current assets | 22,659,000 | 4,188,000 |
| Property and equipment, net of depreciation | 527,000 | 426,000 |
| Security deposits | 69,000 | 18,000 |
| | ----- | ----- |
| | \$ 23,255,000 | \$ 4,632,000 |
| | ----- | ----- |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 678,000 | \$ 425,000 |
| Deferred revenue | 1,036,000 | 1,036,000 |
| Capitalized lease - current | 15,000 | 15,000 |
| | ----- | ----- |
| Total current liabilities | 1,729,000 | 1,476,000 |
| | ----- | ----- |
| Capitalized lease - noncurrent | 40,000 | 48,000 |
| | ----- | ----- |
| Stockholders' Equity: | | |
| Preferred stock, \$.001 par value; 5,000,000 shares authorized: | | |
| Series B convertible; None and 1,530,756 shares issued and outstanding at June 30, 2000 and December 31, 1999, respectively | 0 | 2,000 |
| Series C redeemable convertible; None and 2,039 shares issued and outstanding at June 30, 2000 and December 31, 1999, respectively | 0 | 2,481,000 |
| Common stock, \$.001 par value; 35,000,000 authorized; 20,829,652 and 9,689,240 shares issued and outstanding at June 30, 2000 and December 31, 1999 respectively | 21,000 | 10,000 |
| Treasury stock (at cost; 33,743 and 2,000 shares of common stock at June 30, 2000 and December 31, 1999, respectively) | (250,000) | (5,000) |
| Additional paid-in capital | 59,536,000 | 33,749,000 |
| Unearned portion of compensatory stock options | (148,000) | (37,000) |
| Accumulated other comprehensive loss | (44,000) | |
| Deficit accumulated during the development stage | (37,629,000) | (33,092,000) |
| | ----- | ----- |
| Total stockholders' equity | 21,486,000 | 3,108,000 |
| | ----- | ----- |
| | \$ 23,255,000 | \$ 4,632,000 |
| | ----- | ----- |

See notes to financial statements

DISCOVERY LABORATORIES, INC. AND SUBSIDIARY
(a development stage company)

Consolidated Statements of Operations
(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | | May 18, 1993 (Inception) Through June 30, 2000 |
|--|--------------------------------|----------------|------------------------------|----------------|--|
| | 2000 | 1999 | 2000 | 1999 | 2000 |
| Interest | \$ 296,000 | \$ 30,000 | \$ 318,000 | \$ 67,000 | \$ 1,786,000 |
| License Fees | | | | | 68,000 |
| Research Grants | | | 19,000 | | 156,000 |
| | ----- | ----- | ----- | ----- | ----- |
| | 296,000 | 30,000 | 337,000 | 67,000 | 2,010,000 |
| | ----- | ----- | ----- | ----- | ----- |
| Expenses: | | | | | |
| Write-off of acquired in-process research and development and supplies | | | | | 13,508,000 |
| Research and development | 1,259,000 | 472,000 | 2,033,000 | 1,891,000 | 14,902,000 |
| General and administrative | 620,000 | 686,000 | 1,355,000 | 1,322,000 | 8,968,000 |
| Compensatory Stock Options | 634,000 | | 1,447,000 | | 1,589,000 |
| Interest | 1,000 | | 3,000 | | 16,000 |
| | ----- | ----- | ----- | ----- | ----- |
| Total expenses | 2,514,000 | 1,158,000 | 4,838,000 | 3,213,000 | 38,983,000 |
| | ----- | ----- | ----- | ----- | ----- |
| | (2,218,000) | (1,128,000) | (4,501,000) | (3,146,000) | (36,973,000) |
| Minority interest in net loss of subsidiary | | | | | 26,000 |
| | ----- | ----- | ----- | ----- | ----- |
| Net loss | (2,218,000) | (1,128,000) | (4,501,000) | (3,146,000) | (36,947,000) |
| Other comprehensive income: | | | | | |
| Unrealized loss on marketable securities available for sale | (44,000) | (2,000) | (44,000) | (5,000) | (44,000) |
| | ----- | ----- | ----- | ----- | ----- |
| Total comprehensive loss | \$ (2,262,000) | \$ (1,130,000) | \$ (4,545,000) | \$ (3,151,000) | \$ (36,991,000) |
| | ===== | ===== | ===== | ===== | ===== |
| Net loss per share - basic and diluted | \$ (0.11) | \$ (0.18) | \$ (0.27) | \$ (0.51) | |
| | ===== | ===== | ===== | ===== | |
| Weighted average number of common shares outstanding | 20,800,000 | 6,597,000 | 16,734,000 | 6,121,000 | |
| | ===== | ===== | ===== | ===== | |

See notes to financial statements

DISCOVERY LABORATORIES, INC. AND SUBSIDIARY
(a development stage company)

Consolidated Statements of Changes in Stockholders' Equity
January 1, 2000 through June 30, 2000

| | Common Stock | | Treasury Stock | | Preferred Stock | | | |
|---|--------------|-----------|----------------|-------------|-----------------|---------|----------|--------------|
| | | | | | Series B | | Series C | |
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount |
| Balance -- January 1, 2000 | 9,689,240 | \$ 10,000 | (2,000) | \$ (5,000) | 1,530,756 | \$2,000 | 2,039 | \$ 2,481,000 |
| Exercise of Stock Options | 492,059 | | (31,743) | (245,000) | | | | |
| Common placement warrant conversions | 18,232 | | | | | | | |
| Preferred placement warrant conversions | 18,511 | | | | | | | |
| Exercise of Class C & D Warrants | 2,536,911 | 3,000 | | | | | | |
| Series B preferred stock conversions | 4,765,631 | 5,000 | | | (1,530,756) | (2,000) | | |
| Dividend Payable on Series C preferred stock | | | | | | | | 36,000 |
| Series C preferred stock conversions | 398,186 | | | | | | (2,039) | (2,517,000) |
| Compensation charge on vesting/exercisability of stock option | | | | | | | | |
| Compensatory stock options granted | | | | | | | | |
| Common stock issued in payment for services | 8,036 | | | | | | | |
| Issuance of private placement units | 2,902,846 | 3,000 | | | | | | |
| Unrealized loss on marketable securities available for sale | | | | | | | | |
| Net Loss | | | | | | | | |
| Balance June 30, 2000 | 20,829,652 | \$ 21,000 | (33,743) | \$(250,000) | -- | -- | -- | -- |

| | Additional Paid In Capital | Unearned Portion of Compensatory Stock Options | Deficit Accumulated during Development Stage | Accumulated Other Comprehensive Income | Total |
|---|----------------------------|--|--|--|--------------|
| Balance -- January 1, 2000 | \$33,749,000 | \$ (37,000) | \$ (33,092,000) | \$ -- | \$ 3,108,000 |
| Exercise of Stock Options | 445,000 | | | | 200,000 |
| Common placement warrant conversions | | | | | -- |
| Preferred placement warrant conversions | | | | | -- |
| Exercise of Class C & D Warrants | 3,790,000 | | | | 3,793,000 |
| Series B preferred stock conversions | (3,000) | | | | -- |
| Dividend Payable on Series C preferred stock | | | (36,000) | | -- |
| Series C preferred stock conversions | 2,517,000 | | | | -- |
| Compensation charge on vesting/exercisability of stock option | 1,215,000 | | | | 1,215,000 |
| Compensatory stock options granted | 343,000 | | | | 232,000 |
| Common stock issued in payment for services | 40,000 | (111,000) | | | 40,000 |
| Issuance of private placement units | 17,440,000 | | | | 17,443,000 |
| Unrealized loss on marketable securities available for sale | | | | (44,000) | (44,000) |
| Net Loss | | | (4,501,000) | | (4,501,000) |

