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

FORM 10-K

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

For the fiscal year ended December 31, 2002

|_| 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 0-26422

DISCOVERY LABORATORIES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	94-3171943
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

350 SOUTH MAIN STREET, SUITE 307, DOYLESTOWN, PENNSYLVANIA 18901
(Address of principal executive offices) (Zip Code)

(215) 340-4699
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.001 par value

(Title of class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (ss.229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. |_|

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). |_|

The aggregate market value of shares of voting and non-voting common equity held by non-affiliates of the registrant computed using the closing price of common equity as reported on NASDAQ SmallCap Market under the symbol DSCO on June 28, 2002, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $69 million. For the purposes of determining this amount only, the registrant has defined affiliates to include: (a) the executive officers named in Part III of this Annual Report on Form 10-K; (b) all directors of the registrant; and (c) each shareholder that has informed the registrant by February 26, 2003 that it is the beneficial owner of 10% or more of the outstanding shares of common stock of the registrant.

As of February 26, 2003, 32,856,526 shares of the registrant's common stock were outstanding.

The information required by Items 10 through 13 of Part III of this Annual Report on Form 10-K is incorporated by reference to the extent described herein from our definitive proxy statement, which is expected to be filed by us with the Commission within 120 days after the close of our fiscal year.

Unless the context otherwise requires, all references to "we," "us," "our," and the "Company" include Discovery Laboratories, Inc. ("Discovery"), and its wholly-owned, presently inactive subsidiary, Acute Therapeutics, Inc.

FORWARD LOOKING STATEMENTS

The statements set forth under Item 1: "Description of Business" and elsewhere in this prospectus, including in Item 7: "Management's Discussion and Analysis of Financial Condition and Results of Operations - Risks Related to Our Business" and those incorporated by reference herein which are not historical constitute "Forward Looking Statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding the expectations, beliefs, intentions or strategies for the future. We intend that all forward-looking statements be subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are only predictions and reflect our views as of the date they are made with respect to future events and financial performance. Forward-looking statements are subject to many risks and uncertainties which could cause our actual results to differ materially from any future results expressed or implied by the forward-looking statements.

Examples of the risks and uncertainties include, but are not limited to: the inherent risks and uncertainties in developing products of the type we are developing; possible changes in our financial condition; the progress of our research and development (including the results of clinical trials being conducted by us and the risk that our lead product candidate, Surfaxin(R), will not prove to be safe or useful for the treatment of certain indications); clinical trials require adequate supplies of drug substance and drug product, which may be difficult or uneconomical to procure or manufacture; timely obtaining sufficient patient enrollment in our clinical trials; the impact of development of competing therapies and/or technologies by other companies; our ability to obtain additional required financing to fund our research programs; our ability to enter into agreements with collaborators and the failure of collaborators to perform under their agreements with us; the progress of the FDA approvals in connection with the conduct of our clinical trials and the marketing of our products; the additional costs and delays which may result from requirements imposed by the FDA in connection with obtaining the required approvals; and the other risks and certainties detailed in Item 7: "Management's Discussion and Analysis of Financial Condition and Results of Operations - Risks Related to Our Business," and in the documents incorporated by reference in this report.

Except to the extent required by applicable laws or rules, we do not undertake any obligation or duty to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

ITEM 1. DESCRIPTION OF BUSINESS.

COMPANY SUMMARY

We are a late-stage specialty pharmaceutical company applying our humanized lung surfactant technology to develop potential novel respiratory therapies and products. Surfactants are substances that are produced naturally in the lungs and are essential to the lungs' ability to absorb oxygen and to maintain proper airflow through the respiratory system. The absence or depletion of surfactants is involved in a number of respiratory diseases.

Our humanized surfactant technology produces an engineered version of natural human lung surfactant and contains a peptide, sinapultide, that is designed to precisely mimic the essential human lung surfactant protein B (SP-B). We believe that our proprietary surfactant technology is the only surfactant technology presently available to potentially treat a broad range of respiratory diseases including Respiratory Distress Syndrome in adults and infants, asthma, chronic obstructive pulmonary disease (often referred to as COPD, which is a chronic condition of the lung that prevents enough oxygen from reaching the blood), Acute Lung Injury (often referred to as ALI), and upper airway disorders such as sinusitis (infection of the sinuses) and sleep apnea.

Surfaxin(R), our lead product, is being developed initially for critical care patients with life-threatening respiratory disorders where there are few, if any, approved therapies. Surfaxin is currently in two Phase 3 clinical trials for Respiratory Distress Syndrome in premature infants, a Phase 3 clinical trial for Meconium Aspiration Syndrome in full-term infants, and a Phase 2 clinical trial for Acute Respiratory Distress Syndrome in adults. Aerosolized formulations of our humanized surfactant are presently being developed to potentially treat hospitalized patients suffering from severe acute asthma and Acute Lung Injury (ALI), typically requiring mechanical ventilation. In addition, we believe that scientific rationale supports the development of aerosolized formulations of our humanized surfactant to potentially treat chronic obstructive pulmonary disorder (COPD), sinusitis sleep apnea and otitis media (inner ear infection).

We are presently developing a dedicated sales and marketing capability through a collaboration with Quintiles Transnational Corp. to commercialize Surfaxin in neonatal indications in the United States. We also have entered into a strategic alliance with Laboratorios del Dr. Esteve to commercialize Surfaxin in Europe and Latin America. We intend to establish additional strategic alliances, where appropriate, for the development and commercialization of our products in other indications and markets.

SURFACTANT TECHNOLOGY

Surfactants are protein and lipid (fat) compositions that are produced naturally in the lungs and are critical to all air-breathing mammals. They cover the entire alveolar surface, or air sacs, of the lungs and the terminal conducting airways which lead to the alveoli. Surfactants facilitate respiration by continually modifying the surface tension of the fluid normally present within the

alveoli that line the inside of the lungs. In the absence of sufficient surfactant or should the surfactant degrade, these air sacs tend to collapse, and, as a result, the lungs do not absorb sufficient oxygen. In addition to lowering aveolar surface-tension, surfactants play other important roles which include lowering the surface tension of the conducting airways and maintaining airflow and airway patency (keeping the airways open and expanded). Human surfactants include four known surfactant proteins, A, B, C and D. It has been established, through numerous studies, that surfactant protein B (SP-B) is essential for respiratory function.

Presently, the FDA has approved surfactants as replacement therapy only for Respiratory Distress Syndrome in premature infants, a condition in which infants are born with an insufficient amount of their own natural surfactant. The most commonly used of these approved replacement surfactants are derived from pig and cow lungs. Though they are clinically effective, they have drawbacks and cannot readily be scaled or developed to treat broader populations for Respiratory Distress Syndrome in premature infants and other respiratory diseases. There is presently only one approved synthetic surfactant available, however, this product does not contain surfactant proteins, is not widely used, and it is not currently being actively marketed by its manufacturer.

Animal-derived surfactant products are prepared using a chemical extraction process from minced cow and pig lung. Because of the animal-sourced materials and the chemical extraction processes, there is significant variation in production lots and, consequently, product quality specifications must be broad. In addition, the protein levels of these animal-derived surfactants are inherently lower than the protein levels of native human surfactant. The production costs of these animal-derived surfactants are high, relative to other analogous pharmaceutical products, generation of large quantities is severely limited, and these products cannot readily be reformulated for aerosol delivery to the lungs.

Our humanized surfactant product candidates, including Surfaxin, are engineered versions of natural human lung surfactant and contain a humanized peptide, sinapultide. Sinapultide is a 21 amino acid protein-like substance that is designed to precisely mimic the essential human surfactant protein B (SP-B). We believe that our engineered humanized surfactant can be manufactured less expensively than the animal-derived surfactants, in sufficient quantities, in more exact and consistent pharmaceutical grade quality, and that it has no potential to cause adverse immunological responses in young and older adults, all important attributes for our products to potentially meet significant unmet medical needs. Our products also have the ability to be more precisely formulated, such as in the form of aerosolized liquids or dry powders, to address various medical indications. In addition, we believe that our engineered humanized surfactants might possess other pharmaceutical benefits not currently found with the animal surfactants such as longer shelf-life, reduced number of administrations to the patient's lungs, and elimination of the risk of animal-borne diseases including the brain-wasting bovine spongiform encephalopathy (commonly called "mad-cow disease").

Our humanized surfactant technology was invented at The Scripps Research Institute and was exclusively licensed to Johnson & Johnson which, together with its wholly-owned subsidiary, Ortho Pharmaceutical Corporation, developed it further. We acquired the exclusive worldwide sublicense to the technology in October 1996.

PRODUCTS - SURFACTANT BASED THERAPY FOR RESPIRATORY MEDICINE

SURFAXIN(R)

Surfaxin, our lead product, is the first humanized, protein B-based agent that mimics the surface-active properties of human surfactant. Surfaxin has been shown to remove inflammatory and infectious infiltrates from patients' lungs when used by our proprietary lavage (or "lung wash") and replenish the vital surfactant levels in the lungs. Currently, we are developing Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants, and Acute Respiratory Distress Syndrome in adults. Surfaxin is delivered in a liquid form and is injected through an endotracheal tube (a tube inserted into the infant's mouth and down the trachea) in premature infants, and as a proprietary lavage through a tube, called a bronchoscope, in full-term infants and adults.

Respiratory Distress Syndrome in Premature Infants

Respiratory Distress Syndrome is a condition in which premature infants are born with an insufficient amount of their own natural surfactant. Premature infants born prior to 32 weeks gestation have not fully developed a natural lung surfactant and therefore need treatment to sustain life. This condition often results in the need for mechanical ventilation.

We are conducting a pivotal, multinational landmark Phase 3 trial treating up to 1,500 patients for the treatment of Respiratory Distress Syndrome in premature infants. This trial is designed to demonstrate the superiority of Surfaxin over the only commercially available synthetic surfactant and has a reference arm comparing Surfaxin to a bovine (cow) -derived surfactant. This pivotal trial is intended, if successful, to provide the basis for New Drug Applications with the FDA and other worldwide regulatory authorities. This pivotal trial is expected to be completed and data announced early in the fourth quarter of 2003.

We are also conducting another multinational Phase 3 trial treating up to 500 patients for the treatment of Respiratory Distress Syndrome in premature infants. The primary purpose of this trial is to demonstrate the non-inferiority of Surfaxin over a certain porcine (pig) -derived surfactant. This trial is expected to be completed within the same timeframe as the pivotal Phase 3 trial. We are currently evaluating whether to conclude this trial early to conserve financial resources and reallocate clinical resources to our pivotal Phase 3 trial.

Respiratory Distress Syndrome in premature infants affects approximately two million babies worldwide with approximately 270,000 cases occurring in the developed world. Due to limitations associated with the currently approved animal-derived products, only approximately 100,000 infants are estimated to be receiving surfactant therapy worldwide.

The FDA has granted us Orphan Drug Designation for Surfaxin for this indication. Orphan drugs are pharmaceutical products that are intended to treat diseases affecting fewer than 200,000 patients in the United States. The Office of Orphan Product Development of the FDA grants certain advantages to the sponsors of orphan drugs including, but not limited to, seven

years of market exclusivity upon approval of the drug, certain tax incentives for clinical research and grants to fund testing of the drug. We are also seeking Orphan Product designation from the European Medicines Evaluation Agency (The European Union's regulatory approval agency that is similar to the FDA) for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants.

Acute Respiratory Distress Syndrome in Adults

Acute Respiratory Distress Syndrome (often referred to as ARDS) in adults is a life-threatening disorder for which no approved therapies exist anywhere in the world. It is characterized by an excess of fluid in the lungs and decreased oxygen levels in the patient. One prominent characteristic of this disorder is the destruction of surfactants naturally present in lung tissue. The conditions are caused by illnesses including pneumonia and septic shock (a toxic condition caused by infection) and events such as smoke inhalation, near drowning, industrial accidents and other traumas.

We are presently conducting a Phase 2 open-label, controlled, multi-center clinical trial of Surfaxin for adults with Acute Respiratory Distress Syndrome. Up to 110 patients will receive high concentrations of Surfaxin via a proprietary lavage technique that administers the drug sequentially through a tube, called a bronchoscope. The procedure is intended to cleanse and remove inflammatory substances and debris from the lungs, while leaving amounts of Surfaxin behind to help re-establish the lungs' capacity to absorb oxygen. The objective is to restore functional surfactant levels and to allow critically ill patients to be removed from mechanical ventilation.

In July 2002, we completed the first part of this trial, a dose escalation safety and tolerability study in 22 patients in four groups (of up to six patients per group). In consultation with the Independent Safety Review Committee, comprised of three prominent pulmonologists, that was assembled for this trial, we determined that the Part A portion of the trial procedure is generally safe and tolerable and that it was appropriate to proceed onto the larger safety and efficacy portion of the study.

The last part of this Phase 2 trial, Part B, will evaluate safety and efficacy of Surfaxin in direct comparison to standard of care at approximately 40 centers in the United States. The primary endpoint of this part of the trial is to determine the incidence rate of patients being alive and off mechanical ventilation at the end of day 28 with one of the key secondary endpoints being mortality. Our contract manufacturer for drug product for this trial has experienced certain operational difficulties which have delayed the completion of this part of the trial. However, we expect that clinical drug supply will be available to allow us to complete this trial in the fourth quarter of 2003. See Item 1: "Manufacturing and Distribution - Third Party Suppliers."

The current standard of care for Acute Respiratory Distress Syndrome includes placing patients on mechanical ventilators in intensive care units at a cost of approximately $8,500 per day, typically for an average of 21 to 28 days. There are estimated to be between 150,000 and 250,000 adults per year in the United States suffering from Acute Respiratory Distress Syndrome

with similar numbers afflicted in Europe. Because there are no approved treatments for these diseases, the mortality rate can range from 35% to 50%.

The FDA has granted us Fast-Track Approval Status and Orphan Drug Designation for Surfaxin for the treatment of Acute Respiratory Distress Syndrome for adults. The European Medicines Evaluation Agency has granted us Orphan Product designation for Surfaxin for the treatment of Acute Lung Injury in adults (which in this circumstance encompasses Acute Respiratory Distress Syndrome). We were awarded a $1 million Fast-Track Small Business Innovative Research Grant by the National Institutes of Health to develop Surfaxin for the treatment of Acute Respiratory Distress Syndrome and Acute Lung Injury in adults, of which $307,000 is still to be received, subject to certain performance criteria.

Meconium Aspiration Syndrome in Full-Term Infants

Meconium Aspiration Syndrome is a condition in which full-term infants are born with meconium in their lungs that depletes the natural surfactant in their lungs. Meconium is a baby's first bowel movement in its mother's womb and when inhaled, Meconium Aspiration Syndrome can occur. Meconium Aspiration Syndrome can be life-threatening as a result of the failure of the lungs to absorb sufficient oxygen. This condition results in the need for mechanical ventilation.

Surfaxin is being evaluated in a Phase 3 clinical trial for the treatment of Meconium Aspiration Syndrome in full-term infants. To our knowledge, Surfaxin is the only product being developed worldwide to treat this syndrome. The trial is designed for the enrollment of up to 200 infants at medical centers throughout the United States to compare Surfaxin lavage to the current standard of care. Enrollment is ongoing but has been slower than expected and completion is now anticipated for 2004. Given our belief in the importance of the pivotal Phase 3 trial for Respiratory Distress Syndrome in premature infants to our present development plan, resources have been reallocated from the Meconium Aspiration Syndrome program to the Respiratory Distress Syndrome program.

We also have initiated a Phase 2 clinical trial for Surfaxin lavage in up to 60 full-term infants for use as a prophylactic or early treatment for patients who are at risk for Meconium Aspiration Syndrome but have not shown symptoms of compromised respiratory function. There are approximately 600,000 babies born each year that are at risk for Meconium Aspiration Syndrome, of which about 10% develop the condition. We believe an effective and affordable surfactant prophylactic therapy could significantly lower the risk to meconium-stained infants of chronic respiratory conditions and reduce the need for costly mechanical ventilation.

There are presently no drug therapies approved for the treatment of Meconium Aspiration Syndrome in full-term infants. The FDA has granted us Fast-Track Approval Status and Orphan Drug Designation for Surfaxin for the treatment of Meconium Aspiration Syndrome in full-term infants. We have also received Orphan Product designation of Surfaxin as for the treatment of Meconium Aspiration Syndrome from the European Medicines Evaluation Agency.

OUR AEROSOLIZED HUMANIZED SURFACTANTS FOR RESPIRATORY THERAPY

Many respiratory diseases are associated with an inflammatory event that causes surfactant dysfunction and a loss of patency of the conducting airways. Scientific data supports that the therapeutic use of surfactants in aerosol form has the ability to reestablish airway patency, improve pulmonary mechanics, and act as an anti-inflammatory. Surfactant normally prevents moisture from accumulating in the airways' most narrow sections and in this way maintains patency of the conducting airways. However, use of currently available animal-derived surfactants is not considered feasible for aerosolization and because of their potential to cause an adverse immunological response such products may exacerbate the inflammatory event associated with such diseases.

We are currently developing aerosolized formulations of our humanized surfactant to potentially treat patients who could benefit from surfactant-based therapy to improve lung function and maintain proper airflow through the respiratory system. Our aerosol development program is initially focused on surfactant-based therapy for hospitalized patients suffering from severe acute asthma or Acute Lung Injury (ALI), hopefully avoiding or reducing the need for mechanical ventilation. In addition, we believe that scientific rationale supports the development of aerosolized formulations of our humanized surfactant to potentially treat COPD, sinusitis, sleep apnea and otitis media (inner ear infection).

We are presently working with various aerosol devices towards achieving the following important development objectives:

- -- Full retention of the surface-tension lowering properties of a functioning surfactant necessary to restore lung function and maintain patency of the conducting airways.

- -- Full retention of the surfactant composition upon aerosolization.

- -- Drug particle size suitable for deposition in the deep-lungs.

- -- Delivery rates to achieve therapeutic dosages in a reasonable time period.

- -- Reproducible aerosol output and minimal waste of surfactant dose.

Our lead programs for surfactant-based therapy as an aerosol are:

Asthma

Asthma is a common disease characterized by sudden constriction and inflammation of the lungs. Constriction of the upper airway system is caused by a tightening of airway muscles, while inflammation is a swelling of the airways usually due to an allergic reaction due to an airborne irritant. Both of these events cause airways to narrow and may result in wheezing, shortness of breath and chest tightness. Several studies have shown that surfactant damage and dysfunction is a significant component of asthma -- airway obstruction occurs when there is a surfactant dysfunction in the airways of the deep lung of the type that develops during an asthma

attack. Surfactant replacement therapy has the potential to relieve the obstruction in the airways associated with asthma.

According to information provided by the American Lung Association, asthma afflicts approximately 20.3 million people in the United States and its incidence rate is rising. Asthma is a chronic disease; prevalent in people of all ages and an estimated 12 million people have experienced an asthma attack within the past year. In the United States alone, there are roughly 1 million hospital outpatient visits, approximately 1.8 million emergency room visits, and 9.3 million physician visits each year due to asthma. Asthma ranks within the top 10 prevalent activity-limiting health conditions costing $14 billion in United States healthcare costs annually.

Asthma may require life-long therapy to prevent or treat episodes. Ten percent of patients are considered severe asthmatics and require moderate to high doses of drugs. Currently available medications to treat and control asthma include inhaled and oral steroids and bronchodilators. Bronchodilators cannot be used to control severe episodes or chronic, severe asthma. Steroidal medications are used to address these conditions, however, steroids can cause serious side effects when used for prolonged periods. As a result, steroid use is typically limited to severe asthmatic episodes and chronic, severe asthma.

Several small scientific studies report that patients suffering from a severe, acute asthma attack were relieved when they inhaled aerosolized surfactant. We believe that supplying surfactant as an aerosol spray would be a simple and gentle way of relieving airway obstruction and thereby augmenting currently available conventional asthma therapies to lead to a more rapid improvement in symptoms.

Acute Lung Injury

Acute Lung Injury is associated with conditions that either directly or indirectly injure the air sacs of the lung, the alveoli. Acute Lung Injury is a syndrome of inflammation and increased permeability of the lungs with an associated breakdown of the lungs' surfactant layer. The most serious manifestation of Acute Lung Injury is Acute Respiratory Distress Syndrome.

Among the causes of Acute Lung Injury are complications typically associated with certain major surgeries, mechanical ventilator induced lung injury (often referred to as VILI), smoke inhalation, pneumonia, and sepsis. There is an estimated 1 million patients at risk in the United States for Acute Lung Injury annually and there are no currently-approved therapies.

We believe that our proprietary humanized aerosol surfactant may be effective as a preventive measure for patients at risk for Acute Lung Injury. This prophylactic approach may result in fewer patients requiring costly intensive care therapy and shorter periods of therapy - thus offering cost savings in the hospital setting.

Collaborative Research Arrangements

We have a collaborative relationship with Aerogen, Inc., to evaluate its aerosol generator technology for the delivery of our proprietary aerosolized surfactants to prevent and treat

respiratory diseases in the hospital. Aerogen's technology is designed to be used with a hospital ventilator system or in an ambulatory manner to treat patients anywhere in the hospital, including the emergency room, the hospital floor and during patient transport.

We also have a collaborative research arrangement for our aerosolized surfactant programs with CollaGenex Pharmaceuticals, Inc. to evaluate the combination of their protease inhibitor technologies with our proprietary aerosolized surfactant technology for the development of novel respiratory disease therapeutics. Through the collaboration we anticipate developing and assessing aerosol formulations of humanized lung surfactant and protease inhibitors as potential treatments for diseases such as Acute Lung Injury and chronic obstructive lung disease (COPD).

AEROSOLIZED HUMANIZED SURFACTANTS FOR PULMONARY DRUG DELIVERY

We are evaluating formulations of our engineered humanized surfactants as novel pulmonary drug delivery vehicles with the potential to deliver other pharmaceutical products to the lungs so that such products can exert their pharmacological effects locally or systemically. Existing drug delivery technology has effectively addressed the development of delivery devices, drug storage systems and compatible drug formulations. However, a significant unmet need in pulmonary drug delivery is to provide better performance once a drug is deposited in the lungs.

An aerosol version of our humanized lung surfactant, with its ability to penetrate and spread in an even manner throughout the lungs, has the potential to more efficiently deliver drugs via or within the respiratory tract. These drugs include antibiotics, pulmonary vasodilators that lower blood pressure in the lung arteries, elastase inhibitors (drugs that are anti-inflammatory by inhibiting a potentially destructive enzyme that comes from certain types of white blood cells), bronchodilators (drugs that mitigate constriction of small airways), steroids and proteins.

STRATEGIC ALLIANCES

LABORATORIOS DEL DR. ESTEVE, S.A.

In March 2002, we significantly expanded our existing relationship with Laboratorios del Dr. Esteve by entering into a new collaboration arrangement with Esteve. This new collaboration expands the territory covered by the original agreements to include all of Europe and Latin America.

In connection with this new Esteve collaboration, Esteve purchased 821,862 shares of our common stock at $4.867 per share for $4.0 million in cash and paid us a non-refundable licensing fee of $500,000. Esteve agreed to provide certain commercialization services in the expanded territory for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants and Acute Lung Injury/Acute Respiratory Distress Syndrome in adult patients.

We have agreed to an exclusive supply agreement which provides that Esteve will purchase from us all of its Surfaxin drug product requirements at an established transfer price based on sales of Surfaxin by Esteve and/or its sublicensee(s). Esteve has also agreed to sponsor certain clinical

trial costs related to obtaining European Medicines Evaluation Agency approval for commercialization of Surfaxin in Europe for the Acute Lung Injury/Acute Respiratory Distress Syndrome indications. Esteve also agreed to make certain milestone payments upon the attainment of European Medicines Evaluation Agency marketing regulatory approval of Surfaxin for sale in Europe for the foregoing indications.

QUINTILES TRANSNATIONAL CORP., AND PHARMABIO DEVELOPMENT, INC.

In December 2001, we entered into a collaboration arrangement with Quintiles, and its affiliate, PharmaBio Development, Inc., to provide certain commercialization services in the United States for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants and Meconium Aspiration Syndrome in full-term infants. We issued to PharmaBio 791,905 shares of our common stock and warrants to purchase approximately 677,143 shares of our common stock for aggregate net proceeds of approximately $2.7 million. Quintiles will hire and train a dedicated United States sales force that will be branded in the market as ours. PharmaBio has agreed to fund up to $70 million of the sales force costs and other sales and marketing costs for Surfaxin for seven years of commercialization of Surfaxin in the United States. Additionally, the collaboration allows for the specialty sales force to become ours at the end of the seven year term, with an option to acquire it sooner.

Under the collaboration, we will receive 100% of the revenues from sales of Surfaxin and have agreed to pay PharmaBio a commission on net sales in the United States of Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants and Meconium Aspiration Syndrome in full-term infants and all "off-label" uses for 10 years following first launch of the product in the United States. The collaboration allows us to retain product ownership and to have sales and marketing expertise in place for the commercialization of Surfaxin, if approved.