Balance -- June 30, 2000 \$59,536,000 \$ (148,000) \$ (37,629,000) \$ (44,000) \$ 21,486,000

=====

See notes to financial statements

DISCOVERY LABORATORIES, INC. AND SUBSIDIARY
(a development stage company)

Consolidated Statements of Cash Flows
(Unaudited)

| | Six Months Ended June 30, | | May 18, 1993 (Inception) Through June 30, 2000 |
|---|------------------------------|----------------|--|
| | 2000 | 1999 | 2000 |
| | ----- | ----- | ----- |
| Cash flows from operating activities: | | | |
| Net loss | \$ (4,501,000) | \$ (3,146,000) | \$(36,947,000) |
| Adjustments to reconcile net loss to net cash used in operating activities | | | |
| Write-off of acquired in-process research and development and supplies | | | 13,508,000 |
| Write-off of licenses | | | 683,000 |
| Depreciation and amortization | 53,000 | 39,000 | 269,000 |
| Compensatory stock options | 1,447,000 | 124,000 | 1,589,000 |
| Expenses paid using treasury stock and common stock | 40,000 | | 118,000 |
| Changes in: | | | |
| Prepaid expenses and other current assets | (167,000) | 135,000 | (202,000) |
| Accounts payable and accrued expenses | 253,000 | 69,000 | 545,000 |
| Deferred revenue | | | 1,036,000 |
| Other assets | (51,000) | | (69,000) |
| Expenses paid on behalf of company | | | 18,000 |
| Employee stock compensation | | | 42,000 |
| Reduction of research and development supplies | | | (161,000) |
| | ----- | ----- | ----- |
| Net cash used in operating activities | (2,926,000) | (2,780,000) | (19,571,000) |
| | ----- | ----- | ----- |
| Cash flows from investing activities: | | | |
| Purchase of furniture and equipment | (156,000) | (33,000) | (702,000) |
| Proceeds from disposal of furniture and equipment | | | 25,000 |
| Acquisition of licenses | | | (711,000) |
| Purchase of marketable securities | (10,082,000) | | (31,827,000) |
| Proceeds from sale or maturity of investments | | 1,063,000 | 22,150,000 |
| Net cash payments on merger | | | (1,670,000) |
| | ----- | ----- | ----- |
| Net cash provided by (used in) investing activities | (10,238,000) | 1,030,000 | (12,735,000) |
| | ----- | ----- | ----- |
| Cash flows from financing activities: | | | |
| Proceeds on private placements of units, net of expenses | 17,444,000 | | 40,166,000 |
| Purchase of treasury stock | | (5,000) | (95,000) |
| Principal payments under capital lease obligation | (8,000) | | (18,000) |
| Collections on stock subscriptions and proceeds on conversion of stock options and warrants | 3,994,000 | 1,009,000 | 4,066,000 |
| | ----- | ----- | ----- |
| Net cash (used in) provided by financing activities | 21,430,000 | 1,004,000 | 44,119,000 |
| | ----- | ----- | ----- |
| Net (decrease) increase in cash and cash equivalents | 8,266,000 | (745,000) | 11,813,000 |
| Cash and cash equivalents - beginning of period | 3,547,000 | 1,474,000 | |
| | ----- | ----- | ----- |
| Cash and cash equivalents - end of period | \$ 11,813,000 | \$ 729,000 | \$ 11,813,000 |
| | ===== | ===== | ===== |
| Supplementary disclosure of cash flows information: | | | |
| Interest Paid: | \$ 3,000 | \$ | \$ 16,000 |
| Noncash transactions: | | | |
| Accrued dividends on preferred stock | \$ 36,000 | \$ 102,000 | \$ 682,000 |
| Common stock and treasury stock issued in payment of services | 40,000 | 69,000 | 113,000 |
| Preferred Stock issued for inventory | | | 575,000 |
| Treasury stock received on exercise of options | 245,000 | | 245,000 |
| Equipment acquired through capitalized lease | | | 73,000 |
| Series C preferred stock dividends paid using common stock | | | 204,000 |

See notes to financial statements

NOTE 1 - THE COMPANY AND BASIS OF PRESENTATION

The Company

Discovery Laboratories, Inc. (the "Company"), was formed to license and develop pharmaceutical products to treat a variety of human diseases. The accompanying financial statements include the accounts of the Company and its wholly owned subsidiary, Acute Therapeutics, Inc. ("ATI"). ATI is presently inactive, and all intercompany balances and transactions have been eliminated.

The accompanying unaudited, consolidated, condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information in accordance with the instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normally recurring accruals) considered for fair presentation have been included. Operating results for the six-month period ended June 30, 2000, are not necessarily indicative of the results that may be expected for the year ended December 31, 2000. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's 1999 Annual Report on Form 10-KSB.

The Company's activities since incorporation have primarily consisted of conducting research and development, performing business and financial planning and raising capital. Accordingly, the Company is considered to be in the development stage, and expects to incur increasing losses and require additional financial resources to achieve commercialization of its products.

The Company also depends on third parties to conduct research on the Company's behalf through various research agreements. All of the Company's current products under development are subject to license agreements that will require the payment of future royalties.

Net Loss Per Share

Net loss per share is computed based on the weighted average number of common shares outstanding for the periods and common shares issuable for little or no cash consideration. Common shares issuable upon the exercise of options and warrants and the conversion of convertible securities are not included in the calculation of the net loss per share as their effect would be antidilutive.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Plan of Operations

Since its inception, the Company has concentrated its efforts and resources on the development and commercialization of pharmaceutical products and technologies. The Company has been unprofitable since its inception and has incurred a cumulative net loss of approximately \$36.9 million as of June 30, 2000. The Company expects to incur significantly increasing operating losses over the next several years, primarily due to the expansion of its research and development programs, including clinical trials for some or all of its existing products and technologies and other products and technologies that it may acquire or develop. The Company's ability to achieve profitability depends upon, among other things, its ability to discover and develop products, obtain regulatory approval for its proposed products and enter into agreements for product development, manufacturing and commercialization. None of the Company's products currently generates revenues and the Company does not expect to achieve product revenues for the foreseeable future. Moreover, there can be no assurance that the Company will ever achieve significant revenues or profitable operations from the sale of any of its products or technologies.

The Company is a development stage pharmaceutical company that is focused on developing compounds intended for use in critical care hospital settings. The Company is also developing its lead product candidate, Surfaxin(R), for the treatment of various critical care respiratory conditions. The Company anticipates that during the next 12 months it will conduct substantial research and development of its compounds.

The Company anticipates that during the next 12 months it will conduct substantial research and development of its products under development and that it will focus primarily on the conduct of clinical trials for Surfaxin(R) indications. The Company expects to continue to expand its research and development activities as a result of its receipt of approximately \$17.4 million of net proceeds from its offering completed in March 2000. The Company

anticipates the near term acquisition of equipment necessary to manufacture Surfaxin(R). The Company also anticipates the hiring of further personnel to augment the clinical development of Surfaxin(R).

SURFAXIN(R) (lucinactant)

Meconium Aspiration Syndrome (MAS) in full-term infants

The Company recently initiated a pivotal Phase 3 trial in MAS. The trial intends to enroll 200 MAS patients. The Company announced results of a Phase 2 clinical trial in MAS in full-term newborns in February 1999. The 22-patient Phase 2 trial showed an improvement in oxygenation parameters and a three-day savings on mechanical ventilation. An Orphan Products Development Grant awarded to the Company by the United States Food and Drug Administration (the "FDA") Office of Orphan Products Development is expected to contribute significantly towards reducing the costs of this Phase 3 trial. The Company has received Fast Track designation for Surfaxin(R) from the FDA for MAS.

Respiratory Distress Syndrome (RDS) in premature infants

The Company is currently planning to commence a Phase 3 clinical trial of Surfaxin(R) for the treatment of RDS in premature infants during fourth quarter of 2000. Such trial, and any other clinical trials of the Company's products in development that have not yet commenced, will require the approvals by the FDA and/or world health authorities. There can be no assurance as to the receipt or the timing of such approvals.

Acute Lung Injury/Acute Respiratory Distress Syndrome (ALI/ARDS)

A pivotal Phase 2/3 clinical trial of Surfaxin(R) for the treatment of ALI/ARDS was commenced in July 1998. This trial was stopped on January 27, 2000, due to the Company's cash position and so that a new Phase 2 ARDS/ALI trial could be commenced using a new, less viscous formulation of Surfaxin(R). A new Phase 2 trial is currently being planned, which the Company expects to commence following submission of a protocol and subsequent agreement by the FDA. The Company has received Fast Track designation for Surfaxin(R) from the FDA for ARDS.

SUPERVENT(TM) (tyloxapol)

Cystic Fibrosis (CF)

The Company began a Phase 2A clinical trial of SuperVent(TM) for the treatment of CF on August 4, 1999. Preliminary analysis of the data shows that SuperVent(TM) decreased the amount of Interleukin 8 (IL-8) in the sputum of treated patients compared to controls. IL-8 is an important body chemical that causes the migration of inflammatory cells to the site of release. The Phase 2A clinical trial involved 8 patients. An additional Phase 2 trial will likely be required prior to commencement of a Phase 3 trial. Previously, the Company completed a Phase 1 trial in 20 normal healthy volunteers and determined a dose (1.25% tyloxapol concentration) that did not produce significant adverse effects.

Chronic Bronchitis (CB)

The Company plans to investigate the potential clinical application of SuperVent(TM) in CB following its successful Phase 2 trial in CF. A pilot study will be reviewed during 2000.

DSC-103 (Vitamin D analog)

Postmenopausal Osteoporosis

On December 5, 1997, a Phase 1 clinical study of DSC-103 as a once-daily, orally administered drug for the treatment of postmenopausal osteoporosis in the United States was initiated. Part B of such trial was commenced on April 2, 1998, and was successfully completed on June 29, 1998. The Company is discussing with the licensor of DSC-103 the possibility of terminating its license.

Results of Operations

The Company's expenses increased from \$3,213,000 in the six months ended June 30, 1999, to \$4,501,000 in the six months ended June 30, 2000. The increase was primarily due to a compensation charge of \$1,447,000 recorded as a result of the grant of options and the vesting of certain milestone-based employee stock options and an increase in the Company's research and development activities. The Company's total comprehensive net loss increased from \$3,151,000 in the six months ended June 30, 1999, to \$4,838,000 in the six months ended June 30, 2000. In addition, due to the increase in the weighted average common shares outstanding during the first half of 2000, the Company's net loss per share decreased from \$0.51 in 1999 to \$0.27 in 2000.

Liquidity

At June 30, 2000, the Company had working capital of \$20.9 million. In March 2000, the Company completed a private placement from which it received net proceeds of approximately \$17.4 million. The Company believes it has sufficient resources to meet its planned research and development activities through the first quarter of 2002.

The Company will be required to raise additional capital in order to meet its business objectives, and there can be no assurance that it will be successful in doing so or, in general, that the Company will be able to achieve its business objectives.

The Company's working capital requirements will depend upon numerous factors, including, without limitation, progress of the Company's research and development programs, preclinical and clinical testing, timing and cost of obtaining regulatory approvals, levels of resources that the Company devotes to the development of manufacturing and marketing capabilities, technological advances, status of competitors and the ability of the Company to establish collaborative arrangements with other organizations.

Safe Harbor Statement Under the Private Securities Litigation Act of 1996

Certain statements set forth in this report, including, without limitation, statements concerning the Company's research and development programs, the possibility of submitting regulatory filings for the Company's products under development, the seeking of collaboration arrangements with pharmaceutical companies or others to develop, manufacture and market products, the research and development of particular compounds and technologies and the period of time for which the Company's existing resources will enable the Company to fund its operations, are forward-looking statements. All such statements involve significant risks and uncertainties. Actual results may differ materially from those contemplated in the forward looking statements as a result of risks and uncertainties, including but not limited to the following: the Company's ability to obtain substantial additional funds; the uncertainties inherent in the process of developing products of the kind being developed by the Company; the Company's ability to establish additional collaborative and licensing arrangements and the degree of success of the Company's collaboration partners; the Company's ability to obtain and maintain all necessary patents or licenses; the Company's ability to demonstrate the safety and efficacy of product candidates and to receive required regulatory approvals; the Company's ability to meet obligations and required milestones under its license agreement; the Company's ability to compete successfully against other products and to market products in a profitable manner; and other risks and uncertainties set forth in the Company's filings with the Securities and Exchange Commission.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGE IN SECURITIES.

In April 2000, the Company issued 713 shares of Common Stock, \$.001 par value per share, of the Company in payment of rent.

For the issuance described above, the securities received by investors were deemed to be exempt from registration under the Act in reliance on Section 4(2) thereof because such issuance did not involve a public offering. Investors in each financing represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the securities certificates issued in such transactions. The investors in such financing had adequate access to information about the Company. Moreover, such investors represented to the Company, and the Company believed, that they were experienced in financial matters.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

At an annual meeting of the stockholders of the Company, held on June 16, 2000, the following matters were voted on by the stockholders: (i) the election of six directors and (ii) approval of an amendment to the 1998 Stock Incentive Plan (the "Plan") to increase the number of shares of Common Stock available for issuance under the Plan and to modify the terms of the automatic grants to non-employee Board members.

(i) Election of Directors

| | For ----- | Withheld ----- |
|-----------------------------|--------------|-------------------|
| Robert J. Capetola, Ph.D. | 11,402,869 | 22,798 |
| Max Link, Ph.D. | 11,380,146 | 45,521 |
| Herbert H. McDade, Jr. | 11,371,946 | 53,721 |
| Richard G. Power | 11,366,727 | 58,940 |
| Mark C. Rogers, M.D. | 11,415,369 | 10,298 |
| Marvin E. Rosenthale, Ph.D. | 11,414,969 | 10,698 |

(ii) Amendment to 1998 Stock Incentive Plan

| For --- | Against ----- | Abstain ----- |
|------------|------------------|------------------|
| 11,022,609 | 227,022 | 176,036 |

ITEM 5. OTHER INFORMATION.

Form 10-QSB for the quarterly period ended March 31, 2000 was amended August, 2000, to report a restatement of first quarter 2000 financial results. The restatement reports a compensation charge of \$812,500 during the first quarter due to the vesting of certain milestone-based options granted to employees. See Form 10-QSB/A for more information.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

10.1 Amended and Restated 1998 Stock Incentive Plan.

27.1 Financial Data Schedule.

(b) Reports on Form 8-K:

1. None.

SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Discovery Laboratories, Inc.
(Registrant)

Date: August 15, 2000

/s/ Robert J. Capetola, Ph.D.

Robert J. Capetola, Ph.D.
President/Chief Executive Officer

Date: August 15, 2000

/s/ Evan Myrianthopoulos

Evan Myrianthopoulos
Vice President, Finance
(Principal Financial Officer)

Date: August 15, 2000

/s/ Cynthia Davis

Cynthia Davis
Controller
(Principal Accounting Officer)

ARTICLE ONE

GENERAL PROVISIONS

I. PURPOSE OF THE PLAN

This Amended and Restated 1998 Stock Incentive Plan (the "Plan") is intended to promote the interests of Discovery Laboratories, Inc., a Delaware corporation, by providing eligible persons with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in the Corporation as an incentive for them to remain in the service of the Corporation.