PharmaBio also extended to us a secured revolving credit facility of up to $8.5 million to $10 million to fund pre-marketing activities associated with the launch of Surfaxin in the United States as we achieve certain milestones. We are obligated to use a significant portion of the funds borrowed under the credit facility for pre-launch marketing services to be provided by Quintiles. Principal amounts owed by us under the credit facility may be repaid out of the proceeds of milestone payments to be paid to us by PharmaBio upon the achievement of certain corporate milestones. To the extent availability under the credit facility is increased to greater than $8.5 million, for each such $1 million dollar increase, the amount of shares of common stock issuable pursuant to the warrants will be increased by approximately 38,000 shares. See "Item 7: Management's Discussion and Analysis - Liquidity and Capital Resources - Secured, Revolving Credit Facility and Capital Lease Arrangement."

LICENSING ARRANGEMENTS; PATENTS AND PROPRIETARY RIGHTS

PATENTS AND PROPRIETARY RIGHTS

Johnson & Johnson and The Scripps Research Institute

Our humanized surfactant platform technology, including Surfaxin, is based on the proprietary peptide, sinapultide, (a 21 amino acid protein-like substance that precisely mimics the essential human lung protein SP-B). This technology was invented at The Scripps Research Institute and was exclusively licensed to, and further developed by, Johnson & Johnson, and its wholly owned subsidiary, Ortho Pharmaceutical. We have received an exclusive, worldwide sublicense from Johnson & Johnson and Scripps for, and have rights to, a series of over 30 patents and patent filings (worldwide) which are important, either individually or collectively, to our strategy of commercializing our humanized surfactant technology for the diagnosis, prevention and treatment of disease. The sublicense gives us the rights to such patents for the life of the patents.

Patents covering our proprietary humanized surfactant technology that have been issued or are pending worldwide include composition of matter, formulation, manufacturing and uses, including the pulmonary lavage, or "lung wash" techniques. Our most significant patent rights principally consist of five issued United States patents: U.S. Patent No. 5,407,914; U.S. Patent No. 5,260,273; U.S. Patent No. 5,164,369; U.S. Patent No.5,789,381; and U.S. Patent No. 6,013,619 (along with corresponding issued and pending foreign patents). These patents relate to engineered humanized pulmonary surfactants (including Surfaxin), certain related peptides (amino acid protein-like substances) and compositions, methods of treating respiratory distress syndromes with these surfactants and compositions, and our proprietary pulmonary lavage method of treating respiratory distress syndrome with these surfactants. We also have certain pending United States and foreign patent applications that relate to methods of manufacturing certain peptides which may be used in the manufacture of Surfaxin and other aspects of our humanized surfactant technology.

In October 2002, we were issued European Patent No. 59006 which covers claims directed to compositions that contain our proprietary peptide, sinapultide, and related peptides for use as a therapeutic surfactant for treating respiratory distress syndrome and related conditions. We also have an issued European Patent, No. 0350506, covering certain other surfactant peptides.

U.S. Patent No. 6,013,619 was issued to Scripps and licensed to us and covers all known engineered (including Surfaxin), animal- or human-derived surfactants for use in any form of pulmonary lavage for respiratory distress syndromes. Our proprietary pulmonary lavage techniques (using surfactant) include lavage via a bronchoscope in adults as well as direct pulmonary lung lavage via an endotracheal tube in newborn babies with Meconium Aspiration Syndrome. Scientific rationale supports that our proprietary lavage technique may provide a clinical benefit to the treatment of Acute Lung Injury/Acute Respiratory Distress Syndrome in adults and Meconium Aspiration Syndrome in full-term infants by decreasing the amount of infectious and inflammatory debris in the lungs, restoring the air sacs to a more normal state and possibly resulting in patients getting off mechanical ventilation sooner.

Such patents, which include relevant European patents, expire on various dates beginning in 2009 and ending 2017 or, in some cases, possibly later.

THE SCRIPPS RESEARCH INSTITUTE RESEARCH AGREEMENT

We are parties with Scripps to a research funding and option agreement which expires in February 2005, subject to termination by us at any time with 90 days prior notice. Pursuant to this agreement, we fund a portion of Scripps' research efforts and are entitled to an option to acquire an exclusive worldwide license to the technology developed from the research program during the term of the agreement. Scripps owns all of the technology that it developed pursuant to work performed under the agreement. To the extent we do not exercise our option, we have the right to receive 50% of the net royalty income received by Scripps for inventions that we jointly develop under the agreement.

See Item 7: "Management's Discussion and Analysis - Risks Related to Our Business": " - If we cannot protect our intellectual property, other companies could use our technology in competitive products. If we infringe the intellectual property rights of others, other companies could prevent us from developing or marketing our products"; " - Even if we obtain patents to protect our products, those patents may not be sufficiently broad and others could compete with us"; " - Intellectual property rights of third parties could limit our ability to market our products"; and " - If we cannot meet requirements under our license agreements, we could lose the rights to our products."

MANUFACTURING AND DISTRIBUTION - THIRD PARTY SUPPLIERS

Manufacturing

Our humanized surfactant product candidates must be manufactured in a sterile environment and in compliance with good manufacturing practice requirements (GMPs) set by the FDA and other relevant worldwide regulatory authorities.

Our humanized surfactant product candidates are manufactured through the combination of a synthetically made peptide, sinapultide, (designed to precisely mimic the essential human lung surfactant protein SP-B) which is provided by BACHEM California, Inc., and PolyPeptides Laboratories, Inc., and certain other active ingredients, including certain lipids, that are provided by other suppliers such as Genzyme Pharmaceuticals, a division of the Genzyme Corporation, and Avanti Polar Lipids.

Our humanized surfactant drug product, including Surfaxin, is manufactured using our own specialized equipment, using the ingredients discussed above, under the direction and supervision of our manufacturing and quality control personnel. Currently, our drug product is manufactured at the sterile facilities of a contract manufacturer, Akorn, Inc., which is presently the only manufacturing facility that we have validated to produce appropriate clinical grade material of our humanized surfactant drug substance, including Surfaxin.

Our present manufacturing capabilities should allow sufficient commercial production of Surfaxin, if approved, to supply the present worldwide demand for Respiratory Distress Syndrome for premature infants and Meconium Aspiration Syndrome for full-term infants. We expect these capabilities to allow us to provide adequate supply of Surfaxin for our planned clinical trials for Acute Respiratory Distress Syndrome in adults.

We are presently investing in and evaluating alternative contract manufacturers in order to provide backup for the production of our humanized surfactant drug product and to scale up to meet clinical and commercial needs as they expand. We will rely on outside manufacturers for production of our products after marketing approval.

Should the proper financial and other resources be available, our manufacturing process for our humanized surfactant drug product allows us, unlike that for the currently-approved, animal-derived products, to scale-up production of our humanized surfactant drug product, including Surfaxin. By scaling up our production, we should be able to produce sufficient drug products to potentially treat diseases with larger patient populations, such as Acute Respiratory Disease Syndrome in adults, asthma, Acute Lung Injury, COPD, and other broader respiratory diseases and upper airway disorders.

In December 2002, we reported that Akorn was experiencing certain operating difficulties in a sterile production room primarily used for the filling of sterile pharmaceutical products such as our drug product. Although Akorn's difficulties with this sterile filling room were not directly related to the actual production of our drug product, a delay in the supply of Surfaxin for Part B of our ongoing Phase 2 clinical trial for Acute Respiratory Distress Syndrome in adults occurred. On February 18, 2003, Akorn notified us that their sterile filling room had returned to operational status. We have initiated activities at Akorn and expect to recommence manufacture of Surfaxin in a timeframe that allows us to complete our Phase 2 clinical trial for Acute Respiratory Disease Syndrome in adults in the fourth quarter of 2003. The difficulties experienced by Akorn are not expected to have an effect on our ongoing Phase 3 trials for Surfaxin for Respiratory Distress Syndrome in premature infants or our longer range clinical development plans for our humanized surfactant drug candidates.

Manufacturing or quality control problems could occur at Akorn or our other contract manufacturers, if any, and cause product production and shipment delays or a situation where the contractor may not be able to maintain compliance with the FDA's current GMP requirements necessary to continue manufacturing our drug substance. If any such suppliers or manufacturers of our products fail to comply with GMP requirements or other FDA and comparable foreign regulatory requirements, it could adversely affect our clinical research activities and our ability to market and develop our products. See Item 7: "Management's Discussion and Analysis - Risks Related to Our Business": " - If the parties we depend on for manufacturing our pharmaceutical products do not timely supply these products, it may delay or impair our ability to develop and market our products"; and " - In order to conduct our clinical trials we need adequate supplies of our drug substance and drug product and competitors drug product, which may not be readily available."

Distribution

Our collaboration agreement with Quintiles to provide certain commercialization services in the United States for Surfaxin does not encompass distribution services. We are currently evaluating third party distribution capability in order to commercialize Surfaxin in the United States.

Our collaboration with Esteve provides that Esteve has the responsibility for distribution throughout Europe and Latin America. See Item 7: "Management's Discussion and Analysis - Risks Related to Our Business-Our lack of marketing and sales experience could limit our ability to generate revenues from future product sales."

COMPETITION

We are engaged in highly competitive fields of pharmaceutical research. Competition from numerous existing companies and others entering the fields in which we operate is intense and expected to increase. We expect to compete with, among others, conventional pharmaceutical companies. Most of these companies have substantially greater research and development, manufacturing, marketing, financial, technological personnel and managerial resources than we do. Acquisitions of competing companies by large pharmaceutical or health care companies could further enhance such competitors' financial, marketing and other resources. Moreover, competitors that are able to complete clinical trials, obtain required regulatory approvals and commence commercial sales of their products before we do may enjoy a significant competitive advantage over us. There are also existing therapies that may compete with the products we are developing. See Item 7: "Management's Discussion and Analysis - Risks Related to Our Business - Our industry is highly competitive and we have less capital and resources than many of our competitors, which may give them an advantage in developing and marketing products similar to ours or make our products obsolete."

Presently, the FDA has approved surfactants as replacement therapy only for Respiratory Distress Syndrome in premature infants, a condition in which infants are born with an insufficient amount of their own natural surfactant. The most commonly used of these approved replacement surfactants are derived from a chemical extraction process of pig and cow lungs. Curosurf(R) is a porcine lung extract that is marketed in Europe by Chiesi Farmaceutici S.p.A., and in the United States by Dey Laboratories, Inc. Survanta(R), marketed by the Ross division of Abbott Laboratories, Inc., is derived from minced cow lung that contains the cow version of surfactant protein B. Forest Laboratories, Inc., markets its calf lung surfactant extract, Infasurf(R), in the United States.

There is presently only one approved synthetic surfactant available, Exosurf(R), marketed by GlaxoSmithKline, plc. However, this product does not contain any surfactant proteins, is not widely used, and its active marketing recently has been discontinued by its manufacturer. Our ongoing pivotal, landmark Phase 3 clinical trial for the treatment of Respiratory Distress Syndrome in premature infants is designed as a prophylaxis, superiority trial comparing our Surfaxin to Exosurf(TM).

With respect to the development of lung surfactants for the treatment of other respiratory diseases and upper airway disorders, with the exception of one porcine-derived surfactant drug candidate under development by Leo Pharma A/S in Denmark, we are not aware of any other lung surfactant currently under development.

There are no drugs currently approved that are specifically indicated for the treatment of Acute Respiratory Distress Syndrome in adults or Meconium Aspiration Syndrome in full-term infants. Current therapy consists of general supportive care and mechanical ventilation. There are a significant number of other potential therapies in development for the treatment of Acute Respiratory Distress Syndrome in adults that are not surfactant related. Any of these various drugs or devices could significantly impact the commercial opportunity for Surfaxin.

Our humanized surfactant product candidates, including Surfaxin, are engineered versions of natural human lung surfactant and contain a humanized peptide, sinapultide (a 21 amino acid protein-like substance), that is designed to precisely mimic the essential human surfactant protein B (SP-B). We believe that our engineered humanized surfactant can be manufactured less expensively than the animal-derived surfactants, in sufficient quantities, in exact and consistent pharmaceutical grade quality, and has no potential to cause adverse immunological responses in young and older adults, all important attributes to potentially meet significant unmet medical needs. Our products also have the ability to be more precisely formulated, such as in the form of aerosolized liquids or dry powders to address various medical indications. In addition, we believe that our engineered humanized surfactants might possess other pharmaceutical benefits not currently found with the animal surfactants such as longer shelf-life, reduced number of administrations to the patient's lungs, and elimination of the risk of animal-borne diseases including the brain-wasting bovine spongiform encephalopathy (commonly called "mad-cow disease").

GOVERNMENT REGULATION

The testing, manufacture, distribution, advertising and marketing of drug products are subject to extensive regulation by federal, state and local governmental authorities in the United States, including the FDA, and by similar agencies in other countries. Any product that we develop must receive all relevant regulatory approvals or clearances before it may be marketed in a particular country.

The regulatory process, which includes preclinical studies and clinical trials of each pharmaceutical compound to establish its safety and efficacy and confirmation by the FDA that good laboratory, clinical and manufacturing practices were maintained during testing and manufacturing, can take many years, requires the expenditure of substantial resources and gives larger companies with greater financial resources a competitive advantage over us. Delays or terminations of clinical trials we undertake would likely impair our development of product candidates. Delays or terminations could result from a number of factors, including stringent enrollment criteria, slow rate of enrollment, size of patient population, having to compete with other clinical trials for eligible patients, geographical considerations and others.

The FDA review process can be lengthy and unpredictable, and we may encounter delays or rejections of our applications when submitted. If questions arise during the FDA review process, approval may take a significantly longer period of time. Generally, in order to gain FDA approval, we first must conduct preclinical studies in a laboratory and in animal models to obtain preliminary information on a compound's efficacy and to identify any safety problems. The results of these studies are submitted as part of an IND (Investigational New Drug) application that the FDA must review before human clinical trials of an investigational drug can start.

Clinical trials are normally done in three sequential phases and generally take two to five years or longer to complete. Phase 1 consists of testing the drug product in a small number of humans, normally healthy volunteers, to determine preliminary safety and tolerable dose range. Phase 2 usually involves studies in a limited patient population to evaluate the effectiveness of the drug product in humans having the disease or medical condition for which the product is indicated, determine dosage tolerance and optimal dosage and identify possible common adverse effects and safety risks. Phase 3 consists of additional controlled testing at multiple clinical sites to establish clinical safety and effectiveness in an expanded patient population of geographically dispersed test sites to evaluate the overall benefit-risk relationship for administering the product and to provide an adequate basis for product labeling. Phase 4 clinical trials are conducted after approval to gain additional experience from the treatment of patients in the intended therapeutic indication.

After completion of clinical trials of a new drug product, FDA and foreign regulatory authority marketing approval must be obtained. A New Drug Application submitted to the FDA generally takes one to three years to obtain approval. If questions arise during the FDA review process, approval may take a significantly longer period of time. The testing and approval processes require substantial time and effort and we may not receive approval on a timely basis, if at all. Even if regulatory clearances are obtained, a marketed product is subject to continual review, and later discovery of previously unknown problems or failure to comply with the applicable regulatory requirements may result in restrictions on the marketing of a product or withdrawal of the product from the market as well as possible civil or criminal sanctions. For marketing outside the United States, we also will be subject to foreign regulatory requirements governing human clinical trials and marketing approval for pharmaceutical products. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary widely from country to country. None of our products under development have been approved for marketing in the United States or elsewhere. We may not be able to obtain regulatory approval for any such products under development. Failure to obtain requisite governmental approvals or failure to obtain approvals of the scope requested will delay or preclude us, or our licensees or marketing partners, from marketing our products, or limit the commercial use of our products, and thereby would have a material adverse effect on our business, financial condition and results of operations. See Item 7: "Management's Discussion and Analysis - Risks Related to Our Business": " - Our technology platform is based solely on our proprietary humanized, engineered surfactant technology and only our lead product candidate, Surfaxin, has been subject to clinical studies. Our ongoing Phase 3 clinical trials for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants may be delayed, or fail, which will harm our business"; and " - The clinical trial and regulatory approval process for our products is expensive and time consuming, and the outcome is uncertain."

The FDA has granted us Fast-Track Approval Status for the Acute Respiratory Distress Syndrome and Meconium Aspiration Syndrome indications. Fast-Track Approval Status facilitates the development and expedites the review of new drugs intended for treatment of life-threatening conditions for which there is presently no medical option or an unmet medical need by providing for the FDA's review of the New Drug Application for a drug granted such Fast Track Status within six months following filing. We have also received Orphan Drug Designation from the FDA's Office of Orphan Products Development of Surfaxin as a treatment for Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants, and Acute Respiratory Distress Syndrome in adults. We have also received designation of Surfaxin as an Orphan Product for Meconium Aspiration Syndrome and Acute Lung Injury (which, in this circumstance, encompasses Acute Respiratory Distress Syndrome) from the European Medicines Evaluation Agency (EMEA).

EMPLOYEES

We have approximately 65 full-time employees, primarily employed in the United States, Europe and Latin America. Our future success depends in significant part upon the continued service of our key scientific personnel and executive officers and our continuing ability to attract and retain highly qualified scientific and managerial personnel. It is a competitive market for such personnel and we may not be able to retain our key employees or attract, assimilate or retain other highly qualified technical and managerial personnel in the future. See Item 7: "Management's Discussion and Analysis - Risks Related to Our Business - We depend upon key employees and consultants in a competitive market for skilled personnel. If we are unable to attract and retain key personnel, it could adversely affect our ability to develop and market our products."

1998 MERGER WITH ACUTE THERAPEUTICS, INC.

In June 1998, we completed the acquisition of the outstanding minority interest of our then majority-owned subsidiary, Acute Therapeutics, Inc., a Delaware corporation. Upon consummation of the merger, Robert J. Capetola, Ph.D., the then President and Chief Executive Officer of Acute Therapeutics, became our President and Chief Executive Officer.

AVAILABLE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document we file with the Commission at the Commission's public reference rooms at 450 Fifth Street, N.W., Washington, D.C. 20549, 233 Broadway, New York, New York 10279, and Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661- 2511. Please call the Commission at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from the SEC's Website at "http://www.sec.gov." We make available free of charge our annual, quarterly and current reports, proxy statements and other information upon request. To request such materials, please send an e-mail to ir@DiscoveryLabs.com or

contact John G. Cooper, our Senior Vice President, Chief Financial Officer at our address as set forth above.

We maintain a Website at "http://www.DiscoveryLabs.com" (this is not a hyperlink, you must visit this website through an Internet browser). Our Website and the information contained therein or connected thereto are not incorporated into this Annual Report on Form 10-K.

ITEM 2. DESCRIPTION OF PROPERTY.

Our principal offices and quality control laboratory facility is located at 350 South Main Street, Suite 307, Doylestown, Pennsylvania 18901. The telephone number of our executive office is (215) 340-4699 and the facsimile number is (215) 340-3940. In January 2002, we established a research facility in Redwood City, California, to develop aerosolized formulations of our proprietary humanized surfactant. We maintain a satellite office in the United Kingdom to manage and oversee our European clinical research programs. We lease all of these properties.

ITEM 3. LEGAL PROCEEDINGS.

We are not aware of any pending or threatened legal actions other than disputes arising in the ordinary course of our business that would not, if determined adversely to us, have a material adverse effect on our business and operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2002.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Our common stock is traded on the Nasdaq SmallCap Market under the symbol "DSCO." As of February 26, 2003, the number of stockholders of record of shares of our common stock was approximately 235, and the number of beneficial owners of shares of our common stock was approximately 4,500. As of February 26, 2003, there were approximately 32,857,000 shares of our common stock issued and outstanding.

The following table sets forth the quarterly price ranges of our common stock for the periods indicated, as reported by Nasdaq.

First Quarter 2001	$2.72	$5.91
Second Quarter 2001	$2.94	$5.49
Third Quarter 2001	$2.00	$4.65
Fourth Quarter 2001	$2.22	$4.38
First Quarter 2002	$2.70	$4.19
Second Quarter 2002	$1.28	$3.26
Third Quarter 2002	$0.90	$1.97
Fourth Quarter 2002	$1.60	$3.20
First Quarter 2003 (through February 26, 2003)	$1.76	$2.94

We have not paid dividends on our common stock. It is anticipated that we will not pay dividends on our common stock in the foreseeable future.

SALES OF UNREGISTERED SECURITIES

In the year ended December 31, 2002, we granted an aggregate of 1,131,000 options to our officers, directors, employees and consultants at various exercise prices ranging from $1.26 per share to $3.65 per share. These securities were offered and sold in reliance upon exemptions from registration pursuant to Section 4(2) of the Securities Act of 1933 as transactions not involving any public offering. No broker/dealers were involved in the sale and no commissions were paid. The recipients of these options either received adequate information about us or had access, through employment or other relationships, to such information.

ITEM 6. SELECTED FINANCIAL DATA

Selected Financial Data

Consolidated Statement of Operations Data:
(in thousands, except per share data)

	For the year ended December 31,				
	2002	2001	2000	1999	1998
Revenues from collaborative agreements	$ 1,782	$ 1,112	$ 741	$ 178	$ 27
Operating Expenses:					
Research and development	14,347	8,007	7,494	2,869	5,082
General and administrative	5,458	5,067	5,145	2,421	2,788
Write-off of acquired in-process research and development and supplies	--	--	--	--	8,220
Total expenses	19,805	13,074	12,639	5,290	16,090
Operating loss	(18,023)	(11,962)	(11,898)	(5,112)	(16,063)
Other income and expense	580	816	1,037	154	394
Minority interest in net loss of subsidiary	--	--	--	--	24
Net loss	$(17,443)	$(11,146)	$(10,861)	$(4,958)	$(15,645)
Net loss per common share - basic and diluted	$ (0.64)	$ (0.51)	$ (0.58)	$ (0.66)	$ (4.02)
Weighted average number of common shares outstanding	27,351	22,038	18,806	7,545	3,896

Consolidated Balance Sheet Data:
(in thousands)

	For the year ended December 31,				
	2002	2001	2000	1999	1998
ASSETS					
Current Assets:					
Cash/cash equivalents and marketable securities	$ 19,190	$ 16,696	$ 18,868	$ 3,547	$ 4,018
Prepaid expenses and other current assets	327	1,582	149	641	778
Total current assets	19,517	18,278	19,017	4,188	4,796
Property and equipment, net of depreciation	1,231	822	697	426	326
Other assets	314	965	3	18	18
Total assets	$ 21,062	$ 20,065	$ 19,717	$ 4,632	$ 5,140
LIABILITIES AND STOCKHOLDERS' EQUITY					
Total current liabilities	$ 3,202	$ 1,794	$ 2,399	$ 440	$ 1,088
Deferred revenue	1,393	615	851	1,036	--
Credit facility with corporate partner	1,450	--	--	--	--
Capitalized lease	256	33	31	48	--
Total liabilities	6,301	2,442	3,281	1,524	1,088
Stockholders' equity	14,761	17,623	16,436	3,108	4,052
Total liabilities and stockholders' equity	$ 21,062	$ 20,065	$ 19,717	$ 4,632	$ 5,140
Common Stock, $0.001 par value, issued	32,857	25,546	20,871	9,689	5,085

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Item 7: "Management's Discussion and Analysis of Financial Condition and Results of Operations" should be read in connection with our Consolidated Financial Statements. See Item 15: "Exhibits, Financial Statement Schedules, and Reports on Form 8-K."

OVERVIEW

We are a late-stage specialty pharmaceutical company applying our humanized lung surfactant technology to develop potential novel respiratory therapies and products. Surfactants are substances that are produced naturally in the lungs and are essential to the lungs' ability to absorb oxygen and to maintain proper airflow through the respiratory system. The absence or depletion of surfactant is involved in a number of respiratory diseases. Our humanized surfactant technology produces an engineered version of natural human lung surfactant and contains a peptide, sinapultide, that is designed to precisely mimic the essential human lung surfactant protein B (SP-B).

Surfaxin(R), our lead product, is being developed initially for critical care patients with life-threatening respiratory disorders for which there are few, if any, approved therapies. Surfaxin is currently in two Phase 3 clinical trials for Respiratory Distress Syndrome in premature infants, a Phase 3 clinical trial for Meconium Aspiration Syndrome in full-term infants, and a Phase 2 clinical trial for Acute Respiratory Distress Syndrome in adults. Aerosolized formulations of our humanized surfactant are presently being developed to potentially treat hospitalized patients suffering from severe acute asthma and Acute Lung Injury, typically requiring mechanical ventilation. In addition, we believe there is the scientific rationale for the development of aerosolized formulations of our humanized surfactant to potentially treat COPD, sinusitis, sleep apnea and otitis media (inner ear infection).

We are presently developing a dedicated sales and marketing capability through a collaboration with Quintiles to commercialize Surfaxin for neonatal indications in the United States. We also have entered into a strategic alliance with Esteve to commercialize Surfaxin in Europe and Latin America. We intend to establish additional strategic alliances, where appropriate, for the development and commercialization of our products in other indications and markets.