The Plan amends and restates the Corporation's 1998 Stock Incentive Plan and shall serve as the successor to the Corporation's 1995 Stock Option Plan and 1993 Stock Option Plan (the "Predecessor Plans"). No further option grants shall be made under the Predecessor Plans after the Initial Approval Date. All options outstanding under the Predecessor Plans on the Initial Approval Date are incorporated into the Plan and shall be treated as outstanding options under the Plan. However, each outstanding option so incorporated shall continue to be governed solely by the terms of the documents evidencing such option, and no provision of the Plan shall be deemed to affect or otherwise modify the rights or obligations of the holders of such incorporated options with respect to their acquisition of shares of Common Stock.

Capitalized terms shall have the meanings assigned to such terms in the attached Appendix.

II. STRUCTURE OF THE PLAN

A. The Plan shall be divided into three separate equity programs:

(i) the Discretionary Option Grant Program under which eligible persons may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock,

(ii) the Stock Issuance Program under which eligible persons may, at the discretion of the Plan Administrator, be issued shares of Common Stock directly, either through the immediate purchase of such shares or as a bonus for services rendered the Corporation (or any Parent or Subsidiary), and

(iii) the Automatic Option Grant Program under which eligible non-employee board members shall automatically receive option grants at periodic intervals to purchase shares of Common Stock.

B. The provisions of Articles One and Five shall apply to all equity programs under the Plan and shall govern the interests of all persons under the Plan.

III. ADMINISTRATION OF THE PLAN

A. The Board shall have authority to administer the Discretionary Option Grant and Stock Issuance Programs with respect to Section 16 Insiders but may delegate such authority to the Primary Committee. Administration of the Discretionary Option Grant and Stock Issuance Programs with respect to all other persons eligible to participate in those programs may, at the Board's discretion, be vested in the Primary Committee or a Secondary Committee, or the Board may retain the power to administer those programs with respect to all such persons.

B. Members of the Primary Committee or any Secondary Committee shall serve for such period of time as the Board may determine and may be removed by the Board at any time. The Board may also at any time terminate the functions of any Secondary Committee and reassume all powers and authority previously delegated to such committee.

C. Each Plan Administrator shall, within the scope of its administrative functions under the Plan, have full power and authority (subject to the provisions of the Plan) to establish such rules and regulations as it may deem appropriate for proper administration of the Discretionary Option Grant and Stock Issuance Programs and to make such determinations under, and issue such interpretations of, the provisions of such programs and any outstanding options or stock issuances thereunder as it may deem necessary or advisable. Decisions of the Plan

Administrator within the scope of its administrative functions under the Plan shall be final and binding on all parties who have an interest in the Discretionary Option Grant and Stock Issuance Programs under its jurisdiction or any option or stock issuance thereunder.

D. Service on the Primary Committee or the Secondary Committee shall constitute service as a Board member, and members of each such committee shall accordingly be entitled to full indemnification and reimbursement as Board members for their service on such committee. No member of the Primary Committee or the Secondary Committee shall be liable for any act or omission made in good faith with respect to the Plan or any option grants or stock issuances under the Plan.

IV. ELIGIBILITY

A. The persons eligible to participate in the Discretionary Option Grant and Stock Issuance Programs are as follows:

(i) Employees,

(ii) non-employee members of the Board or the board of directors of any Parent or Subsidiary, and

(iii) consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. Each Plan Administrator shall, within the scope of its administrative jurisdiction under the Plan, have full authority to determine, (i) with respect to the option grants under the Discretionary Option Grant Program, which eligible persons are to receive option grants, the time or times when such option grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Non-Statutory Option, the time or times when each option is to become exercisable, the vesting schedule (if any) applicable to the option shares and the maximum term for which the option is to remain outstanding and (ii) with respect to stock issuances under the Stock Issuance Program, which eligible persons are to receive stock issuances, the time or times when such issuances are to be made, the number of shares to be issued to each Participant, the vesting schedule (if any) applicable to the issued shares and the consideration for such shares.

C. The Plan Administrator shall have the absolute discretion either to grant options in accordance with the Discretionary Option Grant Program or to effect stock issuances in accordance with the Stock Issuance Program.

D. Only non-employee members of the Board shall be eligible to participate in the Automatic Option Grant Program.

V. STOCK SUBJECT TO THE PLAN

A. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock, including shares repurchased by the Corporation on the open market. The maximum number of shares of Common Stock reserved for issuance over the term of the Plan shall not exceed 3,000,000 shares. Such authorized share reserve is comprised of (i) the number of shares which remained available for issuance under the Predecessor Plans as of the Initial Approval Date, comprised of the shares subject to the outstanding options incorporated into the 1998 Stock Incentive Plan upon its initial approval by the stockholders of the Corporation and outstanding options issued subsequent to the Initial Approval Date, but not in excess of the additional shares which were otherwise available for future grant under the Predecessor Plans as of the Initial Approval Date (403,162 shares in the aggregate), plus (ii) an additional 1,022,566 shares which became issuable under the 1998 Stock Incentive Plan on the Initial Approval Date plus (iii) an additional increase of 775,231 shares authorized by the Board on December 7, 1998, and approved by the Corporation's stockholders at the 1999 Annual Meeting, plus (iv) an additional increase of 799,041 shares authorized by the Board on March 17, 2000, subject to approval by the Corporation's shareholders at the 2000 Annual Meeting.

B. No one person participating in the Plan may receive options, separately exercisable stock appreciation rights and direct stock issuances for more than 250,000 shares of Common Stock in the aggregate per calendar year, beginning with the 1998 calendar year.

C. Shares of Common Stock subject to outstanding options (including options incorporated into this Plan from the Predecessor Plans) shall be available for subsequent issuance under the Plan to the extent those options expire or terminate for any reason prior to exercise in full. Unvested shares issued under the Plan and subsequently cancelled or repurchased by the Corporation, at the original issue price paid per share, pursuant to the

Corporation's repurchase rights under the Plan shall be added back to the number of shares of Common Stock reserved for issuance under the Plan and shall accordingly be available for reissuance through one or more subsequent option grants or direct stock issuances under the Plan. However, should the exercise price of an option under the Plan be paid with shares of Common Stock or should shares of Common Stock otherwise issuable under the Plan be withheld by the Corporation in satisfaction of the withholding taxes incurred in connection with the exercise of an option or the vesting of a stock issuance under the Plan, then the number of shares of Common Stock available for issuance under the Plan shall be reduced by the gross number of shares for which the option is exercised or which vest under the stock issuance, and not by the net number of shares of Common Stock issued to the holder of such option or stock issuance.

D. If any change is made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the maximum number and/or class of securities issuable under the Plan, (ii) the number and/or class of securities for which any one person may be granted options, separately exercisable stock appreciation rights and direct stock issuances under this Plan per calendar year, (iii) the number and/or class of securities for which grants are subsequently to be made under the Automatic Option Grant Program to new and continuing non-employee Board members, (iv) the number and/or class of securities and the exercise price per share in effect under each outstanding option under the Plan and (v) the number and/or class of securities and price per share in effect under each outstanding option incorporated into this Plan from the Predecessor Plan. Such adjustments to the outstanding options are to be effected in a manner which shall preclude the enlargement or dilution of rights and benefits under such options. The adjustments determined by the Plan Administrator shall be final, binding and conclusive.

ARTICLE TWO

DISCRETIONARY OPTION GRANT PROGRAM

I. OPTION TERMS

Each option shall be evidenced by one or more documents in the form approved by the Plan Administrator; provided, however, that each such document shall comply with the terms specified below. Each document evidencing an Incentive Option shall, in addition, be subject to the provisions of the Plan applicable to such options.

A. Exercise Price.

1. The exercise price per share shall be fixed by the Plan Administrator but shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.