Since our inception, we have incurred significant losses and, as of December 31, 2002, had a deficit accumulated during the development stage of approximately $73 million (including historical results of predecessor companies). The majority of our expenditures to date have been for research and development activities. Research and development expenses represent costs incurred for scientific and clinical personnel, clinical trials, regulatory filings and manufacturing efforts (including raw material costs). We expense our research and development costs as they are incurred. General and administrative expenses consist primarily of executive management, financial, business development, legal and general corporate activities and related expenses. See Item 7: "Management's Discussion and Analysis - Plan of Operations."

Historically, we have funded our operations with working capital provided principally through public and private equity financings and strategic collaborations. In November 2002, we completed the sale of securities in a private placement to selected institutional and accredited investors for gross proceeds of approximately $12.8 million. As of December 31, 2002, we had cash and investments of approximately $19.2 million, a secured revolving credit facility of $8.5 million to $10 million with Quintiles, of which $5.7 million was available for borrowing and $1.45 million was outstanding, and a $1 million capital equipment lease financing arrangement of which approximately $285,000 has been used. See Item 7: "Management's Discussion and Analysis - Liquidity and Capital Resources."

CRITICAL ACCOUNTING POLICIES

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

We have identified below some of our more critical accounting policies and changes to accounting policies. For further discussion of our accounting policies see Footnote 2 "Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements. See Item 15: "Exhibits, Financial Statement Schedules, and Reports on Form 8-K."

Revenue Recognition - research and development collaborative agreements

For up-front payments and licensing fees related to our contract research or technology, we defer and recognize revenue as earned over the life of the related agreement. Milestone payments are recognized as revenue upon achievement of contract-specified events and when there are no remaining performance obligations.

Revenue earned under our research and development collaborative agreement contracts is recognized over a number of years as we perform research and development activities. For up-front payments and licensing fees related to our contract research or technology, we defer and recognize revenue as earned over the estimated period the services are expected to be performed.

Research and Development Costs

Research and development costs are expensed as incurred. We will continue to incur research and development costs as we continue to expand our product development activities. Our research and development costs have included, and will continue to include, expenses for internal development personnel, supplies and facilities, clinical trials, regulatory compliance and reviews, validation of processes and start up costs to establish commercial manufacturing capabilities. At the time our product candidates are approved by the FDA and we begin commercial manufacturing, we will no longer expense certain manufacturing costs as research and development costs.

PLAN OF OPERATIONS

We expect to continue to incur increasing operating losses for the foreseeable future, primarily due to our continued research and development activities attributable to new and existing products, manufacturing, initial commercialization, and general and administrative activities.

We anticipate that during the next 12 to 24 months we will:

(i) significantly increase our research, development and regulatory activities.

It is anticipated that our research and development activities will be the several clinical trials for Surfaxin indications and related regulatory filings. We are presently conducting a pivotal, multinational landmark Phase 3 trial treating up to 1,500 patients for the treatment of Respiratory Distress Syndrome in premature infants. This pivotal trial is intended, if successful, to provide the basis for New Drug Applications with the FDA and other worldwide regulatory authorities. This pivotal trial is expected to be completed and data announced early in the fourth quarter of 2003. We are also conducting another multinational Phase 3 trial treating up to 500 patients for the treatment of Respiratory Distress Syndrome in premature infants. This trial is expected to be completed within the same timeframe as the pivotal Phase 3 trial. We are currently evaluating whether to conclude this trial early to conserve financial resources and reallocate clinical resources to our pivotal Phase 3 trial. For Acute Respiratory Distress Syndrome in adults, we currently are conducting a Phase 2 dose-ranging safety and efficacy study of up to 110 patients in the United States. We expect to complete this trial in the third quarter of 2003. For Meconium Aspiration Syndrome in full-term infants, we currently are conducting a Phase 3 clinical trial of up to 200 patients in the United States. Enrollment is ongoing but has been slower than expected and completion is now anticipated in 2004. Given our belief in the importance of the pivotal Phase 3 trial for Respiratory Distress Syndrome in premature infants to our present development plan, resources have been and may continue to be reallocated from the Meconium Aspiration Syndrome program to the Respiratory Distress Syndrome program, as needed. We are conducting a Phase 2 clinical trial of Surfaxin lavage in up to 60 infant patients for use as a prophylactic for patients who are at risk for Meconium Aspiration Syndrome. The clinical trial and regulatory process is lengthy, expensive and uncertain and subject to numerous risks including, without limitation, the following risks discussed in the "Risks Related to Our Business" section: "The clinical trial and regulatory approval process for our products is expensive and time consuming, and the outcome is uncertain"; and "Our technology platform is based solely on our proprietary humanized, engineered surfactant technology and only our lead product candidate, Surfaxin, has been subject to clinical studies. Our ongoing Phase 3 clinical trials for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants may be delayed, or fail, which will harm our business."

Aerosolized formulations of our humanized surfactant are presently being developed to potentially treat hospitalized patients suffering from severe acute asthma and Acute Lung Injury. In addition, we are evaluating the development of aerosolized formulations of our

humanized surfactant to potentially treat COPD, sinusitis, sleep apnea and otitis media (inner ear infection).

(ii) invest in additional manufacturing capability in order to provide backup for the production of our humanized surfactant drug product and to scale up to meet clinical and commercial needs as they expand.

(iii) invest in additional general and administrative resources primarily to support our business development initiatives, financial systems and controls and management information technologies.

(iv) invest in marketing and commercialization management infrastructure to manage the strategic relationships with our collaborative partners for the launch of Surfaxin, if approved, and the execution of our "Discovery/Surfaxin" worldwide marketing strategy.

In December 2001, we entered into a collaboration arrangement with Quintiles, and its affiliate, PharmaBio, to provide certain commercialization services in the United States for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants and Meconium Aspiration Syndrome in full-term infants. Quintiles will hire and train a dedicated United States sales force that will be branded in the market as ours. Quintiles will make available up to $70 million in post-launch funding to cover the first seven years of U.S. sales and marketing costs. In return, Quintiles will receive a commission on net sales of Surfaxin over a 10-year period. The Quintiles arrangement allows us to retain product ownership and have sales and marketing expertise in place for the commercialization of Surfaxin in the United States, if approved.

In March 2002, we expanded our existing alliance with Esteve to develop, market and sell Surfaxin throughout Europe and Latin America. Esteve will provide certain commercialization services for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants and Acute Lung Injury/Acute Respiratory Distress Syndrome in adult patients. Our exclusive supply agreement with Esteve provides that Esteve will purchase from us all of its Surfaxin drug product requirements at an established transfer price based on sales of Surfaxin by Esteve and/or its sublicensee(s). Esteve has also agreed to sponsor certain clinical trial costs related to obtaining regulatory approval in Europe for the Acute Lung Injury/Acute Respiratory Distress Syndrome indications. Esteve also agreed to make certain milestone payments to us upon the attainment of European marketing regulatory approval for Surfaxin.

We will need to generate significant revenues from product sales and or related royalties and transfer prices to achieve and maintain profitability. Through December 31, 2002, we had no revenues from any product sales, and have not achieved profitability on a quarterly or annual basis. Our ability to achieve profitability depends upon, among other things, our ability to develop products, obtain regulatory approval for products under development and enter into agreements for product development, manufacturing and commercialization. In addition, our results are dependent upon the performance of our strategic partners and third party contract manufacturers and suppliers. Moreover, we may never achieve significant revenues or profitable operations from the sale of any of our products or technologies.

Through December 31, 2002, we had not generated taxable income. On December 31, 2002, net operating losses available to offset future taxable income for Federal tax purposes were approximately $65.1 million. The future utilization of such loss carryforwards may be limited pursuant to regulations promulgated under Section 382 of the Internal Revenue Code. In addition, we have a research and development tax credit carryforward of $1,225,000. The Federal net operating loss and research and development tax credit carryforwards expire beginning in 2008 and continuing through 2021.

RESULTS OF OPERATIONS

The net loss for the three years ended December 31, 2002, 2001 and 2000 was $17,443,000 (or $0.64 per common share), $11,146,000 (or $0.51 per common share), and $10,861,000 (or $0.58 per common share), respectively. These increased losses were primarily the result of increasing research and development expenditures as discussed below.

Revenue

Total revenues recognized for the three years ended December 31, 2002, 2001 and 2000 were $1,782,000, $1,112,000, and $741,000, respectively. These revenues are associated with our research and development collaborative arrangements, primarily our alliance with Esteve to develop, market and sell Surfaxin throughout Europe and Latin America. Additional collaborative revenues relate to our Small Business Innovative Research (SBIR) grant to develop Surfaxin for Acute Lung Injury/Acute Respiratory Distress Syndrome in adults and our Orphan Products Development grant to develop Surfaxin for Meconium Aspiration Syndrome in full-term infants.

Expenses

Research and development expenses for the three years ended December 31, 2002, 2001 and 2000 were $14,347,000, $8,007,000, and $7,494,000, respectively. The increases primarily reflect clinical trial costs incurred for our lead product, Surfaxin, currently in three Phase 3 trials and one Phase 2 trial for critical care patients with life threatening respiratory disorders, and research and development activities related to the development of aerosolized formulations of our humanized lung surfactant to potentially treat a variety of respiratory and upper airway conditions.

General and administrative expenses for the three years ended December 31, 2002, 2001 and 2000 were $5,458,000, $5,067,000, and $5,145,000, respectively. General and administrative expenses consist primarily of costs of business and commercial development, executive management, financial and accounting, legal, facility and other administrative costs. Included in the year ended December 31, 2002, is a charge of $1,450,000 for pre-launch commercialization activities for Surfaxin in connection with a collaboration agreement with Quintiles (for which funding is provided by a secured, revolving credit facility with PharmaBio, discussed below in "Liquidity and Capital Resources"). Additionally, included in the years ended December 31, 2002, 2001, and 2000, are non-cash compensation charges of $402,000, $517,000,

and $2,515,000, respectively. The 2002 and 2001 non-cash compensation charges primarily relate to the grant of stock options to non-employee members of our Board of Directors under our stock option plan and certain modifications to certain options held by three departing members of our Board of Directors. The 2000 non-cash compensation charge is primarily related to the grant of stock options to non-employee members of our Board of Directors under the Company's Stock Option Plan and the vesting of certain milestone-based stock options.

Other Income and Expense

Interest income for the three years ended December 31, 2002, 2001, and 2000 was $724,000, $842,000 and $1,042,000, respectively. Interest income decreased primarily due to the decline in interest rates and the average balance of marketable securities throughout the three year period.

Interest expense for the three years ended December 31, 2002, 2001, and 2000 was $144,000, $26,000 and $5,000, respectively. The increase in interest expense is primarily related to the secured, revolving credit facility with PharmaBio (discussed below in "Liquidity and Capital Resources").

LIQUIDITY AND CAPITAL RESOURCES

Cash, Cash Equivalents and Marketable Securities

As of December 31, 2002, we had cash, cash equivalents and marketable securities of approximately $19.2 million.

Secured, Revolving Credit Facility and Capital Lease Arrangement

In December 2001, we entered into a secured revolving credit facility of up to $8.5 million to $10 million with PharmaBio to fund pre-marketing activities for a Surfaxin launch in the United States. The credit facility is available for use until December 10, 2004, and monies become available in three tranches upon satisfying certain conditions. We have satisfied the conditions for availability of the first two tranches and at December 31, 2002, the amount available under the credit facility was approximately $5.7 million, of which $1.45 million was outstanding. Interest on amounts advanced under the credit facility will be payable quarterly in arrears. We may repay principal amounts owed by us under the credit facility from proceeds of milestone payments to be paid to us by PharmaBio upon the achievement of certain corporate milestones. We are obligated to use a significant portion of the funds borrowed under the credit facility for pre-launch marketing services to be provided by Quintiles.

In December 2002, we entered into a lease financing arrangement with the Life Science and Technology Finance Division of General Electric Capital Corporation that provides, subject to certain conditions, for up to $1 million in financing for capital purchases. As of December 31, 2002, we had used approximately $285,000 of this financing arrangement.

We believe our current working capital is sufficient to meet our planned research and development and operational activities into the second quarter of 2004. We will need additional

financing from investors or collaborators to complete research and development and commercialization of our current product candidates under development.

Our working capital requirements will depend upon numerous factors, including, without limitation, the progress of our research and development programs, clinical trials, timing and cost of obtaining regulatory approvals, timing and cost of pre-launch marketing activities, levels of resources that we devote to the development of manufacturing and marketing capabilities, levels of resources that our collaboration partners devote to the development of sales and marketing capabilities, technological advances, status of competitors and our ability to establish collaborative arrangements with other organizations, the ability to defend and enforce our intellectual property rights and the establishment of additional strategic or licensing arrangements with other companies or acquisitions.

Historically, the Company's working capital has been provided from the proceeds of private financings and strategic alliances:

In November 2002, we completed the sale of securities in a private placement to selected institutional and accredited investors for net proceeds of approximately $11.9 million. We issued 6,397,517 shares of Common Stock and 2,878,883 Class I Warrants to purchase shares of Common Stock at an exercise price of $2.425 per share. The Class I warrants have a five-year term.

Pursuant to our collaboration arrangement with Esteve on March 6, 2002, we issued 821,862 shares of Common Stock to Esteve at a purchase price equal to $4.867 per share and received a licensing fee of $500,000, for approximate net aggregate proceeds of $4.45 million. See Item 1: "Description of Business."

Pursuant to the collaboration arrangement we entered into with Quintiles and PharmaBio in December 2001, we issued to PharmaBio, for approximate net aggregate proceeds of $2.7 million: (i) 791,905 shares of common stock at a price equal to $3.79 per share; and (ii) Class G warrants to purchase 357,143 shares of common stock at an exercise price equal to $3.485 per share (subject to adjustment). In connection with the credit facility, we issued to PharmaBio Class H warrants to purchase 320,000 shares of common stock. The Class H warrants are exercisable at $3.03 per share (subject to adjustment) and are exercisable proportionately only upon availability of the credit facility. To the extent the credit facility availability is increased to greater than $8.5 million, for each $1 million increase, the amount of shares of common stock issuable pursuant to the Class H warrants shall be increased by approximately 38,000 shares. See Item 1: "Description of Business."

In October 2001, we received approximately $7.3 million in net proceeds from a private financing. In the financing, we issued 3,562,759 shares of common stock and 712,553 Class F warrants to purchase shares of common stock at an exercise price of $2.365 per share. The Class F warrants have a five-year term.

In April 2001, we received approximately $1 million in proceeds in a private offering of 296,560 shares of common stock at a per share price equal to $3.37.

In March 2000, we received approximately $17,500,000 in net proceeds in a private placement offering from the sale of 2,902,846 shares of common stock and 580,567 Class E warrants to purchase common stock at $7.38 per share. The Class E warrants issued in the offering are exercisable through March 2005.

In October 1999, in connection with our strategic alliance with Esteve, we issued to Esteve in a private placement 317,164 shares of common stock at a purchase price of $2.68 per share.

In July 1999, we raised approximately $2,233,000 in net proceeds in a private placement offering of an aggregate of 2,024,792 shares of common stock and 2,024,792 Class D warrants to purchase common stock. All of the Class D warrants have been exercised.

During March and April 1999, we raised $1.0 million in a private placement offering of 826,447 shares of common stock and 569,026 Class C warrants to purchase common stock at an exercise price of $2.15 per share. The Class C warrants are exercisable through April 2006.

We will require substantial additional funding to conduct our business, including our expanded research and product development activities. Based on our current operating plan, we believe that our currently available resources will be adequate to satisfy our capital needs into the second quarter of 2004. Our future capital requirements will depend on the results of our research and development activities, clinical studies and trials, competitive and technological advances and the regulatory process. Our operations will not become profitable before we exhaust our current resources; therefore, we will need to raise substantial additional funds through additional debt or equity financings or through collaborative ventures with potential corporate partners. We may in some cases elect to develop products on our own instead of entering into collaboration arrangements and this would increase our cash requirements. Other than our credit facility with Esteve and our capital lease financing arrangement with General Electric Capital Corporation, we have not entered into any additional arrangements to obtain any additional financing. The sale of additional equity and debt securities may result in additional dilution to our stockholders, and we cannot be certain that additional financing will be available in amounts or on terms acceptable to us, if at all. If we fail to enter into collaborative ventures or to receive additional funding, we may have to reduce significantly the scope of or discontinue our planned research, development and commercialization activities, which could significantly harm our financial condition and operating results. Furthermore, we could cease to qualify for listing of our common stock on the NASDAQ SmallCap Market if the market price of our common stock declines as a result of the dilutive aspects of such potential financings. See "Risks Related to Our Business": " - We will need additional capital, and our ability to continue all of our existing planned research and development activities is uncertain. Any additional financing could result in equity dilution"; " - The market price of our stock may be adversely affected by market volatility"; and " - A substantial number of our securities are eligible for future sale and this could affect the market price for our stock and our ability to raise capital."

RISKS RELATED TO OUR BUSINESS

The following risks, among others, could cause our actual results, performance, achievements or industry results to differ materially from those expressed in our forward-looking statements contained herein and presented elsewhere by management from time to time.

BECAUSE WE ARE A DEVELOPMENT STAGE COMPANY, WE MAY NOT SUCCESSFULLY DEVELOP AND MARKET OUR PRODUCTS, AND EVEN IF WE DO, WE MAY NOT GENERATE ENOUGH REVENUE OR BECOME PROFITABLE.

We are a development stage company. Therefore, you must evaluate us in light of the uncertainties and complexities present in a development stage biotechnology company. We currently have no products approved for sale and are conducting research and development on our product candidates. As a result, we have not begun to market or generate revenues from the commercialization of any of these products. Our long-term viability will be impaired if we are unable to obtain regulatory approval for, or successfully market, our product candidates.

To date, we have only generated revenues from investments, research grants and collaborative research and development agreements. We will need to engage in significant, time-consuming and costly research, development, pre-clinical studies, clinical testing and regulatory approval for our products under development prior to their commercialization. In addition, pre-clinical or clinical studies may show that our products are not effective or safe for one or more of their intended uses. We may fail in the development and commercialization of our products. As of December 31, 2002, we have incurred a deficit accumulated during the development stage of approximately $72 million, and we expect to continue to incur significant increasing operating losses over the next several years. If we succeed in the development of our products, we still may not generate sufficient or sustainable revenues or we may not be profitable.

OUR TECHNOLOGY PLATFORM IS BASED SOLELY ON OUR PROPRIETARY HUMANIZED, ENGINEERED SURFACTANT TECHNOLOGY AND ONLY OUR LEAD PRODUCT CANDIDATE, SURFAXIN, HAS BEEN SUBJECT TO CLINICAL STUDIES. OUR ONGOING PHASE 3 CLINICAL TRIALS FOR SURFAXIN FOR THE TREATMENT OF RESPIRATORY DISTRESS SYNDROME IN PREMATURE INFANTS MAY BE DELAYED, OR FAIL, WHICH WILL HARM OUR BUSINESS.

Our humanized, engineered surfactant platform technology is based on the scientific rationale for surfactant replacement therapy to treat life threatening respiratory disorders and as the foundation for the development of novel respiratory therapies and products. Our business is dependent upon the successful development and approval of our product candidates based on this platform technology. Our lead product, Surfaxin, is currently in two Phase 3 clinical trials for Respiratory Distress Syndrome in premature infants, a Phase 3 clinical trial for Meconium Aspiration Syndrome in full-term infants, and a Phase 2 clinical trial for Acute Respiratory Distress syndrome in adults.

Companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in advanced clinical trials, even after obtaining promising results in earlier trials. Data obtained from tests are susceptible to varying interpretations which may delay, limit or prevent regulatory

approval. In addition, we may be unable to enroll patients quickly enough to meet our expectations for completing any or all of these trials. The timing and completion of current and planned clinical trials of our product candidates depend on, among other factors, the rate at which patients are enrolled, which is a function of many factors, including:

- -- the number of clinical sites;

- -- the size of the patient population;

- -- the proximity of patients to the clinical sites;

- -- the eligibility criteria for the study;

- -- the existence of competing clinical trials; and

- -- the existence of alternative available products.

Delays in patient enrollment in clinical trials may occur, which would likely result in increased costs, program delays or both.

WE WILL NEED ADDITIONAL CAPITAL, AND OUR ABILITY TO CONTINUE ALL OF OUR EXISTING PLANNED RESEARCH AND DEVELOPMENT ACTIVITIES IS UNCERTAIN. ANY ADDITIONAL FINANCING COULD RESULT IN EQUITY DILUTION.

We will need substantial additional funding to conduct our presently planned research and product development activities. Based on our current operating plan, we believe that our currently available financial resources will be adequate to satisfy our capital needs into the second quarter of 2004. Our future capital requirements will depend on a number of factors that are uncertain, including the results of our research and development activities, clinical studies and trials, competitive and technological advances and the regulatory process, among others. We will likely need to raise substantial additional funds through collaborative ventures with potential corporate partners and through additional debt or equity financings. We may also continue to seek additional funding through capital lease transactions. We may in some cases elect to develop products on our own instead of entering into collaboration arrangements. This would increase our cash requirements for research and development.

We have not entered into arrangements to obtain any additional financing, except for the credit facility with PharmaBio and our capital equipment lease financing arrangement with General Electric Capital Corporation. Any additional financing could include unattractive terms or result in significant dilution of stockholders' interests and share prices may decline. If we fail to enter into collaborative ventures or to receive additional funding, we may have to delay, scale back or discontinue certain of our research and development operations, and consider licensing the development and commercialization of products that we consider valuable and which we otherwise would have developed ourselves. If we are unable to raise required capital, we may be forced to limit many, if not all, of our research and development programs and related operations, curtail commercialization of out product candidates and, ultimately, cease operations.

Furthermore, we could cease to qualify for listing of our securities on the NASDAQ SmallCap Market if the market price of our common stock declines as a result of the dilutive aspects of such potential financings. See "Risks Related to Our Business-The market price of our stock may be adversely affected by market volatility."

THE CLINICAL TRIAL AND REGULATORY APPROVAL PROCESS FOR OUR PRODUCTS IS EXPENSIVE AND TIME CONSUMING, AND THE OUTCOME IS UNCERTAIN.

In order to sell our products that are under development, we must receive regulatory approvals for each product. The FDA and comparable agencies in foreign countries extensively and rigorously regulate the testing, manufacture, distribution, advertising, pricing and marketing of drug products like our products. This approval process includes preclinical studies and clinical trials of each pharmaceutical compound to establish its safety and effectiveness and confirmation by the FDA and comparable agencies in foreign countries that the manufacturer maintains good laboratory and manufacturing practices during testing and manufacturing. Although we are involved in certain late-stage clinical trials, pharmaceutical and biotechnology companies have suffered significant setbacks in advanced clinical trials, even after promising results in earlier clinical trials.

The approval process is lengthy, expensive and uncertain. It is also possible that the FDA or comparable foreign regulatory authorities could interrupt, delay or halt any one or more of our clinical trials. If we, or any regulatory authorities, believe that trial participants face unacceptable health risks, any one or more of our trials could be suspended or terminated. We also may not reach agreement with the FDA and/or comparable foreign agencies on the design of any one or more of the clinical studies necessary for approval. Conditions imposed by the FDA and comparable agencies in foreign countries on our clinical trials could significantly increase the time required for completion of such clinical trials and the costs of conducting the clinical trials. Data obtained from clinical testing are susceptible to varying interpretations which may delay, limit or prevent regulatory approval.

Delays and terminations of the clinical trials we conduct could result from insufficient patient enrollment. Patient enrollment is a function of several factors, including the size of the patient population, stringent enrollment criteria, the proximity of the patients to the trial sites, having to compete with other clinical trials for eligible patients, geographical and geopolitical considerations and others. Delays in patient enrollment can result in greater costs and longer trial timeframes. Patients may also suffer adverse medical events or side effects that are common to this class of drug such as a decrease in the oxygen level of the blood upon administration.

Clinical trials generally take two to five years or more to complete, and, accordingly, our first product is not expected to be commercially available in the United States until at least 2004, and our other product candidates will take longer. The FDA has notified us that two of our intended indications for Surfaxin, Meconium Aspiration Syndrome in full-term infants and Acute Respiratory Distress Syndrome in adults, have been granted designation as "fast-track" products under provisions of the Food and Drug Administration Modernization Act of 1997, and the FDA has awarded us an Orphan Products Development Grant to support our development of Surfaxin for the treatment of Meconium Aspiration Syndrome. Fast-Track Status does not accelerate the clinical trials nor does it mean that the regulatory requirements are less stringent. The Fast-Track Status provisions are designed to expedite the FDA's review of new drugs intended to treat serious or life-threatening conditions. The FDA generally will review the New Drug Application

for a drug granted Fast-Track Status within six months instead of the typical one to three years. Our products may not, however, continue to qualify for expedited review and our other drug candidates may fail to qualify for fast track development or expedited review. Even though some of our drug candidates have qualified for expedited review, the FDA may not approve them at all or any sooner than other drug candidates that do not qualify for expedited review.

The FDA and comparable foreign agencies could withdraw any approvals we obtain. Further, if there is a later discovery of unknown problems or if we fail to comply with other applicable regulatory requirements at any stage in the regulatory process, the FDA may restrict or delay our marketing of a product or force us to make product recalls. In addition, the FDA could impose other sanctions such as fines, injunctions, civil penalties or criminal prosecutions. To market our products outside the United States, we also need to comply with foreign regulatory requirements governing human clinical trials and marketing approval for pharmaceutical products. The FDA and foreign regulators have not yet approved any of our products under development for marketing in the United States or elsewhere. If the FDA and other regulators do not approve our products, we will not be able to market our products.

IN ORDER TO CONDUCT OUR CLINICAL TRIALS WE NEED ADEQUATE SUPPLIES OF OUR DRUG SUBSTANCE AND DRUG PRODUCT AND COMPETITORS DRUG PRODUCT, WHICH MAY NOT BE READILY AVAILABLE.

To succeed, clinical trials require adequate supplies of drug substance and drug product, which may be difficult or uneconomical to procure or manufacture. We rely on outside manufacturers for our drug substance and other active ingredients for Surfaxin and to produce material that meets appropriate standards for use in clinical studies for our products. We have validated only a single clinical manufacturing facility, owned and operated by Akorn to produce appropriate clinical grade material of our drug substance that meets standards for use in our ongoing clinical studies. Akorn has been experiencing significant operational and financial difficulties and is currently attempting to restructure its financial obligations and improve its day to day operations. In February 2003, Akorn informed us that certain operating difficulties experienced in one of its production rooms primarily used for the filling of sterile pharmaceutical had been rectified and that the room had been returned to operational status. Our ability to timely recommence Surfaxin manufacture for our Phase 2 clinical trial for Acute Respiratory Distress Syndrome in adults is dependent upon the success of Akorn's efforts to correct its difficulties and its ability to maintain operational status of the sterile production room and its other Surfaxin-related facilities.

OUR STRATEGY, IN MANY CASES, IS TO ENTER INTO COLLABORATION AGREEMENTS WITH THIRD PARTIES WITH RESPECT TO OUR PRODUCTS AND WE MAY REQUIRE ADDITIONAL COLLABORATION AGREEMENTS. IF WE FAIL TO ENTER INTO THESE AGREEMENTS OR IF WE OR THE THIRD PARTIES DO NOT PERFORM UNDER SUCH AGREEMENTS, IT COULD IMPAIR OUR ABILITY TO COMMERCIALIZE OUR PRODUCTS.

Our strategy for the completion of the required development and clinical testing of our products and for the manufacturing, marketing and commercialization of our products, in many cases, depends upon entering into collaboration arrangements with pharmaceutical companies to market, commercialize and distribute our products. In March 2002, we expanded our relationship with Esteve by entering into a collaboration arrangement with Esteve for Surfaxin covering all of Europe and Latin America. Esteve will be responsible for the marketing of

Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants, and Acute Lung Injury/Acute Respiratory Distress Syndrome in adults. Esteve will also be responsible for the sponsorship of certain clinical trial costs related to obtaining European Medicines Evaluation Agency approval for commercialization of Surfaxin in Europe for the Acute Lung Injury/Acute Respiratory Distress Syndrome indications. We will be responsible for the remainder of the regulatory activities relating to Surfaxin, including with respect to European Medicines Evaluation Agency filings.

In December 2001, we entered into an exclusive collaboration arrangement in the United States with Quintiles, and its affiliate, PharmaBio, to commercialize, sell and market Surfaxin in the United States for indications of Respiratory Distress Syndrome and Meconium Aspiration Syndrome. As part of our collaboration with Quintiles, Quintiles will build a sales force solely dedicated to the sale of Surfaxin upon the approval of a New Drug Application for either of the two indications. If Quintiles and we fail to devote appropriate resources to commercialize, sell and market Surfaxin, sales of Surfaxin could be reduced. As part of the collaboration, PharmaBio is obligated to provide us with certain financial assistance in connection with the commercialization of Surfaxin, including, but not limited to, a secured, revolving credit facility for at least $8.5 million which may be increased to $10 million. A failure by us to repay amounts outstanding under the credit facility would have a material adverse effect on us. To obtain the benefits of such financing, we are obligated to meet certain development and performance milestones. The failure by us to meet the milestones or other terms and conditions of the financing leading to PharmaBio's termination thereof or the failure by PharmaBio to fulfill its obligation to partially fund the commercialization of Surfaxin, may affect our ability to successfully market Surfaxin.

If Esteve, Quintiles or we breach or terminate the agreements that make up such collaboration arrangements or Esteve or Quintiles otherwise fail to conduct their Surfaxin-related activities in a timely manner or if there is a dispute about their respective obligations, we may need to seek other partners or we may have to develop our own internal sales and marketing capability for the indications of Surfaxin which Esteve and/or Quintiles have agreed to assist in commercializing. Accordingly, we may need to enter into additional collaboration agreements and our success, particularly outside of the United States, may depend upon obtaining additional collaboration partners. In addition, we may depend on our partners' expertise and dedication of sufficient resources to develop and commercialize our proposed products. We may, in the future, grant to collaboration partners rights to license and commercialize pharmaceutical products developed under collaboration agreements. Under these arrangements, our collaboration partners may control key decisions relating to the development of the products. The rights of our collaboration partners would limit our flexibility in considering alternatives for the commercialization of our products. If we fail to successfully develop these relationships or if our collaboration partners fail to successfully develop or commercialize any of our products, it may delay or prevent us from developing or commercializing our products in a competitive and timely manner and would have a material adverse effect on the commercialization of Surfaxin. See "Risks Related to Our Business-Our lack of marketing and sales experience could limit our ability to generate revenues from future product sales."

IF WE CANNOT PROTECT OUR INTELLECTUAL PROPERTY, OTHER COMPANIES COULD USE OUR TECHNOLOGY IN COMPETITIVE PRODUCTS. IF WE INFRINGE THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS, OTHER COMPANIES COULD PREVENT US FROM DEVELOPING OR MARKETING OUR PRODUCTS.

We seek patent protection for our drug candidates so as to prevent others from commercializing equivalent products in substantially less time and at substantially lower expense. The pharmaceutical industry places considerable importance on obtaining patent and trade secret protection for new technologies, products and processes. Our success will depend in part on our ability and that of parties from whom we license technology to:

- -- defend our patents and otherwise prevent others from infringing on our proprietary rights;

- -- protect trade secrets; and

- -- operate without infringing upon the proprietary rights of others, both in the United States and in other countries.

The patent position of firms relying upon biotechnology is highly uncertain and involves complex legal and factual questions for which important legal principles are unresolved. To date, the United States Patent and Trademark Office has not adopted a consistent policy regarding the breadth of claims that the United States Patent and Trademark Office allows in biotechnology patents or the degree of protection that these types of patents afford. As a result, there are risks that we may not develop or obtain rights to products or processes that are or may seem to be patentable.

EVEN IF WE OBTAIN PATENTS TO PROTECT OUR PRODUCTS, THOSE PATENTS MAY NOT BE SUFFICIENTLY BROAD AND OTHERS COULD COMPETE WITH US.

We, or the parties licensing technologies to us, have filed various United States and foreign patent applications with respect to the products and technologies under our development, and the United States Patent and Trademark Office and foreign patent offices have issued patents with respect to our products and technologies. These patent applications include international applications filed under the Patent Cooperation Treaty. Our pending patent applications, those we may file in the future or those we may license from third parties may not result in the United States Patent and Trademark Office or foreign patent office issuing patents. Also, if patent rights covering our products are not sufficiently broad, they may not provide us with sufficient proprietary protection or competitive advantages against competitors with similar products and technologies. Furthermore, if the United States Patent and Trademark Office or foreign patent offices issue patents to us or our licensors, others may challenge the patents or circumvent the patents, or the patent office or the courts may invalidate the patents. Thus, any patents we own or license from or to third parties may not provide any protection against competitors.

Furthermore, the life of our patents is limited. We have licensed a series of patents from Johnson & Johnson and Ortho Pharmaceutical which are important, either individually or collectively, to our strategy of commercializing our surfactant technology. Such patents, which include relevant European patents, expire on various dates beginning in 2009 and ending in 2017 or, in some cases, possibly later. We have filed, and when possible and appropriate, will file, other patent applications with respect to our products and processes in the United States and in foreign

countries. We may not be able to develop additional products or processes that will be patentable or additional patents may not be issued to us. See also "Risks Related to Our Business-If we cannot meet requirements under our license agreements, we could lose the rights to our products."

INTELLECTUAL PROPERTY RIGHTS OF THIRD PARTIES COULD LIMIT OUR ABILITY TO MARKET OUR PRODUCTS.

Our commercial success also significantly depends on our ability to operate without infringing the patents or violating the proprietary rights of others. The United States Patent and Trademark Office keeps United States patent applications confidential while the applications are pending. As a result, we cannot determine which inventions third parties claim in pending patent applications that they have filed. We may need to engage in litigation to defend or enforce our patent and license rights or to determine the scope and validity of the proprietary rights of others. It will be expensive and time consuming to defend and enforce patent claims. Thus, even in those instances in which the outcome is favorable to us, the proceedings can result in the diversion of substantial resources from our other activities. An adverse determination may subject us to significant liabilities or require us to seek licenses that third parties may not grant to us or may only grant at rates that diminish or deplete the profitability of the products to us. An adverse determination could also require us to alter our products or processes or cease altogether any related research and development activities or product sales.

IF WE CANNOT MEET REQUIREMENTS UNDER OUR LICENSE AGREEMENTS, WE COULD LOSE THE RIGHTS TO OUR PRODUCTS.

We depend on licensing arrangements with third parties to maintain the intellectual property rights to our products under development. Presently, we have licensed rights from Johnson & Johnson and Ortho Pharmaceutical. These agreements require us to make payments and satisfy performance obligations in order to maintain our rights under these licensing arrangements. All of these agreements last either throughout the life of the patents, or with respect to other licensed technology, for a number of years after the first commercial sale of the relevant product.

In addition, we are responsible for the cost of filing and prosecuting certain patent applications and maintaining certain issued patents licensed to us. If we do not meet our obligations under our license agreements in a timely manner, we could lose the rights to our proprietary technology.

In addition, we may be required to obtain licenses to patents or other proprietary rights of third parties in connection with the development and use of our products and technologies. Licenses required under any such patents or proprietary rights might not be made available on terms acceptable to us, if at all.

WE RELY ON CONFIDENTIALITY AGREEMENTS THAT COULD BE BREACHED AND MAY BE DIFFICULT TO ENFORCE.

Although we believe that we take reasonable steps to protect our intellectual property, including the use of agreements relating to the non-disclosure of confidential information to third parties,

as well as agreements that purport to require the disclosure and assignment to us of the rights to the ideas, developments, discoveries and inventions of our employees and consultants while we employ them, the agreements can be difficult and costly to enforce. Although we seek to obtain these types of agreements from our consultants, advisors and research collaborators, to the extent that they apply or independently develop intellectual property in connection with any of our projects, disputes may arise as to the proprietary rights to this type of information. If a dispute arises, a court may determine that the right belongs to a third party, and enforcement of our rights can be costly and unpredictable. In addition, we will rely on trade secrets and proprietary know-how that we will seek to protect in part by confidentiality agreements with our employees, consultants, advisors or others. Despite the protective measures we employ, we still face the risk that:

- -- they will breach these agreements;

- -- any agreements we obtain will not provide adequate remedies for this type of breach or that our trade secrets or proprietary know-how will otherwise become known or competitors will independently develop similar technology; and

- -- our competitors will independently discover our proprietary information and trade secrets.

IF THE PARTIES WE DEPEND ON FOR MANUFACTURING OUR PHARMACEUTICAL PRODUCTS DO NOT TIMELY SUPPLY THESE PRODUCTS, IT MAY DELAY OR IMPAIR OUR ABILITY TO DEVELOP AND MARKET OUR PRODUCTS.

We rely on outside manufacturers for our drug substance and other active ingredients for Surfaxin and to produce material that meets appropriate standards for use in clinical studies for our products. We have validated only a single clinical manufacturing facility owned and operated by Akorn to produce appropriate clinical grade material of our drug substance that meets standards for use in our ongoing clinical studies. Recently, Akorn has experienced a number of operational and financial difficulties that, although not directly involving the manufacturing process for our Surfaxin and other proprietary surfactant drug substance or drug product, may have an adverse effect on our clinical research and development activities. We will also rely on outside manufacturers for production of our products after marketing approval. We may also enter into arrangements with other manufacturers for the manufacture of materials for use in clinical testing and after marketing approval.

Our outside manufacturers may not perform as they have agreed or may not remain in the contract manufacturing business for a sufficient time to successfully produce and market our product candidates. If we do not maintain important manufacturing relationships, we may fail to find a replacement manufacturer or to develop our own manufacturing capabilities. If we cannot do so, it could delay or impair our ability to obtain regulatory approval for our products and substantially increase our costs or deplete any profit margins. If we do find replacement manufacturers, we may not be able to enter into agreements with them on terms and conditions favorable to us and, there could be a substantial delay before a new facility could be qualified and registered with the FDA and foreign regulatory authorities.

We may in the future elect to manufacture some of our products on our own. Although we own certain specialized manufacturing equipment, are considering an investment in additional

manufacturing equipment and employ certain manufacturing managerial personnel, we do not presently maintain a complete manufacturing facility or manufacturing department and we do not anticipate manufacturing on our own any of our products during the next 12 months. If we decide to manufacture products on our own and do not successfully develop manufacturing capabilities, it will adversely affect sales of our products.

The FDA and foreign regulatory authorities require manufacturers to register manufacturing facilities. The FDA and corresponding foreign regulators also inspect these facilities to confirm compliance with good manufacturing practices (GMPs) or similar requirements that the FDA or corresponding foreign regulators establish. Manufacturing or quality control problems could occur at the contract manufacturers causing product production and shipment delays or a situation where the contractor may not be able to maintain compliance with the FDA's current GMP requirements necessary to continue manufacturing our drug substance. If our third-party foreign or domestic suppliers or manufacturers of our products or, if we decide to manufacture our products on our own, we, fail to comply with GMP requirements or other FDA and comparable foreign regulatory requirements, it could adversely affect our clinical research activities and our ability to market and develop our products.

OUR LACK OF MARKETING AND SALES EXPERIENCE COULD LIMIT OUR ABILITY TO GENERATE REVENUES FROM FUTURE PRODUCT SALES.

We do not have marketing, sales or distribution experience or marketing or sales personnel. As a result, we will depend on our collaboration with Quintiles for the marketing and sales of Surfaxin for indications of Respiratory Distress Syndrome in premature infants and Meconium Aspiration Syndrome in full-term infants in the United States and with Esteve for the marketing and sales of Surfaxin for the treatment of Respiratory Distress Syndrome, Meconium Aspiration Syndrome and Acute Lung Injury/Acute Respiratory Distress Syndrome in adult patients in all of Europe and Latin America. See "Risks Related to Our Business-Our strategy, in many cases, is to enter into collaboration agreements with third parties with respect to our products and we may require additional collaboration agreements. If we fail to enter into these agreements or if we or the third parties do not perform under such agreements, it could impair our ability to commercialize our products." If we do not develop a marketing and sales force of our own, then we will depend on arrangements with corporate partners or other entities for the marketing and sale of our remaining products.

The sales and marketing of Surfaxin for indications of Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants, and Acute Lung Injury/Acute Respiratory Distress Syndrome in adult patients in the relevant territories depends, in part, on Quintiles' and Esteve's performance of their contractual obligations. The failure of either party to do so would have a material adverse effect on the sales and marketing of Surfaxin. We may not succeed in entering into any satisfactory third party arrangements for the marketing and sale of our remaining products. In addition, we may not succeed in developing marketing and sales capabilities, our commercial launch of certain products may be delayed until we establish marketing and sales capabilities or we may not have sufficient resources to do so. If we fail to establish marketing and sales capabilities or fail to enter into arrangements with third parties, either in a timely manner, it will adversely affect sales of our products.

WE DEPEND UPON KEY EMPLOYEES AND CONSULTANTS IN A COMPETITIVE MARKET FOR SKILLED PERSONNEL. IF WE ARE UNABLE TO ATTRACT AND RETAIN KEY PERSONNEL, IT COULD ADVERSELY AFFECT OUR ABILITY TO DEVELOP AND MARKET OUR PRODUCTS.

We are highly dependent upon the principal members of our management team, especially our Chief Executive Officer, Dr. Capetola, and our directors, as well as our scientific advisory board members, consultants and collaborating scientists. Many of these people have been involved in our formation or have otherwise been involved with us for many years, have played integral roles in our progress and we believe that they will continue to provide value to us. A loss of any of these personnel may have a material adverse effect on aspects of our business and clinical development and regulatory programs. We have an employment agreement with Dr. Capetola that expires on December 31, 2005. We also have employment agreements with other key personnel with termination dates from 2003 through 2005. Although these employment agreements generally provide for severance payments that are contingent upon the applicable employee's refraining from competition with us, the loss of any of these persons' services would adversely affect our ability to develop and market our products and obtain necessary regulatory approvals, and the applicable noncompete provisions can be difficult and costly to monitor and enforce. Further, we do not maintain key-man life insurance.

Our future success also will depend in part on the continued service of our key scientific and management personnel and our ability to identify, hire and retain additional personnel, including marketing and sales staff. We experience intense competition for qualified personnel, and the existence of non-competition agreements between prospective employees and their former employers may prevent us from hiring those individuals or subject us to suit from their former employers.

While we attempt to provide competitive compensation packages to attract and retain key personnel, some of our competitors are likely to have greater resources and more experience than we have, making it difficult for us to compete successfully for key personnel.

OUR INDUSTRY IS HIGHLY COMPETITIVE AND WE HAVE LESS CAPITAL AND RESOURCES THAN MANY OF OUR COMPETITORS, WHICH MAY GIVE THEM AN ADVANTAGE IN DEVELOPING AND MARKETING PRODUCTS SIMILAR TO OURS OR MAKE OUR PRODUCTS OBSOLETE.

Our industry is highly competitive and subject to rapid technological innovation and evolving industry standards. We compete with numerous existing companies intensely in many ways. We intend to market our products under development for the treatment of diseases for which other technologies and treatments are rapidly developing and, consequently, we expect new companies to enter our industry and that competition in the industry will increase. Many of these companies have substantially greater research and development, manufacturing, marketing, financial, technological, personnel and managerial resources than we have. In addition, many of these competitors, either alone or with their collaborative partners, have significantly greater experience than we do in:

- -- developing products;

- -- undertaking preclinical testing and human clinical trials;

- -- obtaining FDA and other regulatory approvals or products; and

- -- manufacturing and marketing products.

Accordingly, our competitors may succeed in obtaining patent protection, receiving FDA or comparable foreign approval or commercializing products before us. If we commence commercial product sales, we will compete against companies with greater marketing and manufacturing capabilities who may successfully develop and commercialize products that are more effective or less expensive than ours. These are areas in which, as yet, we have limited or no experience. In addition, developments by our competitors may render our product candidates obsolete or noncompetitive.

Presently, there are no approved drugs that are specifically indicated for Meconium Aspiration Syndrome in full-term infants or Acute Lung Injury/Acute Respiratory Distress Syndrome in adults. Current therapy consists of general supportive care and mechanical ventilation.

Four products, three that are animal-derived and one that is a synthetic, are specifically approved for the treatment of Respiratory Distress Syndrome in premature infants. Exosurf(R) is synthetic and is marketed by GlaxoSmithKline, plc, outside the United States and contains only phospholipids (the fats normally present in the lungs) and synthetic organic detergents and no stabilizing protein or peptides. Curosurf(R) is a porcine lung extract that is marketed in Europe by Chiesi Farmaceutici S.p.A., and in the United States by Dey Laboratories, Inc. Survanta(R), marketed by the Ross division of Abbott Laboratories, Inc., is an extract of bovine lung that contains the cow version of surfactant protein B. Forrest Laboratories, Inc., markets its calf lung surfactant, Infasurf(R) in the United States for the treatment of Respiratory Distress Syndrome in premature infants. Although none of the four approved surfactants for Respiratory Distress Syndrome in premature infants is approved for Acute Lung Injury or Acute Respiratory Distress Syndrome in adults, which are significantly larger markets, there are a significant number of other potential therapies in development for the treatment of Acute Lung Injury/Acute Respiratory Distress Syndrome that are not surfactant-related. Any of these various drugs or devices could significantly impact the commercial opportunity for Surfaxin. We believe that engineered humanized surfactants such as Surfaxin will be far less expensive to produce than the animal-derived products approved for the treatment of Respiratory Distress Syndrome in premature infants and will have no capability of transmitting the brain-wasting bovine spongiform encephalopathy (commonly called "mad-cow disease") or causing adverse immunological responses in young and older adults.

We also face, and will continue to face, competition from colleges, universities, governmental agencies and other public and private research organizations. These competitors are becoming more active in seeking patent protection and licensing arrangements to collect royalties for use of technology that they have developed. Some of these technologies may compete directly with the technologies that we are developing. These institutions will also compete with us in recruiting highly qualified scientific personnel. We expect that therapeutic developments in the areas in which we are active may occur at a rapid rate and that competition will intensify as advances in this field are made. As a result, we need to continue to devote substantial resources and efforts to research and development activities.

IF PRODUCT LIABILITY CLAIMS ARE BROUGHT AGAINST US, IT MAY RESULT IN REDUCED DEMAND FOR OUR PRODUCTS OR DAMAGES THAT EXCEED OUR INSURANCE COVERAGE.

The clinical testing of, marketing and use of our products exposes us to product liability claims in the event that the use or misuse of those products causes injury, disease or results in adverse effects. Use of our products in clinical trials, as well as commercial sale, could result in product liability claims. In addition, sales of our products through third party arrangements could also subject us to product liability claims. We presently carry product liability insurance with coverages of up to $10,000,000 per occurrence and $10,000,000 in the aggregate, an amount we consider reasonable and customary relating to our clinical trials of Surfaxin. However, this insurance coverage includes various deductibles, limitations and exclusions from coverage, and in any event might not fully cover any potential claims. We may need to obtain additional product liability insurance coverage prior to initiating other clinical trials. We expect to obtain product liability insurance coverage before commercialization of our proposed products; however, the insurance is expensive and insurance companies may not issue this type of insurance when we need it. We may not be able to obtain adequate insurance in the future at an acceptable cost. Any product liability claim, even one that was not in excess of our insurance coverage or one that is meritless and/or unsuccessful, could adversely affect our cash available for other purposes, such as research and development. In addition, the existence of a product liability claim could affect the market price of our common stock.

WE EXPECT TO FACE UNCERTAINTY OVER REIMBURSEMENT AND HEALTHCARE REFORM.

In both the United States and other countries, sales of our products will depend in part upon the availability of reimbursement from third party payors, which include government health administration authorities, managed care providers and private health insurers. Third party payors are increasingly challenging the price and examining the cost effectiveness of medical products and services.

DIRECTORS, EXECUTIVE OFFICERS, PRINCIPAL STOCKHOLDERS AND AFFILIATED ENTITIES OWN A SIGNIFICANT PERCENTAGE OF OUR CAPITAL STOCK, AND THEY MAY MAKE DECISIONS THAT YOU DO NOT CONSIDER TO BE IN YOUR BEST INTEREST.

As of February 26, 2003, our directors, executive officers, principal stockholders and affiliated entities beneficially owned, in the aggregate, approximately 14% of our outstanding voting securities. As a result, if some or all of them acted together, they would have the ability to exert substantial influence over the election of our Board of Directors and the outcome of issues requiring approval by our stockholders. This concentration of ownership may have the effect of delaying or preventing a change in control of our company that may be favored by other stockholders. This could prevent transactions in which stockholders might otherwise recover a premium for their shares over current market prices.

THE MARKET PRICE OF OUR STOCK MAY BE ADVERSELY AFFECTED BY MARKET VOLATILITY.

The market price of our common stock, like that of many other development stage pharmaceutical or biotechnology companies, has been and is likely to be volatile. In addition to general economic, political and market conditions, the price and trading volume of our stock could fluctuate widely in response to many factors, including:

- -- announcements of the results of clinical trials by us or our competitors;

- -- adverse reactions to products;

- -- governmental approvals, delays in expected governmental approvals or withdrawals of any prior governmental approvals or public or regulatory agency concerns regarding the safety or effectiveness of our products;

- -- changes in the United States or foreign regulatory policy during the period of product development;

- -- developments in patent or other proprietary rights, including any third party challenges of our intellectual property rights;

- -- announcements of technological innovations by us or our competitors;

- -- announcements of new products or new contracts by us or our competitors;

- -- actual or anticipated variations in our operating results due to the level of development expenses and other factors;

- -- changes in financial estimates by securities analysts and whether our earnings meet or exceed the estimates;

- -- conditions and trends in the pharmaceutical and other industries;

- -- new accounting standards; and

- -- the occurrence of any of the risks described in these "Management's Discussion and Analysis - Risks Related to Our Business."

Our common stock is listed for quotation on the NASDAQ SmallCap Market. For the 12-month period ended December 31, 2002, the price of our common stock has ranged from $0.90 to $4.19. We expect the price of our common stock to remain volatile. The average daily trading volume in our common stock varies significantly. For the 12-month period ending December 31, 2002, the average daily trading volume in our common stock was approximately 50,072 shares and the average number of transactions per day was approximately 57. Our relatively low average volume and low average number of transactions per day may affect the ability of our stockholders to sell their shares in the public market at prevailing prices and a more active market may never develop.