2. The exercise price shall become immediately due upon exercise of the option and shall, subject to the provisions of Section I of Article Five and the documents evidencing the option, be payable in one or more of the forms specified below:

(i) cash or check made payable to the Corporation,

(ii) shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date, or

(iii) to the extent the option is exercised for vested shares, through a special sale and remittance procedure pursuant to which the Optionee shall concurrently provide irrevocable written instructions to (a) a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (b) the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent such sale and remittance procedure is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

B. Exercise and Term of Options. Each option shall be exercisable at such time or times, during such period and for such number of shares as shall be determined by the Plan Administrator and set forth in the documents evidencing the option. However, no option shall have a term in excess of ten (10) years measured from the option grant date.

C. Effect of Termination of Service.

1. The following provisions shall govern the exercise of any options held by the Optionee at the time of cessation of Service or death:

(i) Any option outstanding at the time of the Optionee's cessation of Service for any reason shall remain exercisable for such period of time thereafter as shall be determined by the Plan Administrator and set forth in the documents evidencing the option, but no such option shall be exercisable after the expiration of the option term.

(ii) Any option exercisable in whole or in part by the Optionee at the time of death may be subsequently exercised by the personal representative of the Optionee's estate or by the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution.

(iii) During the applicable post-Service exercise period, the option may not be exercised in the aggregate for more than the number of vested shares for which the option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Service, terminate and cease to be outstanding to the extent the option is not otherwise at that time exercisable for vested shares.

(vi) Should the Optionee's Service be terminated for Misconduct, then all outstanding options held by the Optionee shall terminate immediately and cease to remain outstanding.

2. The Plan Administrator shall have complete discretion, exercisable either at the time an option is granted or at any time while the option remains outstanding, to:

(i) extend the period of time for which the option is to remain exercisable following the Optionee's cessation of Service from the limited exercise period otherwise in effect for that option to such greater period of time as the Plan Administrator shall deem appropriate, but in no event beyond the expiration of the option term, and/or

(ii) permit the option to be exercised, during the applicable post-Service exercise period, not only with respect to the number of vested shares of Common Stock for which such option is exercisable at the time of the Optionee's cessation of Service but also with respect to one or more additional installments in which the Optionee would have vested had the Optionee continued in Service.

D. Stockholder Rights. The holder of an option shall have no stockholder rights with respect to the shares subject to the option until such person shall have exercised the option, paid the exercise price and become a holder of record of the purchased shares.

E. Repurchase Rights. The Plan Administrator shall have the discretion to grant options which are exercisable for unvested shares of Common Stock. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the document evidencing such repurchase right.

F. Limited Transferability of Options. During the lifetime of the Optionee, Incentive Options shall be exercisable only by the Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following the Optionee's death. However, a Non-Statutory Option may, in connection with the Optionee's estate plan, be assigned in whole or in part during the Optionee's lifetime to one or more members of the Optionee's immediate family or to a trust established exclusively for one or more such family members. The assigned portion may only be exercised by the person or persons who acquire a proprietary interest in the option pursuant to the assignment. The terms applicable to the assigned portion shall be the same as those in effect for the option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Plan Administrator may deem appropriate.

II. INCENTIVE OPTIONS

The terms specified below shall be applicable to all Incentive Options. Except as modified by the provisions of this Section II, all the provisions of Articles One, Two and Five shall be applicable to Incentive Options. Options which are specifically designated as Non-Statutory Options when issued under the Plan shall not be subject to the terms of this Section II.

A. Eligibility. Incentive Options may only be granted to Employees.

B. Dollar Limitation. The aggregate Fair Market Value of the shares of Common Stock (determined as of the respective date or dates of grant) for which one or more options granted to any Employee under the Plan (or any other option plan of the Corporation or any Parent or Subsidiary) may for the first time become exercisable as Incentive Options during any one calendar year shall not exceed the sum of One Hundred Thousand Dollars (\$100,000). To the extent the Employee holds two (2) or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

C. 10% Stockholder. If any Employee to whom an Incentive Option is granted is a 10% Stockholder, then the exercise price per share shall not be less than one hundred ten percent (110%) of the Fair Market Value per share of Common Stock on the option grant date, and the option term shall not exceed five (5) years measured from the option grant date.

III. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. In the event of any Corporate Transaction, each outstanding option shall automatically accelerate so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable with respect to the total number of shares of Common Stock at the time subject to such option and may

be exercised for any or all of those shares as fully-vested shares of Common Stock. However, an outstanding option shall not so accelerate if and to the extent: (i) such option is, in connection with the Corporate Transaction, either to be assumed by the successor corporation (or parent thereof) or to be replaced with a comparable option to purchase shares of the capital stock of the successor corporation (or parent thereof), (ii) such option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested option shares at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same vesting schedule applicable to those option shares or (iii) the acceleration of such option is subject to other limitations imposed by the Plan Administrator at the time of the option grant. The determination of option comparability under clause (i) above shall be made by the Plan Administrator, and its determination shall be final, binding and conclusive.

B. All outstanding repurchase rights shall also terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent: (i) those repurchase rights are to be assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

C. The Plan Administrator shall have the discretion, exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration of one or more outstanding options upon the occurrence of a Corporate Transaction, whether or not those options are to be assumed or replaced in the Corporate Transaction.

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments to reflect such Corporate Transaction shall also be made to (i) the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same, (ii) the maximum number and/or class of securities available for issuance over the remaining term of the Plan and (iii) the maximum number and/or class of securities for which any one person may be granted stock options, separately exercisable stock appreciation rights and direct stock issuances under the Plan per calendar year.

E. Notwithstanding Section III.A. of this Article Two, the Plan Administrator shall have the discretionary authority, exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration of one or more outstanding options under the Discretionary Option Grant Program upon the occurrence of a Corporate Transaction, whether or not those options are to be assumed or replaced in the Corporate Transaction. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights with respect to shares held by the Optionee at the time of such Corporate Transaction shall immediately terminate, and the shares subject to those terminated repurchase rights shall accordingly vest in full, even in the event the options are to be assumed.

F. The Plan Administrator shall have full power and authority exercisable, either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration of one or more outstanding options under the Discretionary Option Grant Program in the event the Optionee's Service terminates by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those options are assumed or replaced and do not otherwise accelerate. Any options so accelerated shall remain exercisable for fully-vested shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (1)-year period measured from the effective date of the Involuntary Termination. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights with respect to shares held by the Optionee at the time of such Involuntary Termination shall immediately terminate, and the shares subject to those terminated repurchase rights shall accordingly vest in full.

G. The Plan Administrator shall have full power and authority, exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration of one or more outstanding options under the Discretionary Option Grant Program upon (i) a Change in Control or (ii) the termination of the Optionee's Service by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of such Change in Control. Each option so accelerated shall remain exercisable for fully-vested shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (1)-year period measured from the effective date of the Optionee's cessation of Service. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights

with respect to shares held by the Optionee at the time of such Change in Control or Involuntary Termination shall immediately terminate, and the shares subject to those terminated repurchase rights shall accordingly vest in full.

H. The portion of any Incentive Option accelerated in connection with a Corporate Transaction or Change in Control shall remain exercisable as an Incentive Option only to the extent the applicable One Hundred Thousand Dollar limitation is not exceeded. To the extent such dollar limitation is exceeded, the accelerated portion of such option shall be exercisable as a Non-Statutory Option under the Federal tax laws.

I. The outstanding options shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

IV. CANCELLATION AND REGRANT OF OPTIONS

The Plan Administrator shall have the authority to effect, at any time and from time to time, with the consent of the affected option holders, the cancellation of any or all outstanding options under the Discretionary Option Grant Program (including outstanding options incorporated from the Predecessor Plan) and to grant in substitution therefor new options covering the same or different number of shares of Common Stock but with an exercise price per share based on the Fair Market Value per share of Common Stock on the new grant date.