In addition, we may not be able to continue to adhere to the strict listing criteria of the SmallCap Market. If the common stock were no longer listed on the SmallCap Market, investors might only be able to trade in the over-the-counter market in the Pink Sheets(R) (a quotation medium operated by the National Quotation Bureau, LLC) or on the OTC Bulletin Board(R) of the National Association of Securities Dealers, Inc. This would impair the liquidity of our securities not only in the number of shares that could be bought and sold at a given price, which might be depressed by the relative illiquidity, but also through delays in the timing of transactions and reduction in media coverage.

In the past, following periods of volatility in the market price of the securities of companies in our industry, securities class action litigation has often been instituted against companies in our industry. If we face securities litigation in the future, even if meritless or unsuccessful, it would result in substantial costs and a diversion of management attention and resources, which would negatively impact our business.

A SUBSTANTIAL NUMBER OF OUR SECURITIES ARE ELIGIBLE FOR FUTURE SALE AND THIS COULD AFFECT THE MARKET PRICE FOR OUR STOCK AND OUR ABILITY TO RAISE CAPITAL.

The market price of our common stock could drop due to sales of a large number of shares of our common stock or the perception that these sales could occur. As of February 26, 2003, we had 32,856,526 shares of common stock outstanding. In addition, as of February 26, 2003, up to approximately 11,504,000 shares of our common stock were issuable on exercise of outstanding options and warrants.

Holders of our stock options and warrants are likely to exercise them, if ever, at a time when we otherwise could obtain a price for the sale of our securities that is higher than the exercise price per security of the options or warrants. This exercise, or the possibility of this exercise, may impede our efforts to obtain additional financing through the sale of additional securities or make this financing more costly, and may reduce the price of our common stock.

PROVISIONS OF OUR CERTIFICATE OF INCORPORATION AND DELAWARE LAW COULD DEFER A CHANGE OF OUR MANAGEMENT WHICH COULD DISCOURAGE OR DELAY OFFERS TO ACQUIRE US.

Provisions of our Certificate of Incorporation and Delaware law may make it more difficult for someone to acquire control of us or for our stockholders to remove existing management, and might discourage a third party from offering to acquire us, even if a change in control or in management would be beneficial to our stockholders. For example, our Certificate of Incorporation allows us to issue shares of preferred stock without any vote or further action by our stockholders. Our Board of Directors has the authority to fix and determine the relative rights and preferences of preferred stock. Our Board of Directors also has the authority to issue preferred stock without further stockholder approval. As a result, our Board of Directors could authorize the issuance of a series of preferred stock that would grant to holders the preferred right to our assets upon liquidation, the right to receive dividend payments before dividends are distributed to the holders of common stock and the right to the redemption of the shares, together with a premium, prior to the redemption of our common stock. In addition, our Board of Directors, without further stockholder approval, could issue large blocks of preferred stock.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is confined to our cash, cash equivalents and available for sale securities. We place our investments with high quality issuers and, by policy, limit the amount of credit exposure to any one issuer. We currently do not hedge interest rate or currency exchange exposure. We classify highly liquid investments purchased with a maturity of three months or less as "cash equivalents" and commercial paper and fixed income mutual funds as

"available for sale securities." Fixed income securities may have their fair market value adversely affected due to a rise in interest rates and we may suffer losses in principal if forced to sell securities that have declined in market value due to a change in interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

See Index to Consolidated Financial Statements on Page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not Applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Information called for by Item 10 with respect to directors, executive officers and compliance with Section 16(a) of the Securities Act may be found in the sections captioned "Nominees for Election to the Board of Directors," "Executive Officers" " and "Section 16(a) Beneficial Ownership Reporting Compliance" appearing in our definitive Proxy Statement and is hereby incorporated by reference to such Proxy Statement, which is expected to be filed within 120 days after the close of our fiscal year.

ITEM 11. EXECUTIVE COMPENSATION.

Information called for by Item 11 is hereby incorporated by reference to the information in our definitive proxy statement under the heading "Executive Compensation," which is expected to be filed by us within 120 days after the close of our fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Information called for by Item 12 is hereby incorporated by reference to the information in our definitive proxy statement under the heading "Security Ownership of Directors, Officers and Certain Beneficial Owners," which is expected to be filed by us within 120 days after the close of our fiscal year.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Information called for by Item 13 is hereby incorporated by reference to the information in our definitive proxy statement under the heading "Certain Relationships and Related Transactions," which is expected to be filed by us within 120 days after the close of our fiscal year.

ITEM 14. CONTROLS AND PROCEDURES.

Our Chief Executive Officer, Chief Operating Officer, Chief Financial Officer and Chief Accounting Officer, after evaluating the effectiveness of our "disclosure controls and procedures" (as defined in Rules 13a-14(c) and 15d-14(c) of the Securities Exchange Act of 1934) as of a date within 90 days before the filing date of this annual report, have concluded that as of the time of such evaluation, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in this annual report is accumulated and communicated by our management, to allow timely decisions regarding required disclosure.

There were no significant changes in our internal controls or other factors that could significantly affect our disclosure controls and procedures subsequent to the date of their evaluation and there were no corrective actions with regard to significant deficiencies and material weaknesses.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) EXHIBITS

Exhibits are listed on the Index to Exhibits at the end of this Annual Report. The exhibits required by Item 601 of Regulation S-K, listed on such Index in response to this Item, are incorporated herein by reference.

(b) REPORTS ON FORM 8-K

We filed two Current Reports on Form 8-K during the three months ended December 31, 2002. A Current Report was filed on November 12, 2002, reporting our completion of a private placement of approximately 6.4 million shares of our common stock and approximately 2.8 million warrants to purchase our common stock. On December 19, 2002, a Current Report was filed reporting a delay in our ongoing Phase 2 clinical trial for Acute Respiratory Distress Syndrome in adults due to an interruption in the supply of Surfaxin caused by operational difficulties experienced by Akorn.

SIGNATURES

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

DISCOVERY LABORATORIES, INC.

Date: March 31, 2003 By: /s/ Robert J. Capetola

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

In accordance with the Exchange Act, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	NAME & TITLE	DATE
/s/ Robert J. Capetola	Robert J. Capetola, Ph.D. President and Chief Executive Officer	March 31, 2003
/s/ John G. Cooper	John G. Cooper Senior Vice President and Chief Financial Officer	March 31, 2003
/s/ Cynthia Davis	Cynthia Davis Vice President, Administrative Operations and Controller (Principal Accounting Officer)	March 31, 2003
/s/ Herbert H. McDade, Jr.	Herbert H. McDade, Jr. Chairman of the Board of Directors	March 31, 2003
/s/ Marvin E. Rosenthale	Marvin E. Rosenthale, Ph.D. Director	March 31, 2003
/s/ Max E. Link	Max E. Link, Ph.D. Director	March 31, 2003
/s/ Antonio Esteve	Antonio Esteve, Ph.D. Director	March 31, 2003

CERTIFICATIONS

CERTIFICATIONS PURSUANT TO
SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

I, Robert J. Capetola, certify that:

1. I have reviewed this annual report on Form 10-K of Discovery Laboratories, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003 /s/ Robert J. Capetola

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

CERTIFICATIONS PURSUANT TO
SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

I, John G. Cooper, certify that:

1. I have reviewed this annual report on Form 10-K of Discovery Laboratories, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ John G. Cooper

John G. Cooper
Senior Vice President and
Chief Financial Officer

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
2.1(1)	Agreement and Plan of Merger dated as of March 5, 1998, among Discovery, ATI Acquisition Corp. and Old ATI.
2.2(3)	Agreement and Plan of Reorganization and Merger, dated as of July 16, 1997, by and between Discovery and Old Discovery.
3.1	Restated Certificate of Incorporation of Discovery, dated September 18, 2002.
3.2(2)	By-laws of Discovery.
3.3(10)	Certificate of Ownership Merging ATI Acquisition Corp., into Discovery.
4.1(6)	Form of Class C Warrant.
4.2(9)	Class E Warrant issued to PharmaBio.
4.3(10)	Unit Purchase Option issued to Paramount Capital, Inc., in connection with the March 1999 private placement.
4.4(14)	Form of Class F Warrant.
4.5(15)	Form of Class G Warrant issued to PharmaBio.
4.6(15)	Form of Class H Warrant issued to PharmaBio.
4.7(15)	Form of Promissory Note issued to PharmaBio.
4.8(23)	Form of Class I Warrant.
4.9	Promissory Note issued to General Electric Capital Corporation
10.1	Reference is made to Exhibits 2.1 and 2.2.
10.2(1)	Investor Rights Agreement, dated as of March 20, 1996, between Old Discovery and RAQ, LLC.
10.3(1)	Registration Rights Agreement, dated as of October 28, 1996, between ATI, Johnson & Johnson Development Corporation ("JJDC"), and The Scripps Research Institute ("Scripps").
10.4(4)+	Sublicense Agreement, dated as of October 28, 1996, between ATI, Johnson & Johnson, Inc., and Ortho Pharmaceutical Corporation.

10.5(2)	Restated 1993 Stock Option Plan of Discovery.
10.6(2)	1995 Stock Option Plan of Discovery.
10.7(22)	Amended and Restated 1998 Stock Incentive Plan of Discovery (amended as of September 13, 2002).
10.8(6)	Indenture of Lease, dated as of July 1, 1998, between SLT1, LLC and Discovery Laboratories, Inc.
10.9(12)	Amendment, dated as of September 15, 2000, to the Indenture of Lease dated as of July 1, 1998, between SLT1, LLC and Discovery.
10.10(6)	Registration Rights Agreement, dated as of June 16, 1998, among Discovery, JJDC and Scripps.
10.11(6)	Stock Exchange Agreement, dated as of June 16, 1998, between Discovery and JJDC.
10.12(12)	Employment Agreement, dated January 1, 2001, between Discovery and Robert J. Capetola, Ph.D.
10.13(18)	Employment Agreement, dated as of June 16, 2001, between Discovery and Christopher J. Schaber.
10.14(18)	Employment Agreement, dated as of June 16, 2001, between Discovery and Cynthia Davis.
10.15(6)	Form of Intellectual Property and Confidential Information Agreement.
10.16(6)	Form of Stock Purchase Agreement Under the 1998 Stock Incentive Plan of Discovery.
10.17(8)	Notice of Grant of Stock Option.
10.18(10)	Securities Purchase Agreement between Discovery and Laboratorios P.E.N., S.A., dated October 26, 1999.
10.19(10)+	Research Funding and Option Agreement, dated as of March 1, 2000, between Discovery and Scripps.
10.20(13)	Amended and Restated 1998 Stock Incentive Plan of Discovery, amended on June 15, 2001.
10.21(18)	Employment Agreement, dated as of December 1, 2001, between Discovery and Ralph Niven, Ph.D.

10.22(18)	Employment Agreement, dated as of December 11, 2001, between Discovery and John G. Cooper.
10.23(18)	Employment Agreement, dated as of August 15, 2000, between Discovery and Deni M. Zodda, Ph.D.
10.24(16)+	Commercialization Agreement, dated as of December 10, 2001, between Discovery and Quintiles.
10.25(16)+	Investment and Commission Agreement, dated as of December 10, 2001, between Discovery and PharmaBio.
10.26(16)	Common Stock and Warrant Purchase Agreement, dated as of December 10, 2001, between Discovery and PharmaBio.
10.27(16)+	Loan Agreement, dated as of December 10, 2001, between Discovery and PharmaBio.
10.28(17)+	Sublicense and Collaboration Agreement, dated as of March 6, 2002, between Discovery and Laboratorios del Dr. Esteve ("Esteve").
10.29(17)+	Supply Agreement, dated as of March 6, 2002, between Discovery and Esteve.
10.30(17)	Common Stock Purchase Agreement, dated as of March 6, 2002, between Discovery and Esteve.
10.31(19)	Form of Common Stock and Warrant Purchase Agreement, dated November 5, 2002, between Discovery and certain investors.
10.32	Master Security Agreement, dated December 23, 2002, between Discovery and General Electric Capital Corporation.
10.33	Amendment, dated December 23, 2003, to the Master Security Agreement between Discovery and General Electric Capital Corporation.
16.1(5)	Letter dated as of January 28, 1998, from Ernst & Young LLP to the Securities and Exchange Commission.
16.2(11)	Letter dated January 9, 2001, from Eisner LLP, to the Securities and Exchange Commission.
21.1(1)	Subsidiaries of Discovery.
23.1	Consent of Eisner LLP.

23.2	Consent of Ernst & Young LLP
99.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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(1) Incorporated by reference to Discovery's Annual Report on Form 10-KSB for the year ending December 31, 1997.

(2) Incorporated by reference to Discovery's Registration Statement on Form SB-2 (File No. 33-92-886).

(3) Incorporated by reference to Discovery's Registration Statement on Form S-4 (File No. 333-34337).

(4) Incorporated by reference to Discovery's Registration Statement on Form SB-2 (File No. 333-19375).

(5) Incorporated by reference to Discovery's Current Report on Form 8-K/A dated January 16, 1998.

(6) Incorporated by reference to Discovery's Annual Report on Form 10-KSB for the year ending December 31, 1998.

(7) Incorporated by reference to Discovery's Proxy Statement on Schedule 14A filed June 1, 1999.

(8) Incorporated by reference to Discovery's Quarterly Report on Form 10-QSB for the quarter ending September 30, 1999.

(9) Incorporated by reference to Discovery's Current Report on Form 8-K filed March 29, 2000.

(10) Incorporated by reference to Discovery's Annual Report on Form 10-KSB for the year ending December 31, 1999.

(11) Incorporated by reference to Discovery's Amended Current Report on Form 8-K/A filed January 9, 2001.

(12) Incorporated by reference to Discovery's Annual Report on Form 10-KSB for the year ending December 31, 2000.

(13) Incorporated by Reference to Discovery's Quarterly Report on Form 10-QSB for the quarter ending June 30, 2001.

(14) Incorporated by Reference to Discovery's Current Report on Form 8-K filed October 5, 2001.

(15) Incorporated by Reference to Discovery's Current Report on Form 8-K filed December 19, 2001.

(16) Incorporated by Reference to Discovery's Amended Current Report on Form 8-K/A filed January 14, 2002.

(17) Incorporated by Reference to Discovery's Current Report on Form 8-K filed March 8, 2002.

(18) Incorporated by Reference to Discovery's Annual Report on Form 10-KSB for the year ending December 31, 2001.

(19) Incorporated by Reference to Discovery's Current Report on Form 8-K filed November 12, 2002.

+ Confidential treatment requested as to certain portions of these exhibits. Such portions have been redacted and filed separately with the Commission.

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

CONTENTS

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Stockholders
Discovery Laboratories, Inc.
Doylestown, Pennsylvania

We have audited the accompanying consolidated balance sheets of Discovery Laboratories, Inc. (a development stage enterprise) as of December 31, 2002 and 2001, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002, and for the period May 18, 1993 (inception) through December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated financial statements for the period May 18, 1993 (inception) through December 31, 1999 include total revenues and net loss of $1,673,000 and $32,446,000, respectively. Our opinion on the consolidated statements of operations, stockholders' equity, and cash flows for the period May 18, 1993 (inception) through December 31, 2002, insofar as it relates to amounts for prior periods through December 31, 1999, is based solely on the report of other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Discovery Laboratories, Inc. (a development stage enterprise) at December 31, 2002 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, and for the period May 18, 1993 (inception) through December 31, 2002, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 26, 2003

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
Discovery Laboratories, Inc.
Doylestown, Pennsylvania

We have audited the consolidated statements of operations, changes in stockholders' equity and cash flows of Discovery Laboratories, Inc. and subsidiary's (a development stage company) for the period from May 18, 1993 (inception) through December 31, 1999. The consolidated statements of operations and cash flows are not presented separately herein. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements enumerated above present fairly, in all material respects, the consolidated results of operations and consolidated cash flows of Discovery Laboratories, Inc. and subsidiary for the period from May 18, 1993 (inception) through December 31, 1999, in conformity with accounting principles generally accepted in the United States of America.

/s/ Eisner LLP

New York, New York
February 25, 2000

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

CONSOLIDATED BALANCE SHEETS

	December 31, 2002	December 31, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,538,000	$ 3,758,000
Available-for-sale marketable securities	10,652,000	12,938,000
Note receivable - current	2,000	2,000
Prepaid expenses and other current assets	325,000	1,580,000
Total current assets	19,517,000	18,278,000
Property and equipment, net of accumulated depreciation	1,231,000	822,000
Note receivable, net of current portion	195,000	197,000
Other assets	119,000	768,000
Total assets	$ 21,062,000	$ 20,065,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 3,013,000	$ 1,750,000
Capitalized lease - current	189,000	44,000
Total current liabilities	3,202,000	1,794,000
Deferred revenue	1,393,000	615,000
Credit facility with corporate partner	1,450,000	--
Capitalized lease, net of current portion	256,000	33,000
Total liabilities	6,301,000	2,442,000
Stockholders' Equity:		
Common stock, $.001 par value; 60,000,000 authorized; 32,856,526 and 25,546,293 shares issued and outstanding at December 31, 2002 and 2001, respectively	33,000	26,000
Additional paid-in capital	87,463,000	73,163,000
Unearned portion of compensatory stock options	(95,000)	(264,000)
Deficit accumulated during the development stage	(72,578,000)	(55,135,000)
Treasury stock (at cost; 38,243 shares of common stock at December 31, 2002 and 2001)	(239,000)	(239,000)
Accumulated other comprehensive income	177,000	72,000
Total stockholders' equity	14,761,000	17,623,000
	$ 21,062,000	$ 20,065,000

See notes to consolidated financial statements

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

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,			May 18, 1993 (inception) through December 31,
	2002	2001	2000	2002
Revenues:				
Research and development collaborative agreements	$ 1,782,000	$ 1,112,000	$ 741,000	$ 3,840,000
Expenses:				
Research and development	14,347,000	8,007,000	7,494,000	42,717,000
General and administrative	5,458,000	5,067,000	5,145,000	23,425,000
Write-off of acquired in-process research and development and supplies	--	--	--	13,508,000
Total expenses	19,805,000	13,074,000	12,639,000	79,650,000
Operating loss	(18,023,000)	(11,962,000)	(11,898,000)	(75,810,000)
Other income and expense:				
Interest income, dividends, realized gains, and other income	724,000	842,000	1,042,000	4,076,000
Minority interest in net loss of subsidiary	--	--	--	26,000
Interest expense	(144,000)	(26,000)	(5,000)	(188,000)
Net loss	$(17,443,000)	$(11,146,000)	$(10,861,000)	$(71,896,000)
Net loss per common share - basic and diluted	$ (0.64)	$ (0.51)	$ (0.58)	
Weighted average number of common shares outstanding - basic and diluted	27,350,835	22,038,067	18,806,265	

See notes to consolidated financial statements

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

Consolidated Statements of Changes in Stockholders' Equity
May 18, 1993 (Inception) Through December 31, 2002

	Common Stock		Preferred Stock				Additional
			Series B Stock		Series C Stock		
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-in Capital
Issuance of common stock, May 1993	440,720	$ 1,000					$ 1,000
Expenses paid on behalf of the Company, 1993							
Payment on stock subscriptions, 1995							
Issuance of common stock, February 1995	143,016						1,000
Expenses paid on behalf of the Company, 1995							18,000
Issuance of common stock, March 1996	1,070,175	1,000					5,000
Issuance of private placement units August, October and November 1996	856,138	1,000	2,200,256	$ 2,000			18,933,000
Issuance of common stock for cash and compensation, September 1996	82,502						42,000
Exercise of stock options, 1996, 1997, 1998, 1999, 2000	820,438						587,000
Private placement expenses, 1997							(11,000)
Issuance of common stock pursuant to Ansan Merger, November 1997	546,433						2,459,000
Accumulated dividends preferred stock, 1997							
Issuance of common stock pursuant to ATI Merger, June 1998	1,033,500	1,000					5,037,000
Fair value of Common Stock issuabe on Exercise of ATI options, 1998							2,966,000
Series C preferred stock issued pursuant to ATI Merger, June 1998					2,039	$2,039,000	
Accrued dividends payable on Series C Preferred stock at time of ATI Merger, 1998						238,000	
Common Stock issued in settlement of Series C preferred stock dividends, 1998	49,846					(204,000)	204,000
Common Stock and warrants in a private placement offering in March and April 1999	826,447	1,000					999,000
Issuance of private placement units in July and August 1999 (net of offering costs)	2,024,792	2,000					2,231,000
Common Stock issued in connection with sublicense agreement, 1999	317,164	1,000					563,000
Series B preferred stock converted, 1998, 1999, 2000	6,746,219	7,000	(2,200,256)	(2,000)			(5,000)
Noncash exercise of private placement warrants, 1998	8,372						
Common Stock issued in payment for services, 1998, 1999, 2000	30,664						94,000
Compensatory stock options granted							37,000
Dividends payable on Series C preferred stock, 1998, 1999, 2000						444,000	
Treasury stock acquired, 1998, 1999							
Treasury stock issued in payment for services, 1998, 1999, 2000							14,000
Unrealized gain (loss) on Available-for-sale marketable securities, 1998, 1999							
Fair value of options granted, 1998							142,000
Amortization of unearned portion of Compensatory stock options, 1998, 1999							

Common placement warrant conversions, 2000	18,232						
Preferred placement warrant conversions, 2000	18,511						
Exercise of class C & D warrant conversions, 2000	2,536,911	3,000					3,792,000
Compensation charge on vesting of options and warrants, 2000							2,330,000
Compensatory stock options and warrants granted, 2000							495,000
Series C preferred stock conversions, 2000	398,186				(2,039)	(2,517,000)	2,517,000
Issuance of private placement units, 2000	2,902,846	3,000					17,440,000
Other comprehensive income - unrealized gain on marketable securities available-for-sale							
Net loss, Inception through 12/31/00							
Balance - December 31, 2000	20,871,112	$ 21,000	0				$60,891,000
(carried forward)							

	Unearned Portion of Compensatory Stock Options	Deficit Accumulated During Development Stage	Treasury Stock Shares	Treasury Stock Amount
Issuance of common stock, May 1993				
Expenses paid on behalf of the Company, 1993				
Payment on stock subscriptions, 1995				
Issuance of common stock, February 1995				
Expenses paid on behalf of the Company, 1995				
Issuance of common stock, March 1996				
Issuance of private placement units August, October and November 1996				
Issuance of common stock for cash and compensation, September 1996				
Exercise of stock options, 1996, 1997, 1998, 1999, 2000			(31,743)	$ (245,000)
Private placement expenses, 1997				
Issuance of common stock pursuant to Ansan Merger, November 1997				
Accumulated dividends preferred stock, 1997		$ (238,000)		
Issuance of common stock pursuant to ATI Merger, June 1998				
Fair value of Common Stock issuabe on Exercise of ATI options, 1998				
Series C preferred stock issued pursuant to ATI Merger, June 1998				
Accrued dividends payable on Series C Preferred stock at time of ATI Merger, 1998				
Common Stock issued in settlement of Series C preferred stock dividends, 1998				
Common Stock and warrants in a private placement offering in March and April 1999				
Issuance of private placement units in July and August 1999 (net of offering costs)				
Common Stock issued in connection with sublicense agreement, 1999				
Series B preferred stock converted, 1998, 1999, 2000				
Noncash exercise of private placement warrants, 1998				
Common Stock issued in payment for services, 1998, 1999, 2000				

Compensatory stock options granted	$ (37,000)			
Dividends payable on Series C preferred stock, 1998, 1999, 2000		(444,000)		
Treasury stock acquired, 1998, 1999			(33,750)	$ (95,000)
Treasury stock issued in payment for services, 1998, 1999, 2000			38,750	127,000
Unrealized gain (loss) on Available-for-sale marketable securities, 1998, 1999				
Fair value of options granted, 1998	(142,000)			
Amortization of unearned portion of Compensatory stock options, 1998, 1999	142,000			
Common placement warrant conversions, 2000				
Preferred placement warrant conversions, 2000				
Exercise of class C & D warrant conversions, 2000				
Compensation charge on vesting of options and warrants, 2000				
Compensatory stock options and warrants granted, 2000	(310,000)			
Series C preferred stock conversions, 2000				
Issuance of private placement units, 2000				
Other comprehensive income - unrealized gain on marketable securities available-for-sale				
Net loss, Inception through 12/31/00		(43,307,000)		
Balance - December 31, 2000	$ (347,000)	$(43,989,000)	(26,743)	$ (213,000)

(carried forward)