V. STOCK APPRECIATION RIGHTS

A. The Plan Administrator shall have full power and authority to grant to selected Optionees tandem stock appreciation rights and/or limited stock appreciation rights.

B. The following terms shall govern the grant and exercise of tandem stock appreciation rights:

(i) One or more Optionees may be granted the right, exercisable upon such terms as the Plan Administrator may establish, to elect between the exercise of the underlying option for shares of Common Stock and the surrender of that option in exchange for a distribution from the Corporation in an amount equal to the excess of (a) the Fair Market Value (on the option surrender date) of the number of shares in which the Optionee is at the time vested under the surrendered option (or surrendered portion thereof) over (b) the aggregate exercise price payable for such shares.

(ii) No such option surrender shall be effective unless it is approved by the Plan Administrator, either at the time of the actual option surrender or at any earlier time. If the surrender is so approved, then the distribution to which the Optionee shall be entitled may be made in shares of Common Stock valued at Fair Market Value on the option surrender date, in cash, or partly in shares and partly in cash, as the Plan Administrator shall in its sole discretion deem appropriate.

(iii) If the surrender of an option is not approved by the Plan Administrator, then the Optionee shall retain whatever rights the Optionee had under the surrendered option (or surrendered portion thereof) on the option surrender date and may exercise such rights at any time prior to the later of (a) five (5) business days after the receipt of the rejection notice or (b) the last day on which the option is otherwise exercisable in accordance with the terms of the documents evidencing such option, but in no event may such rights be exercised more than ten (10) years after the option grant date.

C. The following terms shall govern the grant and exercise of limited stock appreciation rights:

(i) One or more Section 16 Insiders may be granted limited stock appreciation rights with respect to their outstanding options.

(ii) Upon the occurrence of a Hostile Take-Over, each individual holding one or more options with such a limited stock appreciation right shall have the unconditional right (exercisable for a thirty (30)-day period following such Hostile Take-Over) to surrender each such option to the Corporation, to the extent the option is at the time exercisable for vested shares of Common Stock. In return for the surrendered option, the Optionee shall receive a cash distribution from the Corporation in an amount equal to the excess of (A) the Take-Over Price of the shares of Common Stock which are at the time vested under each surrendered option (or surrendered portion thereof) over (B) the aggregate exercise price payable for such shares. Such cash distribution shall be paid within five (5) days following the option surrender date.

(iii) The balance of the option (if any) shall remain outstanding and exercisable in accordance with the documents evidencing such option.

ARTICLE THREE

STOCK ISSUANCE PROGRAM

I. STOCK ISSUANCE TERMS

Shares of Common Stock may be issued under the Stock Issuance Program through direct and immediate issuances without any intervening option grants. Each such stock issuance shall be evidenced by a Stock Issuance Agreement which complies with the terms specified below.

A. Purchase Price.

1. The purchase price per share shall be fixed by the Plan Administrator, but shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the issuance date.

2. Subject to the provisions of Section I of Article Five, shares of Common Stock may be issued under the Stock Issuance Program for any of the following items of consideration which the Plan Administrator may deem appropriate in each individual instance:

(i) cash or check made payable to the Corporation, or

(ii) past services rendered to the Corporation (or any Parent or Subsidiary).

B. Vesting Provisions.

1. Shares of Common Stock issued under the Stock Issuance Program may, in the discretion of the Plan Administrator, be fully and immediately vested upon issuance or may vest in one or more installments over the Participant's period of Service or upon attainment of specified performance objectives.

2. Any new, substituted or additional securities or other property (including money paid other than as a regular cash dividend) which the Participant may have the right to receive with respect to the Participant's unvested shares of Common Stock by reason of any stock dividend, stock split,

recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration shall be issued subject to (i) the same vesting requirements applicable to the Participant's unvested shares of Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

3. The Participant shall have full stockholder rights with respect to any shares of Common Stock issued to the Participant under the Stock Issuance Program, whether or not the Participant's interest in those shares is vested. Accordingly, the Participant shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

4. Should the Participant cease to remain in Service while holding one or more unvested shares of Common Stock issued under the Stock Issuance Program or should the performance objectives not be attained with respect to one or more such unvested shares of Common Stock, then those shares shall be immediately surrendered to the Corporation for cancellation, and the Participant shall have no further stockholder rights with respect to those shares. To the extent the surrendered shares were previously issued to the Participant for consideration paid in cash or cash equivalent (including the Participant's purchase-money indebtedness), the Corporation shall repay to the Participant the cash consideration paid for the surrendered shares and shall cancel the unpaid principal balance of any outstanding purchase-money note of the Participant attributable to the surrendered shares.

5. The Plan Administrator may in its discretion waive the surrender and cancellation of one or more unvested shares of Common Stock which would otherwise occur upon the cessation of the Participant's Service or the non-attainment of the performance objectives applicable to those shares. Such waiver shall result in the immediate vesting of the Participant's interest in the shares as to which the waiver applies. Such waiver may be effected at any time, whether before or after the Participant's cessation of Service or the attainment or non-attainment of the applicable performance objectives.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. All of the Corporation's outstanding repurchase rights under the Stock Issuance Program shall terminate automatically, and all the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent (i) those repurchase rights are to be

assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed in the Stock Issuance Agreement.

B. The Plan Administrator shall have the discretion, exercisable either at the time the unvested shares are issued or at any time while the Corporation's repurchase right remains outstanding, to provide for the automatic termination of one or more of those outstanding rights and the immediate vesting of the shares of Common Stock subject to such rights upon the occurrence of a Corporate Transaction.

C. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights remain outstanding under the Stock Issuance Program, to provide that those rights shall automatically terminate in whole or in part, and the shares of Common Stock subject to those terminated rights shall immediately vest, in the event the Participant's Service should terminate by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those repurchase rights are assigned to the successor corporation (or parent thereof).

D. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights remain outstanding under the Stock Issuance Program, to provide that those rights shall automatically terminate in whole or in part, and the shares of Common Stock subject to those terminated rights shall immediately vest upon (i) a Change in Control or (ii) the termination of the Participant's Service by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of such Change in Control.

III. SHARE ESCROW/LEGENDS

Unvested shares may, in the Plan Administrator's discretion, be held in escrow by the Corporation until the Participant's interest in such shares vests or may be issued directly to the Participant with restrictive legends on the certificates evidencing those unvested shares.

ARTICLE FOUR

AUTOMATIC OPTION GRANT PROGRAM

I. OPTION TERMS

A. Grant Dates. Option grants shall be made on the dates specified below:

1. Each individual who is first elected or appointed as a non-employee Board member at any time after the Plan Effective Date shall automatically be granted, on the date of such initial election or appointment, a Non-Statutory Option to purchase 20,000 shares of Common Stock, provided that individual has not previously been a director of or in the employ of the Corporation or any Parent or Subsidiary.

2. On the date of the 1998 Annual Meeting (the Stockholder Approval Date) and on the date of each Annual Stockholders Meeting held after such date, each individual who is to continue to serve as an Eligible Director, whether or not that individual is standing for re-election to the Board at that particular Annual Meeting, shall automatically be granted a Non-Statutory Option to purchase 10,000 shares of Common Stock, provided that such amount shall be increased to 20,000 shares for grants on or after the date of the 2000 Annual Meeting, with respect to each Annual Stockholders Meeting, such individual has served as a non-employee board member for at least six (6) months. There shall be no limit on the number of such 10,000 or 20,000-share option grants any one Eligible Director may receive over his or her period of Board Service, and non-employee board members who have previously been a director of or in the employ of the Corporation (or any Parent or Subsidiary) shall be eligible to receive one or more such annual option grants over their period of continued Board Service.