	Stock Subscriptions Receivable	Accumulated Other Comprehensive Loss	Total
Issuance of common stock, May 1993	$ (2,000)	$	--
Expenses paid on behalf of the Company, 1993	1,000		1,000
Payment on stock subscriptions, 1995	2,000		2,000
Issuance of common stock, February 1995	(1,000)		--
Expenses paid on behalf of the Company, 1995			18,000
Issuance of common stock, March 1996			6,000
Issuance of private placement units August, October and November 1996			18,936,000
Issuance of common stock for cash and compensation, September 1996			42,000
Exercise of stock options, 1996, 1997, 1998, 1999, 2000			342,000
Private placement expenses, 1997			(11,000)
Issuance of common stock pursuant to Ansan Merger, November 1997			2,459,000
Accumulated dividends preferred stock, 1997			(238,000)
Issuance of common stock pursuant to ATI Merger, June 1998			5,038,000
Fair value of Common Stock issuabe on Exercise of ATI options, 1998			2,966,000
Series C preferred stock issued pursuant to ATI Merger, June 1998			2,039,000
Accrued dividends payable on Series C Preferred stock at time of ATI Merger, 1998			238,000
Common Stock issued in settlement of Series C preferred stock dividends, 1998			--

Common Stock and warrants in a private placement offering in March and April 1999			1,000,000
Issuance of private placement units in July and August 1999 (net of offering costs)			2,233,000
Common Stock issued in connection with sublicense agreement, 1999			564,000
Series B preferred stock converted, 1998, 1999, 2000			--
Noncash exercise of private placement warrants, 1998			--
Common Stock issued in payment for services, 1998, 1999, 2000			94,000
Compensatory stock options granted			--
Dividends payable on Series C preferred stock, 1998, 1999, 2000			--
Treasury stock acquired, 1998, 1999			(95,000)
Treasury Stock issued in payment for services, 1998, 1999, 2000			141,000
Unrealized gain (loss) on Available-for-sale marketable securities, 1998, 1999			--
Fair value of options granted, 1998			--
Amortization of unearned portion of Compensatory stock options, 1998, 1999			142,000
Common placement warrant conversions, 2000			--
Preferred placement warrant conversions, 2000			--
Exercise of class C & D warrant conversions, 2000			3,795,000
Compensation charge on vesting of options and warrants, 2000			2,330,000
Compensatory stock options and warrants granted, 2000			185,000
Series C preferred stock conversions, 2000			--
Issuance of private placement units, 2000			17,443,000
Other comprehensive income - unrealized gain on marketable securities available-for-sale		73,000	73,000
Net loss, Inception through 12/31/00			(43,307,000)
Balance - December 31, 2000	$ --	$ 73,000	$16,436,000

(carried forward)

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

Consolidated Statements of Changes in Stockholders' Equity
May 18, 1993 (Inception) Through December 31, 2002

	Common Stock		Preferred Stock				Additional
			Series B Stock		Series C Stock		
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-in Capital
(brought forward)							
Balance - December 31, 2000	20,871,112	21,000	--	--	--	--	(60,891,000)
Comprehensive loss:							
Net loss							
Other comprehensive loss - unrealized loss on marketable securities available-for-sale							
Total comprehensive loss							
Exercise of stock options	6,224						2,000
Common Stock issued in payment for services	10,902						42,000
Compensation charge on modifications of options							109,000
Compensatory stock options and warrants granted/earned							325,000
Common Stock issued in April 2001 private financing	296,560						998,000
Common Stock and warrants issued in October 2001 private financing	3,562,759	4,000					7,256,000
Common Stock and warrants issued in December 2001	791,905	1,000					3,540,000
Placement agent warrant exercise	6,831						
Purchase of Treasury Stock							
Balance - December 31, 2001	25,546,293	$ 26,000	--	$ --	--	$ --	$ 73,163,000
Comprehensive loss:							
Net loss							
Other comprehensive loss - unrealized loss on marketable securities available-for-sale							
Total comprehensive loss							
Exercise of stock options	77,925						60,000
Common Stock issued in lieu of payment for services	6,086						26,000
Compensation charge on modification of options							171,000
Compensation charge on vesting of options and warrants							63,000
Common Stock issued in March 2002 private financing	821,862						2,666,000
Private financing expenses							(5,000)
Common Stock issued in November 2002 private financing	6,397,517	7,000					11,937,000
Change in value of Class H warrants							(618,000)
Conversion of warrants	6,843						
Balance - December 31, 2002	32,856,526	$ 33,000	--	$ --	--	$ --	$ 87,463,000

	Unearned Portion of Compensatory	Deficit Accumulated During	Treasury Stock

	Stock Options	Development Stage	Shares	Amount
(brought forward)				
Balance - December 31, 2000	(347,000)	(43,989,000)	(26,743)	(213,000)
Comprehensive loss:				
Net loss		(11,146,000)		
Other comprehensive loss - unrealized loss on marketable securities available-for-sale				
Total comprehensive loss				
Exercise of stock options				
Common Stock issued in payment for services				
Compensation charge on modifications of options				
Compensatory stock options and warrants granted/earned	83,000			
Common Stock issued in April 2001 private financing				
Common Stock and warrants issued in October 2001 private financing				
Common Stock and warrants issued in December 2001				
Placement agent warrant exercise				
Purchase of Treasury Stock			(11,500)	(26,000)
Balance - December 31, 2001	$ (264,000)	$(55,135,000)	(38,243)	$ (239,000)
Comprehensive loss:				
Net loss		(17,443,000)		
Other comprehensive loss - unrealized loss on marketable securities available-for-sale				
Total comprehensive loss				
Exercise of stock options				
Common Stock issued in lieu of payment for services				
Compensation charge on modification of options				
Compensation charge on vesting of options and warrants	169,000			
Common Stock issued in March 2002 private financing				
Private financing expenses				
Common Stock issued in November 2002 private financing				
Change in value of Class H warrants				
Conversion of warrants				
Balance - December 31, 2002	$ (95,000)	$(72,578,000)	(38,243)	$ (239,000)

	Stock Subscriptions Receivable	Accumulated Other Comprehensive Loss	Total
(brought forward)			
Balance - December 31, 2000	--	73,000	16,436,000
Comprehensive loss:			
Net loss			(11,146,000)
Other comprehensive loss - unrealized loss on marketable securities available-for-sale		(1,000)	(1,000)

Total comprehensive loss			(11,147,000)
Exercise of stock options			2,000
Common Stock issued in payment for services			42,000
Compensation charge on modifications of options			109,000
Compensatory stock options and warrants granted/earned			408,000
Common Stock issued in April 2001 private financing			998,000
Common Stock and warrants issued in October 2001 private financing			7,260,000
Common Stock and warrants issued in December 2001			3,541,000
Placement agent warrant exercise			--
Purchase of Treasury Stock			(26,000)
Balance - December 31, 2001	$ --	$ 72,000	17,623,000
Comprehensive loss:			
Net loss			(17,443,000)
Other comprehensive loss - unrealized loss on marketable securities available-for-sale		105,000	105,000
Total comprehensive loss			(17,338,000)
Exercise of stock options			60,000
Common Stock issued in lieu of payment for services			26,000
Compensation charge on modification of options			171,000
Compensation charge on vesting of options and warrants			232,000
Common Stock issued in March 2002 private financing			2,666,000
Private financing expenses			(5,000)
Common Stock issued in November 2002 private financing			11,944,000
Change in value of Class H warrants			(618,000)
Conversion of warrants			--
Balance - December 31, 2002	$ --	$ 177,000	14,761,000

See notes to consolidated financial statements

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,			May 18, 1993 (inception) through December 31,
	2002	2001	2000	2002
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$(17,443,000)	$(11,146,000)	$(10,861,000)	$(71,896,000)
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	285,000	205,000	123,000	829,000
Compensatory stock options	403,000	517,000	2,515,000	3,577,000
Expenses paid using treasury stock and common stock	26,000	42,000	84,000	230,000
Loss on sale of property	--	--	4,000	4,000
Changes in:	--			
Prepaid expenses, inventory and other current assets	1,255,000	(876,000)	492,000	836,000
Accounts payable and accrued expenses	1,263,000	(632,000)	1,957,000	2,880,000
Other assets	(2,000)	(18,000)	15,000	(23,000)
Proceeds from research and development collaborative agreements	1,833,000	--	605,000	3,474,000
Amortization of deferred revenue	(1,055,000)	(791,000)	(790,000)	(2,636,000)
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	(13,435,000)	(12,699,000)	(5,856,000)	(48,635,000)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of property and equipment	(227,000)	(257,000)	(948,000)	(1,978,000)
Proceeds from sale of property and equipment	--	--	550,000	575,000
Loan to related party	--	(200,000)	--	(200,000)
Related party loan payments received	2,000	1,000	--	3,000
Acquisition of licenses	--	--	--	(711,000)
Purchase of marketable securities	(8,569,000)	(10,676,000)	(11,514,000)	(52,504,000)
Proceeds from sale or maturity of marketable securities	10,960,000	9,324,000	--	42,434,000
Net cash payments on merger	--	--	--	(1,670,000)
Net cash provided by (used in) investing activities	2,166,000	(1,808,000)	(11,912,000)	(14,051,000)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from issuance of securities, net of expenses	14,665,000	11,033,000	21,517,000	70,009,000
Proceeds from credit facility	1,450,000	--	--	1,450,000
Purchase of treasury stock	--	(26,000)	--	(121,000)
Principal payments under capital lease obligation	(66,000)	(23,000)	(15,000)	(114,000)
Net cash provided by financing activities	16,049,000	10,984,000	21,502,000	71,224,000
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	4,780,000	(3,523,000)	3,734,000	8,538,000
Cash and cash equivalents - beginning of period	3,758,000	7,281,000	3,547,000	--
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 8,538,000	$ 3,758,000	$ 7,281,000	$ 8,538,000
SUPPLEMENTARY DISCLOSURE OF CASH FLOWS INFORMATION:				
Interest Paid:	$ 88,000	$ 26,000	$ 5,000	$ 132,000
NONCASH TRANSACTIONS:				
Class H warrants issued/revalued	$ (618,000)	$ 768,000	$ --	$ 150,000
Accrued dividends on Series C preferred stock	--	--	36,000	682,000
Series C preferred stock dividends paid using common stock	--	--	--	204,000
Preferred Stock issued for inventory	--	--	--	575,000
Equipment acquired through capitalized lease	434,000	52,000	--	559,000
Unrealized gain (loss) on marketable securities	105,000	(1,000)	73,000	177,000

See notes to consolidated financial statements

NOTE 1 - THE COMPANY AND BASIS OF PRESENTATION

Discovery Laboratories, Inc. (the "Company") is a late-stage specialty pharmaceutical company applying its humanized lung surfactant technology to develop potential novel respiratory therapies and products. Surfactants are substances that are produced naturally in the lungs and are essential to the lungs' ability to absorb oxygen and to maintain proper airflow through the respiratory system. The absence or depletion of surfactant is involved in a number of respiratory diseases.

The Company's humanized surfactant technology produces an engineered version of natural human lung surfactant and contains a peptide, sinapultide, that is designed to precisely mimic the essential human lung surfactant protein B (SP-B). The Company believes that this proprietary surfactant technology is the only surfactant technology presently available to potentially treat a broad range of respiratory diseases.

The Company's lead product, Surfaxin(R), is being developed initially for critical care patients with life-threatening respiratory disorders where there are few, if any, approved therapies. Surfaxin is currently in two Phase 3 clinical trials for Respiratory Distress Syndrome in premature infants, a Phase 3 clinical trial for Meconium Aspiration Syndrome in full-term infants, and a Phase 2 clinical trial for Acute Respiratory Distress Syndrome in adults. Aerosolized formulations of the Company's humanized surfactant are presently being developed to potentially treat patients suffering from severe acute asthma and Acute Lung Injury, the Company's lead preclinical programs, as well as COPD, sinusitis, and upper airway disorders such as sleep apnea and otitis media (inner ear infection).

The Company is presently developing a dedicated sales and marketing capability through a collaboration with Quintiles Transnational Corp. ("Quintiles") to commercialize Surfaxin in neonatal indications in the United States. The Company has also entered into a strategic alliance with Laboratorios del Dr. Esteve ("Esteve") to commercialize Surfaxin in Europe and Latin America. The Company intends to establish strategic alliances, where appropriate, for the development and commercialization of the Company's products in other indications and markets.

HISTORICAL FOUNDING TRANSACTIONS

The Company, formerly known as Ansan Pharmaceuticals, Inc. ("Ansan"), was incorporated in Delaware on November 6, 1992. In November 1997, Ansan merged (the "Ansan Merger") with Discovery Laboratories, Inc. ("Predecessor Discovery") in a transaction accounted for as a reverse acquisition with Predecessor Discovery as the acquirer for financial reporting purposes since its stockholders owned approximately 92% of the merged entity. The consolidated financial statements include the accounts of Ansan from November 25, 1997 (the date of acquisition).

In October 1996, the Company invested $7,500,000 in exchange for 600,000 shares of Series A preferred stock, of Acute Therapeutics, Inc., a Delaware Corporation ("ATI"). The stock represented 75% of the voting securities of ATI.

In June 1998, ATI was merged with and into the Company (the "ATI Merger"). Pursuant to the ATI Merger, each outstanding share of ATI's Common Stock was exchanged for 3.90 shares (the "ATI Exchange Ratio") of the common stock ("Common Stock"), par value $0.001 per share, of the Company; each share of ATI's Series B preferred stock was converted into one share of the Company's Series C preferred stock and all outstanding options to purchase ATI Common Stock were assumed by the Company and became exercisable for shares of the Common Stock on the basis of the ATI Exchange Ratio. Transaction costs of $216,000 were incurred associated with the ATI Merger. The value of the Common Stock issued to ATI's Common Stockholders plus the assumption of the outstanding ATI options and merger related costs has been attributed to in-process research and development upon management's evaluation and was recorded as an expense in connection with the ATI Merger. The accompanying consolidated financial statements include the accounts of the Company and ATI (through the date of its merger into the Company).

The Company currently maintains one subsidiary, which is inactive.

MANAGEMENT'S PLANS AND FINANCINGS

The Company is a development stage company and has incurred substantial losses since inception. To date, the Company has funded its operations primarily through the issuance of equity and strategic alliances. The Company expects to continue to expend substantial amounts for continued product research, development, and commercialization activities for the foreseeable future. Management's plans with respect to funding this development are to secure additional equity, if possible, and to secure additional strategic alliances that will provide available cash funding for operations. Continuation of the Company is dependent on its ability to obtain additional financing and, ultimately, on its ability to achieve profitable operations. There is no assurance, however, that such financing will be available or that the Company's efforts ultimately will be successful.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

AVAILABLE-FOR-SALE MARKETABLE SECURITIES

The investments are classified as available for sale and are comprised of shares of high quality fixed income commercial paper and mutual funds. Investments are carried at fair market value. Realized gains and losses are computed using the average cost of securities sold. Any appreciation/depreciation on these investments is recorded as other comprehensive income (loss) in the statements of changes in stockholders' equity until realized.

PROPERTY AND EQUIPMENT

Property and equipment is recorded at cost. Depreciation of furniture and equipment is computed using the straight-line method over the estimated useful lives of the assets (five to seven years). Leasehold improvements are amortized over the lower of the (a) term of the lease or (b) useful life of the improvements.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

LONG-LIVED ASSETS

Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", was issued in August 2001 and was adopted by the Company in 2002. Under SFAS No. 144, the Company is required to recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and measure any impairment loss as the difference between the carrying amount and the fair value of the asset. No impairment was recorded during the year ended December 31, 2002, as management of the Company believes the sum of its future undiscounted cash flows will exceed the carrying amount of the assets.

RESEARCH AND DEVELOPMENT

Research and development costs are charged to operations as incurred.

REVENUE RECOGNITION - RESEARCH AND DEVELOPMENT COLLABORATIVE AGREEMENTS

The Company received nonrefundable fees from companies under license, sublicense, collaboration and research funding agreements. The Company initially records such funds as deferred revenue and recognizes research and development collaborative contract revenue when the amounts are earned, which occurs over a number of years as the Company performs research and development activities. See Note 7 - License, Research Funding, and Commercialization Agreements for a detailed description of the Company's revenue recognition methodology under these agreements.

Additionally, the Company has been awarded grants from certain third party organizations to help fund research for the drugs that the Company is attempting to bring to full commercial use. Once research and development expenditures qualifying under the grant are incurred, grant reports are periodically completed and submitted to the granting agency for review. If approved, the granting agency will then remit payment to the Company. Such amounts are recorded as revenue upon receipt.

STOCK-BASED COMPENSATION

The Company has adopted SFAS No. 123, "Accounting for Stock-Based Compensation". The provisions of SFAS No. 123 allow companies to either expense the estimated fair value of employee stock options or to continue to follow the intrinsic value method set forth in Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25") but disclose the pro forma effects on net income (loss) had the fair value of the options been expensed. The Company has elected to continue to apply APB 25 in accounting for its employee stock option incentive plans and to provide the required SFAS No. 123 disclosures. See Note 9 - Stock Options.

NET LOSS PER COMMON SHARE

Net loss per common share is computed pursuant to the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share", and is based on the weighted average number of common shares outstanding for the periods. For the years ended December 31, 2002, 2001 and 2000, 4,032,000, 5,211,000 and 2,891,000 common shares, respectively, are potentially issuable upon the exercise of certain of the Company's stock options and warrants and are not included in the calculation of net loss per share as the effect would be anti-dilutive.

RECLASSIFICATION

Certain prior year balances have been reclassified to conform with the current presentation. The reclassification had no effect on net income.

NOTE 3 - INVESTMENTS

The available-for-sale marketable securities are as follows:

	December 31,	
	2002	2001
Cost	$ 10,475,000	$ 12,866,000
Gross unrealized gain	178,000	131,000
Gross unrealized loss	(1,000)	(59,000)
Estimated fair value	$ 10,652,000	$ 12,938,000

NOTE 4 - NOTE RECEIVABLE

Note receivable pertains to a $200,000, 7% per annum mortgagor's note due from a vice president of the Company. This note is secured by a mortgage agreement dated July 24, 2001. The note calls for monthly payments of principal and interest over a 360-month period. The principal balance outstanding at December 31, 2002 and 2001 was approximately $197,000 and $199,000, respectively.

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment as of December 31, 2002 and 2001 was comprised of the following:

	December 31,	
	2002	2001
Leashold Improvements	$ 144,000	$ 144,000
Furniture	239,000	189,000
Equipment	1,600,000	989,000
	1,983,000	1,322,000
Less accumulated depreciation	752,000	500,000
	$1,231,000	$ 822,000

The equipment balance at December 31, 2002 and 2001 includes $559,000 and $125,000, respectively, of property subject to a capital lease. The related accumulated depreciation was $57,000 and $26,000 at December 31, 2002 and 2001, respectively.

As of December 31, 2002, the Company had construction commitments outstanding totaling approximately $188,000 related to the enhancement of manufacturing capabilities for Surfaxin.

NOTE 6 - INCOME TAXES

Since its inception, the Company has never recorded a provision or benefit for Federal and state income taxes.

The reconciliation of the income tax benefit computed at the Federal statutory rates to the Company's recorded tax benefit for the years ended December 31, 2002, 2001, and 2000 are as follows:

	December 31,		
	2002	2001	2000
Income tax benefit, statutory rates	$ 5,938,000	$ 3,783,000	$ 3,652,000
State taxes on income, net of federal benefit	1,088,000	698,000	836,000
Research and development tax credit	274,000	90,000	85,000
Other	(755,000)	3,000	(95,000)
Income tax benefit	6,545,000	4,574,000	4,478,000
Valuation allowance	(6,545,000)	(4,574,000)	(4,478,000)
Income tax benefit	$ --	$ --	$ --

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities, at December 31, 2002 and 2001, are as follows:

	December 31,	
	2002	2001
Long-term deferred tax assets:		
Net operating loss carryforwards (federal and state)	$ 25,526,000	$ 19,275,000
Research and development tax credits	1,225,000	846,000
Capitalized research and development	222,000	268,000
Total long-term deferred tax assets	26,973,000	20,389,000
Long-term deferred tax liabilities:		
Property and equipment	(108,000)	(69,000)
Net deferred tax assets	26,865,000	20,320,000
Less: valuation allowance	(26,865,000)	(20,320,000)
	$ --	$ --

The Company was in a net deferred tax asset position at December 31, 2002 and 2001 before the consideration of a valuation allowance. Due to the fact that the Company is in the development stage and has never realized a profit, management has fully reserved the net deferred tax asset since realization is not assured.

At December 31, 2002 and 2001, the Company had available carryforward net operating losses for Federal tax purposes of approximately $65,112,000 and $47,496,000, respectively, and a research and development tax credit carryforward of $1,225,000 and $846,000, respectively. The Federal net operating loss and research and development tax credit carryforwards expire beginning in 2008 and continuing through 2021. Additionally, at December 31, 2002 and 2001, the Company had available carryforward losses of approximately $51,385,000 and $43,244,000, respectively, for state tax purposes. The utilization of the Federal net operating loss carryforwards is subject to annual limitations in accordance with Section 382 of the Internal Revenue Code. Certain state carryforward net operating losses are also subject to annual limitations.

The difference between the deficit accumulated during the development stage for financial reporting purposes and the net operating loss carryforwards for tax purposes is primarily due to the write-off of the acquired in-process research and development and supplies, which were not deducted for tax purposes.

NOTE 7 - LICENSE, RESEARCH FUNDING, AND COMMERCIALIZATION AGREEMENTS

In March 2002, the Company expanded its existing alliance with Esteve to develop, market and sell Surfaxin throughout Europe and Latin America. In connection with this new Esteve collaboration, Esteve purchased 821,862 shares of Common Stock for an aggregate consideration of $4 million (at a 50% premium over the average closing price for the 30 days prior to the closing date) and paid the Company a non-refundable licensing fee of $500,000. Esteve agreed to provide certain commercialization services for Surfaxin for the treatment of Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants and Acute Lung Injury/Acute Respiratory Distress Syndrome in adult patients. The Company has agreed to an exclusive supply agreement which provides that Esteve will purchase from the Company all of its Surfaxin drug product requirements at an established transfer price based on sales of Surfaxin by Esteve and/or its sublicensee(s). Esteve has also agreed to sponsor certain clinical trial costs related to obtaining regulatory approval in Europe for Acute Lung Injury/Acute Respiratory Distress Syndrome indications. Further, Esteve also agreed to make certain milestone payments to the Company upon the attainment of European marketing regulatory approval of Surfaxin.

In October 1999, the Company granted an exclusive license to Esteve to commercialize and sell Surfaxin within Central and South America, Mexico and certain Southern European countries (with an option to include Italy). This license was terminated and superseded by the collaboration entered into with Esteve in March 2002, discussed above. In connection with this exclusive license, the Company received a nonrefundable license fee of $375,000, an additional $375,000 in advance for Surfaxin supplied for certain clinical trials to be conducted in the licensed territory; and Esteve agreed to reimburse certain research and development expenditures borne by the Company in conducting such clinical trials. In addition, an affiliate of Esteve invested $850,000 in the Company in exchange for Common Stock issued at a 50% premium over the ten-day average closing price preceding the closing of the investment; the Company has accounted for the premium as additional license fees amounting to $286,000.

The Company has accounted for the license fees (including the $286,000 premium paid for Common Stock), the reimbursement of research and development expenditures, and the advance payment for Surfaxin received from Esteve to be used in clinical trials as deferred revenue. The balance in deferred revenue at December 31, 2002 relates entirely to the license agreement with Esteve for which the Company will recognize revenue using a straight line method through the anticipated date of FDA approval for the first Surfaxin neonatal indication.

On December 10, 2001, the Company entered into a collaboration arrangement with Quintiles and its affiliate, PharmaBio Development, Inc. ("PharmaBio"), whereby Quintiles will provide pre- and post-launch marketing services for the commercialization of Surfaxin for Respiratory Distress Syndrome in premature infants and/or for Meconium Aspiration Syndrome in full-term infants in the United States. In connection therewith, the Company issued to PharmaBio for aggregate consideration of $3 million: (i) 791,905 shares of Common Stock; (ii) Class G warrants to purchase 357,143 shares of Common Stock at an exercise price equal to $3.485 per share; and (iii) Class H warrants to purchase 320,000 shares of Common Stock at an exercise price equal to $3.03 per share.

PharmaBio also committed to provide the Company with a secured revolving credit facility (the "Credit Facility"), primarily for use to pay pre-launch marketing services to be provided by Quintiles, subject to the Company satisfying certain conditions, for up to $8.5 million, which may be increased to $10 million in specified circumstances. To the extent the Credit Facility availability is increased to greater than $8.5 million, for each $1 million dollar increase, the amount of shares of Common Stock issuable pursuant to the Class H warrants will be increased by approximately 38,000 shares. Principal amounts owed under the Credit Facility may be paid out of the proceeds of milestone payments to be paid by PharmaBio to the Company at certain intervals upon the achievement of certain corporate milestones by the Company. At December 31, 2002, $1,450,000 was outstanding under the Credit Facility. At December 31, 2001, no amounts were outstanding.

The Company and Ortho Pharmaceuticals, Inc., a wholly-owned subsidiary of Johnson & Johnson, Inc., are parties to an agreement granting an exclusive license of the Surfaxin technology to the Company in exchange for certain license fees ($200,000 of which was paid in November 1996), milestone payments aggregating $2,750,000 and royalties.