B. Exercise Price.

1. The exercise price per share shall be equal to sixty percent (60%) of the Fair Market Value per share of Common Stock on the option grant date.

2. The exercise price shall be payable in one or more of the alternative forms authorized under the Discretionary Option Grant Program. Except to the extent the sale and remittance procedure specified thereunder is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

C. Option Term. Each option shall have a term of ten (10) years measured from the option grant date.

D. Exercise and Vesting of Options. Each option shall be immediately exercisable for any or all of the option shares. However, any shares purchased under the option shall be subject to repurchase by the Corporation, at the exercise price paid per share, upon the Optionee's cessation of Board Service prior to vesting in those shares. With respect to options granted on or after the date of the 1998 annual stockholders' meeting, each option shall vest, and the Corporation's repurchase right shall lapse, on the first anniversary of the date of grant.

E. Termination of Board Service. The following provisions shall govern the exercise of any options held by the Optionee at the time the Optionee ceases to serve as a Board member:

(i) The Optionee (or, in the event of the Optionee's death, the personal representative of the Optionee's estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution) shall have a twelve (12)-month period following the date of such cessation of Board Service in which to exercise each such option.

(ii) During the twelve (12)-month post-service exercise period, the option may not be exercised in the aggregate for more than the number of vested shares of Common Stock for which the option is exercisable at the time of the Optionee's cessation of Board Service.

(iii) Should the Optionee cease to serve as a Board member by reason of death or Permanent Disability, then all shares at the time subject to the option shall immediately vest so that such option may, during the twelve (12)-month exercise period following such cessation of Board Service, be exercised for all or any portion of those shares as fully-vested shares of Common Stock.

(iv) In no event shall the option remain exercisable after the expiration of the option term. Upon the expiration of the twelve (12)-month post-service exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Board Service for any reason other than death or Permanent Disability, terminate and cease to be outstanding to the extent the option is not otherwise at that time exercisable for vested shares.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL/HOSTILE TAKE-OVER

A. In the event of any Corporate Transaction, the shares of Common Stock at the time subject to each outstanding option but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for all or any portion of those shares as fully-vested shares of Common Stock. Immediately following the consummation of the Corporate Transaction, each automatic option grant shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

B. In connection with any Change in Control, the shares of Common Stock at the time subject to each outstanding option but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Change in Control, become fully exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for all or any portion of those shares as fully-vested shares of Common Stock. Each such option shall remain exercisable for such fully-vested option shares until the expiration or sooner termination of the option term or the surrender of the option in connection with a Hostile Take-Over.

C. Upon the occurrence of a Hostile Take-Over, the Optionee shall have a thirty (30)-day period in which to surrender to the Corporation each of his or her outstanding automatic option grants. The Optionee shall in return be entitled to a cash distribution from the Corporation in an amount equal to the excess of (i) the Take-Over Price of the shares of Common Stock at the time subject to each surrendered option (whether or not the Optionee is otherwise at the time vested in those shares) over (ii) the aggregate exercise price payable for such shares. Such cash distribution shall be paid within five (5) days following the surrender of the option to the Corporation. No approval or consent of the Board or any Plan Administrator shall be required in connection with such option surrender and cash distribution.

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same.

E. The grant of options under the Automatic Option Grant Program shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

III. REMAINING TERMS

The remaining terms of each option granted under the Automatic Option Grant Program shall be the same as the terms in effect for option grants made under the Discretionary Option Grant Program.

ARTICLE FIVE

MISCELLANEOUS

I. FINANCING

The Plan Administrator may permit any Optionee or Participant to pay the option exercise price under the Discretionary Option Grant Program or the purchase price of shares issued under the Stock Issuance Program by delivering a full-recourse, interest bearing promissory note payable in one or more installments. The terms of any such promissory note (including the interest rate and the terms of repayment) shall be established by the Plan Administrator in its sole discretion. In no event may the maximum credit available to the Optionee or Participant exceed the sum of (i) the aggregate option exercise price or purchase price payable for the purchased shares plus (ii) any Federal, state and local income and employment tax liability incurred by the Optionee or the Participant in connection with the option exercise or share purchase.

II. TAX WITHHOLDING

A. The Corporation's obligation to deliver shares of Common Stock upon the exercise of options or the issuance or vesting of such shares under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

B. The Plan Administrator may, in its discretion, provide any or all holders of Non-Statutory Options or unvested shares of Common Stock under the Plan (other than the options granted or the shares issued under the Automatic Option Grant Program) with the right to use shares of Common Stock in satisfaction of all or part of the Taxes incurred by such holders in connection with the exercise of their options or the vesting of their shares. Such right may be provided to any such holder in either or both of the following formats:

Stock Withholding: The election to have the Corporation withhold, from the shares of Common Stock otherwise issuable upon the exercise of such Non-Statutory Option or the vesting of such shares, a portion of those shares with an aggregate Fair Market Value equal to the percentage of the Taxes (not to exceed one hundred percent (100%)) designated by the holder.

Stock Delivery: The election to deliver to the Corporation, at the time the Non-Statutory Option is exercised or the shares vest, one or more shares of Common Stock previously acquired by such holder (other than in connection with the option exercise or share vesting triggering the Taxes) with an aggregate Fair Market Value equal to the percentage of the Taxes (not to exceed one hundred percent (100%)) designated by the holder.

III. EFFECTIVE DATE AND TERM OF THE PLAN

A. The Plan shall become effective immediately upon the Plan Effective Date. Options may be granted under the Discretionary Option Grant or Automatic Option Grant Program at any time on or after the Plan Effective Date. However, no options granted under the Plan may be exercised, and no shares shall be issued under the Plan, until the Stockholder Approval Date. If the Stockholder Approval Date does not occur within twelve (12) months after the Plan Effective Date, then all options previously granted under this Plan shall terminate and cease to be outstanding, and no further options shall be granted and no shares shall be issued under the Plan.

B. One or more provisions of the Plan, including (without limitation) the option/vesting acceleration provisions of Article Two relating to Corporate Transactions and Changes in Control, may, in the Plan Administrator's discretion, be extended to one or more options incorporated from the Predecessor

Plan on the Stockholder Approval Date which do not otherwise contain such provisions.

C. The Plan shall terminate upon the earliest of (i) March 24, 2008 (ii) the date on which all shares available for issuance under the Plan shall have been issued as fully-vested shares or (iii) the termination of all outstanding options in connection with a Corporate Transaction. Upon such plan termination, all outstanding option grants and unvested stock issuances shall thereafter continue to have force and effect in accordance with the provisions of the documents evidencing such grants or issuances.

IV. AMENDMENT OF THE PLAN

A. The Board shall have complete and exclusive power and authority to amend or modify the Plan in any or all respects. However, no such amendment or modification shall adversely affect the rights and obligations with respect to stock options or unvested stock issuances at the time outstanding under the Plan

unless the Optionee or the Participant consents to such amendment or modification. In addition, certain amendments may require stockholder approval pursuant to applicable laws or regulations.

B. Options to purchase shares of Common Stock may be granted under the Discretionary Option Grant Programs and shares of Common Stock may be issued under the Stock Issuance Program that are in each instance in excess of the number of shares then available for issuance under the Plan, provided any excess shares actually issued under those programs shall be held in escrow until there is obtained stockholder approval of an amendment sufficiently increasing the number of shares of Common Stock available for issuance under the Plan. If such stockholder approval is not obtained within twelve (12) months after the date the first such excess issuances are made, then (i) any unexercised options granted on the basis of such excess shares shall terminate and cease to be outstanding and (ii) the Corporation shall promptly refund to the Optionees and the Participants the exercise or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow, and such shares shall thereupon be automatically cancelled and cease to be outstanding.

V. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares of Common Stock under the Plan shall be used for general corporate purposes.