The Company and The Scripps Research Institute ("Scripps") are parties to a research funding and option agreement which expires in February 2005, subject to termination by the Company at any time with 90 days prior notice. Pursuant to this agreement, the Company is obligated to fund a portion of Scripps' research efforts and thereby has the option to acquire an exclusive worldwide license to the technology developed from the research program during the term of the agreement. Scripps owns all of the technology that it developed pursuant to work performed under the agreement. To the extent the Company does not exercise its option to technology developed under the agreement, the Company has the right to receive 50% of the net royalty income received by Scripps for inventions that are jointly developed under the agreement. Payments to Scripps under this agreement were $572,000, $508,000 and $468,000 in 2002, 2001 and 2000, respectively.

NOTE 8 - STOCKHOLDERS' EQUITY

2002 PRIVATE PLACEMENT

In November 2002, the Company received approximately $11.9 million in net proceeds from the sale of 6,397,517 shares of Common Stock and 2,878,883 Class I warrants to purchase Common Stock at an exercise price of $2.425 per share. The Class I warrants are exercisable through November 5, 2007. In connection with this private placement, the placement agent received fees of approximately $766,000. As of December 31, 2002, all of the Class I warrants remain unexercised.

2001 PRIVATE PLACEMENTS

In October 2001, the Company received approximately $7.3 million in net proceeds from the sale of 3,562,759 shares of Common Stock and 712,553 Class F warrants to purchase Common Stock at an exercise price of $2.365 per share. The Class F warrants are exercisable through September 30, 2006. In connection with this private placement, the placement agent received fees of approximately $360,000 and warrants to purchase 164,911 shares of Common Stock at $2.394 per share. All of the warrants remain unexercised as of December 31, 2002.

In April 2001, the Company received approximately $1 million in proceeds in a private placement sale of 296,560 shares of Common Stock to a limited partnership.

2000 PRIVATE PLACEMENT

In March 2000, the Company received approximately $17,500,000 in net proceeds from the sale of 2,902,846 shares of Common Stock and 580,567 Class E warrants to purchase shares of Common Stock at an exercise price of $7.38 per share in a private placement offering. The Class E warrants of the Company are exercisable through March 2005. In connection with this private placement, the placement agent received fees of approximately $1,321,000 and warrants to purchase 348,341 shares of Common Stock at $8.113 per share. All of the warrants remain unexercised as of December 31, 2002.

1999 PRIVATE PLACEMENTS

During March and April 1999, the Company raised $1.0 million in a private placement offering of 826,447 shares of Common Stock and 569,026 Class C warrants to purchase Common Stock at an exercise price of $2.15 per share. The Class C warrants are exercisable through April 2006. As of December 31, 2002, approximately 57,000 Class C warrants remain unexercised.

In July 1999, the Company raised approximately $2,233,000 in net proceeds (net of offering costs of approximately $217,000) from the sale of 2,024,792 shares of Common Stock and 2,024,792 Class D warrants to purchase shares of Common Stock at an exercise price of $1.33 per share in a private placement offering. All Class D warrants have been exercised. The placement agent received fees of 7% of the gross proceeds, reimbursement of certain expenses and an option to purchase approximately 405,000 shares of Common Stock at $1.33 per share. As of December 31, 2002, approximately 395,000 options issued to the placement agent remain unexercised.

1996 PRIVATE PLACEMENT

In 1996, in a private placement offering, the Company sold securities which converted in the Ansan Merger into 2,200,256 shares of Series B convertible preferred stock of the Company and 856,138 shares of Common Stock. Net proceeds from the private placement approximated $19,000,000. Pursuant to the terms of the offering, on December 1, 1998, the conversion rate was adjusted whereby each share of preferred stock was convertible at the option of the holders into 3.11 shares of Common Stock. Conversions took place at various dates and on March 14, 2000, all of the remaining Series B shares were converted into 4,766,000 shares of Common Stock of the Company.

The placement agent for the offering received approximately $2,860,000 in cash plus warrants which, pursuant to the Ansan Merger gave the holders thereof the right to acquire 220,025 shares of Series B preferred stock (which as a result of the conversion of the Series B preferred stock were convertible into 685,000 shares of Common Stock) at a price of $11 per share, through November 8, 2006, and to acquire 85,625 shares of Common Stock at a price of $0.64 per share through November 8, 2006. As of December 31, 2002, approximately 47,000 warrants were outstanding.

COMMON SHARES RESERVED FOR ISSUANCE

As of December 31, 2002 and 2001, the Company has reserved shares of Common Stock for issuance upon exercise of options and warrants as follows:

	December 31,	
	2002	2001
Stock option plans	4,908,000	4,275,000
Placement agent and underwriter warrants	1,610,000	1,619,000
Class C warrants (1999 private placement)	57,000	57,000
Class E warrants (2000 private placement)	581,000	581,000
Class F warrants (2001 private placement)	713,000	713,000
Class G warrants (2001 Quintiles Alliance)	357,000	357,000
Class H warrants (2001 Quintiles Credit Facility)	565,000	565,000
Class I warrants (2002 private placement)	2,879,000	--
Other warrants	75,000	115,000
	11,745,000	8,282,000

TREASURY STOCK/COMMON STOCK ISSUED FOR SERVICES

In 1998, the Company's Board of Directors ("Board of Directors") approved a stock repurchase program wherein the Company could buy its own shares from the open market and use such shares to settle indebtedness. Such shares are accounted for as treasury stock.

During 2002, the Company did not acquire, nor did it issue, any Common Stock accounted for as treasury stock.

During 2001, the Company acquired 11,500 shares of Common Stock for approximately $26,000. Such shares are accounted for as treasury stock. In addition, during 2001, the Company issued 10,902 shares of Common Stock in lieu of cash payments for services and rent.

During 2000, the Company acquired 31,743 shares of Common Stock in exchange for option conversions, having a value of $245,000, and issued 7,000 shares of treasury stock in satisfaction of services rendered. In addition, during 2000, the Company issued 9,496 shares of Common Stock in lieu of cash payments for services and rent.

During 1999, the Company acquired 2,000 shares of Common Stock for approximately $5,000 and issued 15,600 shares of treasury stock, having a value of approximately $53,000, in settlement of $39,000 of indebtedness. The difference between fair market value and amount of indebtedness was charged to expense and credited to paid-in-capital.

SERIES C PREFERRED STOCK

The Company's Series C redeemable convertible preferred stock was convertible at the option of the holder into Common Stock at a conversion price equal to the market price of the Common Stock, as defined. On March 3, 2000, the sole Series C shareholder, Johnson & Johnson, Inc., elected to convert its Series C preferred stock shares into 398,186 shares of Common Stock.

NOTE 9 - STOCK OPTIONS

In March 1998, the Company adopted its 1998 Stock Incentive Plan which includes three equity programs (the "1998 Plan"). Under the Discretionary Option Grant Program, options to acquire shares of the Common Stock may be granted to eligible persons who are employees, non-employee directors, consultants and other independent advisors. Pursuant to the Stock Issuance Program, such eligible persons may be issued shares of the Common Stock. Under the Automatic Option Grant Program, eligible non-employee directors will automatically receive option grants at periodic intervals at an exercise price equal to the fair market value per share on the date of the grant. Options granted under the 1998 Plan expire no later than ten years from the date of the grant.

The 1998 Plan was successively amended at each of the Annual Meeting of Stockholders for the years 2002, 2001 and 2000, to increase the maximum number of shares of Common Stock reserved for issuance over the term of the plan by 1,000,000 shares, 1,150,000 shares and 799,041 shares, respectively. After giving effect to these amendments, there are currently 5,150,000 shares of Common Stock reserved for issuance over the term of the plan. In addition, in 2002 the Board of Directors approved amendments to the 1998 Plan that (i) increased the exercise price of options granted to non-employee directors pursuant to the Automatic Option Grant Program from 60% of the fair market value per share on the date of the grant to 100% of such fair market value and (ii) removed the Plan Administrator's authority to effect the cancellation and regrant of any outstanding options under the Discretionary Option Grant Program.

The Company applies APB 25 in accounting for stock options and, accordingly, recognizes compensation expense for the difference between the fair value of the underlying Common Stock and the exercise price of the option at the date of grant. The effect of applying SFAS No. 123 on pro forma net loss is not necessarily representative of the effects on reported net income or loss for future years due to, among other things, (i) the vesting period of the stock options and (ii) the fair value of additional stock options in future years. Had compensation cost for the Company's stock option plans been determined based upon the fair value of the options at the grant date of awards under the plans consistent with the methodology prescribed under SFAS No. 123, the Company's net loss for each of the years ended December 31, 2002, 2001 and 2000 would have been approximately $18,586,000 or $0.68, $13,455,000 or $0.61 per share and $14,092,000 or $0.75 per share per share, respectively. The weighted average fair value of the options granted are estimated at $1.15, $1.93 and $3.40 per share, respectively, for the years ended December 31, 2002, 2001 and 2000, on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: dividend yield 0%, volatility of 95%, 118% and 130%, respectively, risk-free interest rate of 2.5%, 4% and 6%, respectively and expected life of three and a half years.

Additional information with respect to the stock option activity is summarized as follows:

	Price Per Share	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Balance at January 1, 2000	$0.0026 - $7.00	2,479,653	$2.27	7.930 years
Options granted	1.66 - 7.00	1,187,000	4.36	
Options exercised	0.08 - 4.44	(532,059)	0.98	
Options forfeited	0.32	(39,000)	0.32	
Balance at December 31, 2000	0.0026 - 7.00	3,095,594	3.39	8.330 years
Options granted	2.10 - 5.25	1,279,000	2.58	
Options exercised	0.3205 - 0.87	(6,224)	0.47	
Options forfeited	2.10 - 5.19	(92,983)	4.01	
Balance at December 31, 2001	0.0026 - 7.00	4,275,387	3.16	8.018 years
Options granted	1.26 - 3.65	1,131,000	1.79	
Options exercised	0.0821 - 2.10	(77,925)	0.77	
Options forfeited	0.3205 - 7.00	(420,778)	3.3379	
Balance at December 31, 2002	0.0026 - 5.375	4,907,684	2.86	7.550 years

The following table provides further detail with regard to the options outstanding and exercisable at December 31, 2002:

Price per share	Shares	Weightd Average Price per Share	Weighted Average Remaining Contractual Life
$0.0026 - $2.00	1,579,689	$1.44	8.20 years
$2.01 - $4.00	1,780,845	$2.63	8.27 years
$4.00 - $6.00	1,547,150	$4.62	6.74 years

The following table pertains to options granted and exercisable at less than fair value:

	Year Ended December 31, 2002	Year Ended December 31, 2001	Year Ended December 31, 2000
Weighted average exercise price	$2.00	$2.11	$1.94
Weighted average fair value	$3.33	$3.53	$3.24

Currently, all options granted under the 1998 Plan are exercisable immediately upon grant, however, the shares issuable upon exercise of the options are subject to repurchase by the Company at the exercise price paid per share. Such repurchase rights lapse as the options vest according to their stated terms.

In September 1999, management was granted, in the aggregate, options to purchase 500,000 shares of the Common Stock subject to the achievement of certain corporate milestones. In January 2000, certain milestones related to the options had been achieved and 50% of the 250,000 related options vested. In September 2000, the Board of Directors accelerated the remaining 50% of the 250,000 milestone options and the Company incurred non-cash compensation charges amounting to $2,515,000, representing the excess of the fair value over the exercise price of the options granted.

Included in the options outstanding at December 31, 2001, are options to purchase 123,200 shares of Common Stock (at an exercise price of $4.44) granted during 1998, which vest upon the Company achieving specified milestones and expire in June 2008. In December 2002, the related milestones were achieved.

In December 2002, the Board of Directors approved the issuance of options to management to purchase up to 800,000 shares of Common Stock at an exercise price of $2.75 per share. Such options are expressly subject to the requisite approval of the Company's shareholders, obtained no later than the Company's Annual Meeting of Shareholders for 2003, for an amendment to the 1998 Plan authorizing an increase in the number of shares issuable under the plan in an amount equal to or greater than the aggregate amount of such options. Accordingly, such options are not included in the options outstanding at December 31, 2002. Provided the shareholders of the Company approve such amendment, such options shall vest in their entirety upon the fourth anniversary of the date of grant or at such earlier time, if ever, upon the receipt by the Company of a New Drug Application (NDA) approval by the United States Food and Drug Administration for Surfaxin for either Respiratory Distress Syndrome in premature infants, Meconium Aspiration Syndrome in full-term infants, or Acute Respiratory Distress Syndrome in adults.

NOTE 10 - COMMITMENTS

At December 31, 2002, the Company had employment agreements with six officers providing for an aggregate annual salary of $1,249,000. The agreements expire on various dates through December 2005. The Company also had employment agreements with two other executives that provide for an aggregate annual salary of $393,000. The agreements expire on various dates through July 2003. All of the foregoing agreements provide for the issuance of annual bonuses and the granting of options subject to approval by the Board of Directors.

The Company leases office and laboratory space in Doylestown, Pennsylvania under leases which expire in September 2004 and September 2005. Additionally, the Company leases office and laboratory space in Redwood City, California and office space in Windsor, United Kingdom. Payments made under these leases for the years ended December 31, 2002, 2001 and 2000 were $481,000, $273,000 and $170,000, respectively. Aggregate future minimum annual rents for these leases are as follows:

2003	$ 528,000
2004	462,000
2005	274,000
2006	28,000
	$1,292,000

The Company entered into agreements to lease laboratory and office equipment, which are being accounted for as capital leases. Future minimum lease payments for these leases are as follows:

2003	$230,000
2004	168,000
2005	115,000
	513,000
Less amounts repressenting interest	(68,000)
	$445,000

NOTE 11 - RELATED PARTY TRANSACTIONS

In November 2001, the Company entered into an agreement with Clinical Data Management, Inc. (CDM), replacing an earlier similar agreement, to perform duties associated with processing data for the Company's ongoing clinical trials. Such agreement expired on November 14, 2002 pursuant its terms and the Company has not entered into any further

arrangements with CDM. CDM is wholly-owned by the spouse of the Company's President and Chief Executive Officer. Payments made to CDM and its owner for the years ended December 31, 2002, 2001 and 2000 were approximately $289,000, $221,000 and $111,000, respectively.

In March 2002, the Company expanded its existing relationship with Esteve by entering into an agreement to expand the territory covered by the collaboration arrangement entered into with Esteve in October 1999. Pursuant to this agreement, Esteve purchased 821,862 shares of the Company's Common Stock at $4.867 per share for $4 million in cash and paid a non-refundable licensing fee of $500,000. A member of the Company's board of directors is an executive officer of Esteve.

NOTE 12 - SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table contains unaudited statement of operations information for each quarter of 2002 and 2001. The operating results for any quarter are not necessarily indicative of results for any future period.

2002 Quarters Ended:

(in thousands, except per share data)

	Mar. 31	June 30	Sept. 30	Dec. 31	Total Year
Revenues from collaborative agreements	$ 237	$ 783	$ 368	$ 394	$ 1,782
Operating Expenses:					--
Research and development	2,605	3,721	3,475	4,546	14,347
General and administrative	1,132	1,538	1,633	1,155	5,458
Total expenses	3,737	5,259	5,108	5,701	19,805
Operating loss	(3,500)	(4,476)	(4,740)	(5,307)	(18,023)
Other income and expense	130	189	211	50	580
Net loss	$ (3,370)	$ (4,287)	$ (4,529)	$ (5,257)	$(17,443)
Net loss per common share - basic and diluted	$ (0.13)	$ (0.16)	$ (0.17)	$ (0.17)	$ (0.64)
Weighted average number of common shares outstanding	25,834	26,394	26,441	30,717	27,351

2001 Quarters Ended:

(in thousands, except per share data)

	Mar. 31	June 30	Sept. 30	Dec. 31	Total Year
Revenues from collaborative agreements	$ 456	$ 262	$ 197	$ 197	$ 1,112
Operating Expenses:					
Research and development	1,762	2,049	1,921	2,275	8,007
General and administrative	1,055	984	733	2,295	5,067
Total expenses	2,817	3,033	2,654	4,570	13,074
Operating loss	(2,361)	(2,771)	(2,457)	(4,373)	(11,962)
Other income and expense	301	416	(62)	161	816
Net loss	$ (2,060)	$ (2,355)	$ (2,519)	$ (4,212)	$(11,146)
Net loss per common share - basic and diluted	$ (0.10)	$ (0.11)	$ (0.12)	$ (0.17)	$ (0.51)
Weighted average number of common shares outstanding	20,872	21,075	21,188	25,017	22,038

EXHIBIT 3.1

RESTATED CERTIFICATE OF INCORPORATION

OF

DISCOVERY LABORATORIES, INC.

The Corporation was originally incorporated on November 6, 1992, under the name "Ansan, Inc."

FIRST: The name of the corporation (hereinafter called the "Corporation") is Discovery Laboratories, Inc.

SECOND: The address, including street, number, city, and county, of the registered office of the Corporation in the State of Delaware is 1209 Orange Street, City of Wilmington, County of New Castle; and the name of the registered agent of the Corporation in the State of Delaware at such address is The Corporation Trust Company.

THIRD: The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of the State of Delaware.

FOURTH: Authorization.

The total number of shares of all classes of stock which the Corporation shall have authority to issue is 65,000,000 consisting of 60,000,000 shares of common stock, par value $.001 per share (the "Common Stock"), and 5,000,000 shares of preferred stock, par value $.001 per share (the "Preferred Stock").

The Board of Directors may divide the Preferred Stock into any number of series, fix the designation and number of shares of each such series, and determine or change the designation, relative rights, preferences, and limitations of any series of Preferred Stock. The Board of Directors (within the limits and restrictions of any resolutions adopted by it originally fixing the number of any shares of any series of Preferred Stock) may increase or decrease the number of shares initially fixed for any series, but no such decrease shall reduce the number below the number of shares then outstanding and shares duly reserved for issuance.

FIFTH: In furtherance and not in limitation of the powers conferred by statute, the Board of Directors shall have the power, both before and after receipt of any payment for any of the Corporation's capital stock, to adopt, amend, repeal or otherwise alter the Bylaws of the Corporation without any action on the part of the stockholders; provided, however, that the grant of such power to the Board of Directors shall not divest the stockholders of nor limit their power to adopt, amend, repeal, or otherwise alter the Bylaws.

SIXTH: Elections of directors need not be by written ballot unless the Bylaws of the Corporation shall so provide.

SEVENTH: The Corporation reserves the rights to adopt, repeal, rescind or amend in any respect any provisions contained in this Certificate of Incorporation in the manner now or hereafter prescribed by applicable law, and all rights conferred on stockholders herein are granted subject to this reservation.

EIGHTH: A director of the Corporation shall, to the fullest extent permitted by the General Corporation Law of the State of Delaware as it now exists or as it may hereafter be amended, not be liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director. Neither any amendment nor repeal of this Article EIGHTH, nor the adoption of any provision of this Restated Certificate of Incorporation inconsistent with this Article EIGHTH, shall eliminate or reduce the effect of this Article EIGHTH in respect of any matter occurring or any cause of action, suit or claim that, but for this Article EIGHTH, would accrue or arise prior to such amendment, repeal or adoption of an inconsistent provision.

NINTH: This Restated Certificate of Incorporation was duly adopted in accordance with the provisions of Section 245 of the General Corporation Law of the State of Delaware. This Restated Certificate of Incorporation only restates and integrates and does not further amend the provisions of the Corporation's Certificate of Incorporation as heretofore amended and supplemented, and there is no discrepancy between the provisions of such Certificate of Incorporation and this Restated Certificate of Incorporation.

IN WITNESS WHEREOF, Discovery Laboratories, Inc., has caused this Certificate of Amendment to be signed this 18th day of September 2002.

DISCOVERY LABORATORIES, INC.

By: /s/ Robert J. Capetola

Name: Robert J. Capetola, Ph.D.
Title: Chief Executive Officer

EXHIBIT 4.9

PROMISSORY NOTE

December 27, 2002

FOR VALUE RECEIVED, Discovery Laboratories, Inc. a corporation located at the address stated below ("Maker") promises, jointly and severally if more than one, to pay to the order of General Electric Capital Corporation or any subsequent holder hereof (each, a "Payee") at its office located at 401 Merritt 7 Suite 23, Norwalk, CT 06851 or at such other place as Payee or the holder hereof may designate, the principal sum of Two Hundred Eighty-Four Thousand Six Hundred Fifty-Seven-37/100 Dollars ($284,657.37), with interest on the unpaid principal balance, from the date hereof through and including the dates of payment, at a fixed interest rate of Twelve and Fifty-Hundredths percent (12.50%) per annum, to be paid in lawful money of the United States, in Thirty-Six (36) consecutive monthly installments of principal and interest as follows:

Periodic Installment	Amount
Thirty-Five (35)	9,396.26

each ("Periodic Installment") and a final installment which shall be in the amount of the total outstanding principal and interest. The first Periodic Installment shall be due and payable on January 1, 2003 and the following Periodic Installments and the final installment shall be due and payable on the same day of each succeeding month each, a "Payment Date"). Such installments have been calculated on the basis of a 360-day year of twelve 30-day months. Each payment may, at the option of the Payee, be calculated and applied on an assumption that such payment would be made on its due date.

The acceptance by Payee of any payment which is less than payment in full of all amounts due and owing at such time shall not constitute a waiver of Payee's right to receive payment in full at such time or at any prior or subsequent time.

The Maker hereby expressly authorizes the Payee to insert the date value is actually given in the blank space on the face hereof and on all related documents pertaining hereto.

This Note may be secured by a security agreement, chattel mortgage, pledge agreement or like instrument (each of which is hereinafter called a "Security Agreement").

Time is of the essence hereof. If any installment or any other sum due under this Note or any Security Agreement is not received within ten (10) days after its due date, the Maker agrees to pay, in addition to the amount of each such installment or other sum, a late payment charge of five percent (5%) of the amount of said installment or other sum, but not exceeding any lawful maximum. If (i) Maker fails to make payment of any amount due hereunder within ten (10) days after the same becomes due and payable; or (ii) Maker is in default under, or fails to perform under any term or condition contained in any Security Agreement, then the entire principal sum remaining unpaid, together with all accrued interest thereon and any other sum payable under this Note or any Security Agreement, at the election of Payee, shall immediately become due and payable, with interest thereon at the lesser of eighteen percent (18%) per annum or the highest rate not prohibited by applicable law from the date of such accelerated maturity until paid (both before and after any judgment).

Notwithstanding anything to the contrary contained herein or in the Security Agreement, Maker may not prepay in full or in part any indebtedness hereunder without the express written consent of Payee in its sole discretion.

It is the intention of the parties hereto to comply with the applicable usury laws; accordingly, it is agreed that, notwithstanding any provision to the contrary in this Note or any Security Agreement, in no event shall this Note or any Security Agreement require the payment or permit the collection of interest in excess of the maximum amount permitted by applicable law. If any such excess interest is contracted for, charged or received under this Note or any Security Agreement, or if all of the principal balance shall be prepaid, so that under any of such circumstances the

amount of interest contracted for, charged or received under this Note or any Security Agreement on the principal balance shall exceed the maximum amount of interest permitted by applicable law, then in such event (a) the provisions of this paragraph shall govern and control, (b) neither Maker nor any other person or entity now or hereafter liable for the payment hereof shall be obligated to pay the amount of such interest to the extent that it is in excess of the maximum amount of interest permitted by applicable law, (c) any such excess which may have been collected shall be either applied as a credit against the then unpaid principal balance or refunded to Maker, at the option of the Payee, and (d) the effective rate of interest shall be automatically reduced to the maximum lawful contract rate allowed under applicable law as now or hereafter construed by the courts having jurisdiction thereof. It is further agreed that without limitation of the foregoing, all calculations of the rate of interest contracted for, charged or received under this Note or any Security Agreement which are made for the purpose of determining whether such rate exceeds the maximum lawful contract rate, shall be made, to the extent permitted by applicable law, by amortizing, prorating, allocating and spreading in equal parts during the period of the full stated term of the indebtedness evidenced hereby, all interest at any time contracted for, charged or received from Maker or otherwise by Payee in connection with such indebtedness; provided, however, that if any applicable state law is amended or the law of the United States of

America preempts any applicable state law, so that it becomes lawful for the Payee to receive a greater interest per annum rate than is presently allowed, the Maker agrees that, on the effective date of such amendment or preemption, as the case may be, the lawful maximum hereunder shall be increased to the maximum interest per annum rate allowed by the amended state law or the law of the United States of America.

The Maker and all sureties, endorsers, guarantors or any others (each such person, other than the Maker, an "Obligor") who may at any time become liable for the payment hereof jointly and severally consent hereby to any and all extensions of time, renewals, waivers or modifications of, and all substitutions or releases of, security or of any party primarily or secondarily liable on this Note or any Security Agreement or any term and provision of either, which may be made, granted or consented to by Payee, and agree that suit may be brought and maintained against any one or more of them, at the election of Payee without joinder of any other as a party thereto, and that Payee shall not be required first to foreclose, proceed against or exhaust any security hereof in order to enforce payment of this Note. The Maker and each Obligor hereby waives presentment, demand for payment, notice of nonpayment, protest, notice of protest, notice of dishonor, and all other notices in connection herewith, as well as filing of suit (if permitted by law) and diligence in collecting this Note or enforcing any of the security hereof, and agrees to pay (if permitted by law) all expenses incurred in collection, including Payee's actual attorneys' fees. Maker and each Obligor agrees that fees not in excess of twenty percent (20%) of the amount then due shall be deemed reasonable.