VI. REGULATORY APPROVALS

A. The implementation of the Plan, the granting of any stock option under the Plan and the issuance of any shares of Common Stock (i) upon the exercise of any granted option or (ii) under the Stock Issuance Program shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the stock options granted under it and the shares of Common Stock issued pursuant to it.

B. No shares of Common Stock or other assets shall be issued or delivered under the Plan unless and until there shall have been compliance with all applicable requirements of Federal and state securities laws, including the filing and effectiveness of the Form S-8 registration statement for the shares of Common Stock issuable under the Plan, and all applicable listing requirements of any stock exchange (or the Nasdaq National Market, if applicable) on which Common Stock is then listed for trading.

VII. NO EMPLOYMENT/SERVICE RIGHTS

Nothing in the Plan shall confer upon the Optionee or the Participant any right to continue in Service or Board Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining such person) or of the Optionee or the Participant, which rights are hereby expressly reserved by each, to terminate such person's Service or Board Service at any time for any reason, with or without cause.

APPENDIX

The following definitions shall be in effect under the Plan:

A. Automatic Option Grant Program shall mean the automatic option grant program in effect under the Plan.

B. Board shall mean the Corporation's Board of Directors.

C. Board Service shall mean the performance of services for the Corporation by a person in the capacity of a non-employee member of the board of directors.

D. Change in Control shall mean a change in ownership or control of the Corporation effected through either of the following transactions:

(i) the acquisition, directly or indirectly by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which the Board does not recommend such stockholders to accept, or

(ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.

E. Code shall mean the Internal Revenue Code of 1986, as amended.

F. Common Stock shall mean the Corporation's common stock.

G. Corporate Transaction shall mean either of the following stockholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

H. Corporation shall mean Discovery Laboratories, Inc., a Delaware corporation, and its successors.

I. Discretionary Option Grant Program shall mean the discretionary option grant program in effect under the Plan.

J. Eligible Director shall mean a non-employee Board member who is not a 10% Stockholder.

K. Employee shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

L. Exercise Date shall mean the date on which the Corporation shall have received written notice of the option exercise.

M. Fair Market Value per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq SmallCap Market or Nasdaq National Market, then the Fair Market Value shall be deemed equal to the closing selling price per share of Common Stock on the date in question, as such price is reported on such market or any successor

system. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be deemed equal to the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

N. Hostile Take-Over shall mean the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which the Board does not recommend such stockholders to accept.

O. Incentive Option shall mean an option which satisfies the requirements of Code Section 422.

P. Initial Approval Date shall mean June 16, 1998, the date on which the Corporation's 1998 Stock Incentive Plan was initially approved by the stockholders of the Corporation.

Q. Involuntary Termination shall mean the termination of the Service of any individual which occurs by reason of:

(i) such individual's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) Optionee's voluntary resignation following (A) a change in Optionee's position with the Corporation (or Parent or Subsidiary employing Optionee) which materially reduces Optionee's duties and responsibilities or the level of management to which Optionee reports, (B) a reduction in Optionee's level of compensation (including base salary, fringe benefits and target bonus under any corporate performance-based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of Optionee's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without Optionee's consent.

R. Misconduct shall mean, unless otherwise determined by the Plan Administrator and recorded in the agreements evidencing the option grant or stock issuance, the commission of any act of fraud, embezzlement or dishonesty by the Optionee or Participant, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by such person adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of any Optionee, Participant or other person in the Service of the Corporation (or any Parent or Subsidiary).

S. 1934 Act shall mean the Securities Exchange Act of 1934, as amended.

T. Non-Statutory Option shall mean an option not intended to satisfy the requirements of Code Section 422.

U. Optionee shall mean any person to whom an option is granted under the Discretionary Option Grant or Automatic Option Grant Program.

V. Parent shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

W. Participant shall mean any person who is issued shares of Common Stock under the Stock Issuance Program.

X. Permanent Disability or Permanently Disabled shall mean the inability of the Optionee or the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more. However,

solely for purposes of the Automatic Option Grant Program, Permanent Disability or Permanently Disabled shall mean the inability of the non-employee Board member to perform his or her usual duties as a Board member by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more.

Y. Plan shall mean the Corporation's Amended and Restated 1998 Stock Incentive Plan, as set forth in this document.

Z. Plan Administrator shall mean the particular entity, whether the Primary Committee, the Board or the Secondary Committee, which is authorized to administer the Discretionary Option Grant and Stock Issuance Programs with respect to one or more classes of eligible persons, to the extent such entity is carrying out its administrative functions under those programs with respect to the persons under its jurisdiction.

AA. Plan Effective Date shall mean March 24, 1998, the date on which the Plan was adopted by the Board.

BB. Predecessor Plans shall mean the Corporation's 1995 Stock Option Plan and 1993 Stock Option Plan as in effect immediately prior to the Plan Effective Date hereunder.

CC. Primary Committee shall mean the committee of two (2) or more non-employee Board members appointed by the Board to administer the Discretionary Option Grant and Stock Issuance Programs with respect to Section 16 Insiders.

DD. Secondary Committee shall mean a committee of one (1) or more Board members appointed by the Board to administer the Discretionary Option Grant and Stock Issuance Programs with respect to eligible persons other than Section 16 Insiders.

EE. Section 16 Insider shall mean an officer or director of the Corporation subject to the short-swing profit liabilities of Section 16 of the 1934 Act.

FF. Service shall mean the performance of services for the Corporation (or any Parent or Subsidiary) by a person in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor, except to the extent otherwise specifically provided in the documents evidencing the option grant or stock issuance.

GG. Stock Exchange shall mean either the American Stock Exchange or the New York Stock Exchange.

HH. Stockholder Approval Date shall mean the date on which the Plan is approved by the Corporation's stockholders.

II. Stock Issuance Agreement shall mean the agreement entered into by the Corporation and the Participant at the time of issuance of shares of Common Stock under the Stock Issuance Program.

JJ. Stock Issuance Program shall mean the stock issuance program in effect under the Plan.

KK. Subsidiary shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

LL. Take-Over Price shall mean the greater of (i) the Fair Market Value per share of Common Stock on the date the option is surrendered to the Corporation in connection with a Hostile Take-Over or (ii) the highest reported price per share of Common Stock paid by the tender offeror in effecting such Hostile Take-Over. However, if the surrendered option is an Incentive Option, the Take-Over Price shall not exceed the clause (i) price per share.

MM. Taxes shall mean the Federal, state and local income and employment tax liabilities incurred by the holder of Non-Statutory Options or unvested shares of Common Stock in connection with the exercise of those options or the vesting of those shares.

NN. 10% Stockholder shall mean the owner of stock (as determined under Code).

Section 424(d) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Corporation (or any Parent or Subsidiary).

This schedule contains summary financial information extracted from 10-QSB and is qualified in its entirety by reference to such financial statements.

| | | | |
|------------|-------------|------------|---------|
| 3-MOS | DEC-31-2000 | | |
| | APR-01-2000 | | |
| | JUN-30-2000 | | |
| | | 11,813,000 | |
| | | 10,038,000 | |
| | | 0 | |
| | | 0 | |
| | | 575,000 | |
| | 22,659,000 | | 775,000 |
| | | (248,000) | |
| | | 23,255,000 | |
| | 1,729,000 | | 0 |
| | | 0 | |
| | | 0 | |
| | | 21,000 | |
| | | 21,465,000 | |
| 23,255,000 | | | 0 |
| | | 0 | |
| | | 0 | 0 |
| | 2,513,000 | | |
| | | 0 | |
| | 1,000 | | |
| | (2,218,000) | | |
| | | 0 | |
| | 0 | | |
| | | 0 | |
| | | 0 | |
| | | 0 | 0 |
| | (2,218,000) | | |
| | | (0.11) | |
| | | (0.11) | |