Maker hereby irrevocably authorizes and empowers the Prothonotary or Clerk, or any attorney for any Court of record to appear for Maker in such Courts, at any time, and confess a judgement against Maker, without process, in favor of any holder hereof, without the filing of a declaration of default, with release of errors, without stay of execution, for such amount as may appear from the face hereof to be due hereunder (or, if such attorney so elects, for the amount which may be due hereon as evidenced by an affidavit signed by a representative of holder setting forth the amount then due) together with charges, attorney's fees and costs as herein provided, and Maker hereby waives and releases all benefits and relief from any and all appraisement, stay or exemption laws of any state, now in force or hereafter to be passed. If a copy hereof, verified by an affidavit, shall have been filed in said proceeding, it shall not be necessary to file the original as a warrant of attorney. No single exercise of the foregoing warrant and power to confess judgement shall be deemed to exhaust the power, whether or not such exercise shall be held by any Court to be invalid, voidable, or void, but the power shall continue undiminished and may be exercised from time to time as often as the holder hereof shall elect, until all sums payable or that may become payable hereunder by Maker have been paid in full.

THE MAKER HEREBY UNCONDITIONALLY WAIVES ITS RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF, DIRECTLY OR INDIRECTLY, THIS NOTE, ANY OF THE RELATED DOCUMENTS, ANY DEALINGS BETWEEN MAKER AND PAYEE RELATING TO THE SUBJECT MATTER OF THIS TRANSACTION OR ANY RELATED TRANSACTIONS, AND/OR THE RELATIONSHIP THAT IS BEING ESTABLISHED BETWEEN MAKER AND PAYEE. THE SCOPE OF THIS WAIVER IS INTENDED TO BE ALL ENCOMPASSING OF ANY AND ALL DISPUTES THAT MAY BE FILED IN ANY COURT (INCLUDING, WITHOUT LIMITATION, CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW AND STATUTORY CLAIMS.) THIS WAIVER IS IRREVOCABLE MEANING

THAT IT MAY NOT BE MODIFIED EITHER ORALLY OR IN WRITING, AND THE WAIVER SHALL APPLY TO ANY SUBSEQUENT AMENDMENTS, RENEWALS, SUPPLEMENTS OR MODIFICATIONS TO THIS NOTE, ANY RELATED DOCUMENTS, OR TO ANY OTHER DOCUMENTS OR AGREEMENTS RELATING TO THIS TRANSACTION OR ANY RELATED TRANSACTION. IN THE EVENT OF LITIGATION, THIS NOTE MAY BE FILED AS A WRITTEN CONSENT TO A TRIAL BY THE COURT.

This Note and any Security Agreement constitute the entire agreement of the Maker and Payee with respect to the subject matter hereof and supercedes all prior understandings, agreements and representations, express or implied.

No variation or modification of this Note, or any waiver of any of its provisions or conditions, shall be valid unless in writing and signed by an authorized representative of Maker and Payee. Any such waiver, consent, modification or change shall be effective only in the specific instance and for the specific purpose given.

Any provision in this Note or any Security Agreement which is in conflict with any statute, law or applicable rule shall be deemed omitted, modified or altered to conform thereto.

Discovery Laboratories, Inc.

/s/ David Kille
- ----------
(Witness)

David Kille
(Print Name)

350 S. Main St., Suite 307
Doylestown, PA 18901
(Address)

By: /s/ John G. Cooper

Name: John G. Cooper

Title: Senior VP, CFO

Federal Tax ID #: 94-3171943

Address: 350 South Main St. Suite 307,
Doylestown, Bucks County, PA 18901

MASTER SECURITY AGREEMENT
dated as of December 23, 2002 ("Agreement")

THIS AGREEMENT is between GENERAL ELECTRIC CAPITAL CORPORATION (together with its successors and assigns, if any, "SECURED PARTY") and DISCOVERY LABORATORIES, INC. ("DEBTOR"). Secured Party has an office at 401 Merritt 7 Suite 23, Norwalk, CT 06851-1177. Debtor is a corporation organized and existing under the laws of the state of Delaware. Debtor's mailing address and chief place of business is 350 South Main St., Suite 307, Doylestown, PA 18901.

1. CREATION OF SECURITY INTEREST.

Debtor grants to Secured Party, its successors and assigns, a security interest in and against all property listed on any collateral schedule now or in the future annexed to or made a part of this Agreement ("COLLATERAL SCHEDULE"), and in and against all additions, attachments, accessories and accessions to such property, all substitutions, replacements or exchanges therefor, and all insurance and/or other proceeds thereof (all such property is individually and collectively called the "COLLATERAL"). This security interest is given to secure the payment and performance of all debts, obligations and liabilities of any kind whatsoever of Debtor to Secured Party, now existing or arising in the future, including but not limited to the payment and performance of certain Promissory Notes from time to time identified on any Collateral Schedule (collectively "NOTES" and each a "NOTE"), and any renewals, extensions and modifications of such debts, obligations and liabilities (such Notes, debts, obligations and liabilities are called the "INDEBTEDNESS").

2. REPRESENTATIONS, WARRANTIES AND COVENANTS OF DEBTOR.

Debtor represents, warrants and covenants as of the date of this Agreement and as of the date of each Collateral Schedule that:

(a) Debtor's exact legal name is as set forth in the preamble of this Agreement and Debtor is, and will remain, duly organized, existing and in good standing under the laws of the State set forth in the preamble of this Agreement, has its chief executive offices at the location specified in the preamble, and is, and will remain, duty qualified and licensed in every jurisdiction wherever necessary to carry on its business and operations;

(b) Debtor has adequate power and capacity to enter into, and to perform its obligations under this Agreement, each Note and any other documents evidencing, or given in connection with, any of the Indebtedness (all of the foregoing are called the "DEBT DOCUMENTS");

(c) This Agreement and the other Debt Documents have been duly authorized, executed and delivered by Debtor and constitute legal, valid and binding agreements enforceable in accordance with their terms, except to the extent that the enforcement of remedies may he limited under applicable bankruptcy and insolvency laws;

(d) No approval, consent or withholding of objections is required from any governmental authority or instrumentality with respect to the entry into, or performance by Debtor of any of the Debt Documents, except any already obtained;

(e) The entry into, and performance by, Debtor of the Debt Documents will not (i) violate any of the organizational documents of Debtor or any judgment, order, law or regulation applicable to Debtor, or (ii) result in any breach of or constitute a default under any contract to which Debtor is a party, or result in the creation of any lien, claim or encumbrance on any of Debtor's property (except for liens in favor of Secured Party) pursuant to any indenture, mortgage, deed of trust, bank loan, credit agreement, or other agreement or instrument to which Debtor is a party;

(f) There are no suits or proceedings pending in court or before any commission, board or other administrative agency against or affecting Debtor which could, in the aggregate, have a material adverse effect on Debtor, its business or operations, or its ability to perform its obligations under the Debt Documents, nor does Debtor have reason to believe that any such suits or proceedings are threatened;

(g) All financial statements delivered to Secured Party in connection with the Indebtedness have been prepared in accordance with generally accepted accounting principles, and since the date of the most recent financial statement, there has been no material adverse change in Debtors financial condition;

(h) The Collateral is not, and will not be, used by Debtor for personal, family or household purposes;

(i) The Collateral is, and will remain, in good condition and repair and Debtor will not be negligent in its care and use;

(j) Debtor is, and will remain, the sole and lawful owner, and in possession of, the Collateral, and has the sole right and lawful authority to grant the security interest described in this Agreement; and

(k) The Collateral is, and will remain, free and clear of all liens, claims and encumbrances of any kind whatsoever, except for (i) liens in favor of Secured Party, (ii) liens for taxes not yet due or for taxes being contested in good faith and which do not involve, in the judgment of Secured Party, any risk of the sale, forfeiture or loss of any of the Collateral, and (iii) inchoate materialmen's, mechanic's, repairmen's and similar liens arising by operation of

law in the normal course of business for amounts which are not delinquent (all of such liens are called "PERMITTED LIENS").

3. COLLATERAL.

(a) Until the declaration of any default, Debtor shall remain in possession of the Collateral; except that Secured Party shall have the right to possess (i) any chattel paper or instrument that constitutes a part of the Collateral, and (ii) any other Collateral in which Secured Party's security interest may be perfected only by possession. Secured Party may inspect any of the Collateral during normal business hours after giving Debtor reasonable prior notice. If Secured Party asks, Debtor will promptly notify Secured Party in writing of the location of any Collateral.

(b) Debtor shall (i) use the Collateral only in its trade or business, (ii) maintain all of the Collateral in good operating order and repair, normal wear and tear excepted, (iii) use and maintain the Collateral only in compliance with manufacturers recommendations and all applicable laws, and (iv) keep all of the Collateral free and clear of all liens, claims and encumbrances (except for Permitted Liens).

(c) Secured Party does not authorize and Debtor agrees it shall not (i) part with possession of any of the Collateral (except to Secured Party or for maintenance and repair), (ii) remove any of the Collateral from the continental United States, or (iii) sell, rent, lease, mortgage, license, grant a security interest in or otherwise transfer or encumber (except for Permitted Liens) any of the Collateral.

(d) Debtor shall pay promptly when due all taxes, license fees, assessments and public and private charges levied or assessed on any of the Collateral, on its use, or on this Agreement or any of the other Debt Documents. At its option, Secured Party may discharge taxes, liens, security interests or other encumbrances at any time levied or placed on the Collateral and may pay for the maintenance, insurance and preservation of the Collateral and effect compliance with the terms of this Agreement or any of the other Debt Documents. Debtor agrees to reimburse Secured Party, on demand, all costs and expenses incurred by Secured Party in connection with such payment or performance and agrees that such reimbursement obligation shall constitute Indebtedness.

(e) Debtor shall, at all times, keep accurate and complete records of the Collateral, and Secured Party shall have the right to inspect and make copies of all of Debtor's books and records relating to the Collateral during normal business hours, after giving Debtor reasonable prior notice.

(f) Debtor agrees and acknowledges that any third person who may at any time possess all or any portion of the Collateral shall be deemed to hold, and shall hold, the Collateral as the agent of, and as pledge holder for, Secured Party. Secured Party may at any time give notice to any third person described in the preceding sentence that such third person is holding the Collateral as the agent of, and as pledge holder for, the Secured Party.

4. INSURANCE.

(a) Debtor shall at all times bear the entire risk of any loss, theft, damage to, or destruction of, any of the Collateral from any cause whatsoever.

(b) Debtor agrees to keep the Collateral insured against loss or damage by fire and extended coverage perils, theft, burglary, and for any or all Collateral which are vehicles, for risk of loss by collision, and if requested by Secured Party, against such other risks as Secured Party may reasonably require. The insurance coverage shall be in an amount no less than the full replacement value of the Collateral, and deductible amounts, insurers and policies shall be acceptable to Secured Party. Debtor shall deliver to Secured Party policies or certificates of insurance evidencing such coverage. Each policy shall name Secured Party as a loss payee, shall provide for coverage to Secured Party regardless of the breach by Debtor of any warranty or representation made therein, shall not be subject to co-insurance, and shall provide that coverage may not be canceled or altered by the insurer except upon thirty (30) days prior written notice to Secured Party. Debtor appoints Secured Party as its attorney-in-fact to make proof of loss, claim for insurance and adjustments with insurers, and to receive payment of and execute or endorse all documents, checks or drafts in connection with insurance payments. Secured Party shall not act as Debtor's attorney -in-fact unless Debtor is in default. Proceeds of insurance shall be applied, at the option of Secured Party, to repair or replace the Collateral or to reduce any of the Indebtedness.

5. REPORTS.

(a) Debtor shall promptly notify Secured Party of (i) any change in the name of Debtor, (ii) any change in the state of its incorporation or registration, (iii) any relocation of its chief executive offices, (iv) any relocation of any of the Collateral, (v) any of the Collateral being lost, stolen, missing, destroyed, materially damaged or worn out, or (vi) any lien, claim or encumbrance other than Permitted Liens attaching to or being made against any of the Collateral.

(b) Debtor will deliver to Secured Party Debtor's complete financial statements, certified by a recognized firm of certified public accountants, within ninety (90) days of the close of each fiscal year of Debtor. If Secured Party requests, Debtor will deliver to Secured Party copies of Debtor's quarterly financial reports certified by Debtor's chief financial officer, within ninety (90) days after the close of each of Debtor's fiscal quarter. Debtor will deliver to Secured Party copies of all Forms 10-K and 10-Q, if any, within 30 days after the dates on which they are filed with the Securities and Exchange Commission.

6. FURTHER ASSURANCES.

(a) Debtor shall, upon request of Secured Party, furnish to Secured Party such further information, execute and deliver to Secured Party such documents and instruments (including, without limitation, Uniform Commercial Code financing statements) and shall do such other acts and things as Secured Party may at any time reasonably request relating to the perfection or protection of the security interest created by this Agreement or for the purpose of carrying out the intent of this Agreement. Without limiting the foregoing, Debtor shall cooperate and do all acts deemed necessary or advisable by Secured Party to continue in Secured Party a perfected first security interest in the Collateral, and shall obtain and furnish to Secured Party any subordinations, releases, landlord waivers, lessor waivers, mortgagee waivers, or control agreements, and similar documents as may be from time to time requested by, and in form and substance satisfactory to, Secured Party.

(b) Debtor authorizes Secured Party to file a financing statement and amendments thereto describing the Collateral and containing any other information required by the applicable Uniform Commercial Code. Debtor irrevocably grants to Secured Party the power to sign Debtor's name and generally to act on behalf of Debtor to execute and file applications for title, transfers of title, financing statements, notices of lien and other documents pertaining to any or all of the Collateral; this power is coupled with Secured Party's interest in the Collateral. Debtor shall, if any certificate of title be required or permitted by law for any of the Collateral, obtain and promptly deliver to Secured Party such certificate showing the lien of this Agreement with respect to the Collateral. Debtor ratifies its prior authorization for Secured Party to file financing statements and amendments thereto describing the Collateral and containing any other information required by the Uniform Commercial Code if filed prior to the date hereof.

(c) Debtor shall indemnify and defend the Secured Party, its successors and assigns, and their respective directors, officers and employees, from and against all claims, actions and suits (including, without limitation, related attorney fees) of any kind whatsoever arising, directly or indirectly, in connection with any of the Collateral.

7. DEFAULT AND REMEDIES.

(a) Debtor shall be in default under this Agreement and each of the other Debt Documents if:

(i) Debtor breaches its obligation to pay when due any installment or other amount due or coming due under any of the Debt Documents;

(ii) Debtor, without the prior written consent of Secured Party, attempts to or does sell, rent, lease, license, mortgage, grant a security interest in, or otherwise transfer or encumber (except for Permitted Liens) any of the Collateral;

(iii) Debtor breaches any of its insurance obligations under Section 4;

(iv) Debtor breaches any of its other obligations under any of the Debt Documents and fails to cure that breach within thirty (30) days after written notice from Secured Party;

(v) Any warranty, representation or statement made by Debtor in any of the Debt Documents or otherwise in connection with any of the Indebtedness shall be false or misleading in any material respect;

(vi) Any of the Collateral is subjected to attachment, execution, levy, seizure or confiscation in any legal proceeding or otherwise, or if any legal or administrative proceeding is commenced against Debtor or any of the Collateral, which in the good faith judgment of Secured Party subjects any of the Collateral to a material risk of attachment, execution, levy, seizure or confiscation and no bond is posted or protective order obtained to negate such risk;

(vii) Debtor breaches or is in default under any other agreement between Debtor and Secured Party;

(viii) Debtor or any guarantor or other obligor for any of the Indebtedness (collectively "Guarantor") dissolves, terminates its existence, becomes insolvent or ceases to do business as a going concern;

(ix) If Debtor or any Guarantor is a natural person, Debtor or any such Guarantor dies or becomes incompetent;

(x) A receiver is appointed for all or of any part of the property of Debtor or any Guarantor, or Debtor or any Guarantor makes any assignment for the benefit of creditors;

(xi) Debtor or any Guarantor files a petition under any bankruptcy, insolvency or similar law, or any such petition is filed against Debtor or any Guarantor and is not dismissed within forty-five (45) days; or

(xii) Debtor's improper filing of an amendment or termination statement relating to a filed financing statement describing the Collateral.

(b) If Debtor is in default the Secured Party, at its option, may declare any or all of the Indebtedness to be immediately due and payable, without demand or notice to Debtor or any Guarantor. The accelerated obligations and liabilities shall bear interest (both before and after any judgment) until paid in full at the lower of eighteen percent (18%) per annum or the maximum rate not prohibited by applicable law.

(c) After default, Secured Party shall have all of the rights and remedies of a Secured Party under the Uniform Commercial Code, and under any other applicable law. Without limiting the foregoing, Secured Party shall have the right to (i) notify any account debtor of Debtor or any obligor on any instrument which constitutes part of the Collateral to make payment to the Secured Party, (ii) with or without legal process, enter any premises where the Collateral may be and take possession of and remove the Collateral from the premises or store it on the premises, (iii) sell the Collateral at public or private sale, in whole or in part, and have the right to bid and purchase at said sale, or (iv) lease or otherwise dispose of all or part of the Collateral, applying proceeds from such disposition to the obligations then in default. If requested by Secured Party, Debtor shall promptly assemble the Collateral and make it available to Secured Party at a place to be designated by Secured Party which is reasonably convenient to both parties. Secured Party may also render any or all of the Collateral unusable at the Debtor's premises and may dispose of such Collateral on such premises without liability for rent or costs. Any notice that Secured Party is

required to give to Debtor under the Uniform Commercial Code of the time and place of any public sale or the time after which any private sale or other intended disposition of the Collateral is to be made shall be deemed to constitute reasonable notice if such notice is given to the last known address of Debtor at least five (5) days prior to such action.

(d) Proceeds from any sale or lease or other disposition shall be applied: first, to all costs of repossession, storage, and disposition including without limitation attorneys', appraisers', and auctioneers' fees; second, to discharge the obligations then in default; third, to discharge any other Indebtedness of debtor to Secured Party, whether as obligor, endorser, guarantor, surety or indemnitor; fourth, to expenses incurred in paying or settling liens and claims against the Collateral; and lastly, to Debtor, if there exists any surplus. Debtor shall remain fully liable for any deficiency.

(e) Debtor agrees to pay all reasonable attorneys' fees and other costs incurred by Secured Party in connection with the enforcement, assertion, defense or preservation of Secured Party's rights and remedies under this Agreement, or if prohibited by law, such lesser sum as may be permitted. Debtor further agrees that such fees and costs shall constitute Indebtedness.

(f) Secured Party's rights and remedies under this Agreement or otherwise arising are cumulative and may be exercised singularly or concurrently. Neither the failure nor any delay on the part of the Secured Party to exercise any right, power or privilege under this Agreement shall operate as a waiver, nor shall any single or partial exercise of any right, power or privilege preclude any other or further exercise of that or any other right, power or privilege. SECURED PARTY SHALL NOT BE DEEMED TO HAVE WAIVED ANY OF ITS RIGHTS UNDER THIS AGREEMENT OR UNDER ANY OTHER AGREEMENT, INSTRUMENT OR PAPER SIGNED BY DEBTOR UNLESS SUCH WAIVER IS EXPRESSED IN WRITING AND SIGNED BY SECURED PARTY. A waiver on any one occasion shall not be construed as a bar to or waiver of any right or remedy on any future occasion.

(g) DEBTOR AND SECURED PARTY UNCONDITIONALLY WAIVE THEIR RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF THIS AGREEMENT, ANY OF THE OTHER DEBT DOCUMENTS, ANY OF THE INDEBTEDNESS SECURED HEREBY, ANY DEALINGS BETWEEN DEBTOR AND SECURED PARTY RELATING TO THE SUBJECT MATTER OF THIS TRANSACTION OR ANY RELATED TRANSACTIONS, AND/OR THE RELATIONSHIP THAT IS BEING ESTABLISHED BETWEEN DEBTOR AND SECURED PARTY. THE SCOPE OF THIS WAIVER IS INTENDED TO BE ALL ENCOMPASSING OF ANY AND ALL DISPUTES THAT MAY BE FILED IN ANY COURT. THIS WAIVER IS IRREVOCABLE. THIS WAIVER MAY NOT BE MODIFIED EITHER ORALLY OR IN WRITING. THE WAIVER ALSO SHALL APPLY TO ANY SUBSEQUENT AMENDMENTS, RENEWALS, SUPPLEMENTS OR MODIFICATIONS TO THIS AGREEMENT, ANY OTHER DEBT DOCUMENTS, OR TO ANY OTHER DOCUMENTS OR AGREEMENTS RELATING TO THIS TRANSACTION OR ANY RELATED TRANSACTION. THIS AGREEMENT MAY BE FILED AS A WRITTEN CONSENT TO A TRIAL BY THE COURT.

8. MISCELLANEOUS.

(a) This Agreement, any Note and/or any of the other Debt Documents may be assigned, in whole or in part, by Secured Party without notice to Debtor, and Debtor agrees not to assert against any such assignee, or assignee's assigns, any defense, set-off, recoupment claim or counterclaim which Debtor has or may at any time have against Secured Party for any reason whatsoever. Debtor agrees that if Debtor receives written notice of an assignment from Secured Party, Debtor will pay all amounts payable under any assigned Debt Documents to such assignee or as instructed by Secured Party. Debtor also agrees to confirm in writing receipt of the notice of assignment as may be reasonably requested by Secured Party or assignee.

(b) All notices to be given in connection with this Agreement shall be in writing, shall be addressed to the parties at their respective addresses set forth in this Agreement (unless and until a different address may be specified in a written notice to the other party), and shall be deemed given (i) on the date of receipt if delivered in hand or by facsimile transmission, (ii) on the next business day after being sent by express mail, and (iii) on the fourth business day after being sent by regular, registered or certified mail. As used herein, the term "business day" shall mean and include any day other than Saturdays, Sundays, or other days on which commercial banks in New York, New York are required or authorized to be closed.

(c) Secured Party may correct patent errors and fill in all blanks in this Agreement or in any Collateral Schedule consistent with the agreement of the parties.

(d) Time is of the essence of this Agreement. This Agreement shall be binding, jointly and severally, upon all parties described as the "Debtor" and their respective heirs, executors, representatives, successors and assigns, and shall inure to the benefit of Secured Party, its successors and assigns.

(e) This Agreement and its Collateral Schedules constitute the entire agreement between the parties with respect to the subject matter of this Agreement and supersede all prior understandings (whether written, verbal or implied) with respect to such subject matter. THIS AGREEMENT AND ITS COLLATERAL SCHEDULES SHALL NOT BE CHANGED OR TERMINATED ORALLY OR BY COURSE OF CONDUCT, BUT ONLY BY A WRITING SIGNED BY BOTH PARTIES. Section headings contained in this Agreement have been included for convenience only, and shall not affect the construction or interpretation of this Agreement.

(f) This Agreement shall continue in full force and effect until all of the Indebtedness has been indefeasibly paid in full to Secured Party or its assignee. The surrender, upon payment or otherwise, of any Note or any of the other documents evidencing any of the Indebtedness shall not affect the right of Secured Party to retain the Collateral for such other Indebtedness as may then exist or as it may be reasonably contemplated will exist in the future. This Agreement shall automatically be reinstated if Secured Party is ever required to return or restore the payment of all or any portion of the Indebtedness (all as though such payment had never been made).

(g) THIS AGREEMENT AND THE RIGHTS AND OBLIGATIONS OF THE PARTIES HEREUNDER SHALL IN ALL RESPECTS BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF CONNECTICUT (WITHOUT REGARD TO THE CONFLICT OF LAWS PRINCIPLES OF SUCH STATE), INCLUDING ALL MATTERS OF CONSTRUCTION, VALIDITY AND PERFORMANCE, REGARDLESS OF THE LOCATION OF THE EQUIPMENT.

IN WITNESS WHEREOF, Debtor and Secured Party, intending to be legally bound hereby, have duly executed this Agreement in one or more counterparts, each of which shall be deemed to be an original, as of the day and year first aforesaid.

SECURED PARTY:	DEBTOR:
GENERAL ELECTRIC CAPITAL CORPORATION	DISCOVERY LABORATORIES, INC.
By: /s/ John Edel	By: /s/ John G. Cooper
Name: John Edel	Name: John G. Cooper
Title: SVP	Title: Senior VP, CFO

AMENDMENT

THIS AMENDMENT is made as of the 23 day of December 2002, between General Electric Capital Corporation ("Secured Party") and Discovery Laboratories, Inc. ("Debtor") in connection with that certain Master Security Agreement, dated as of December 23, 2002 ("Agreement"). The terms of this Amendment are hereby incorporated into the Agreement as though fully set forth therein. Section references below refer to the section numbers of the Agreement. The Agreement is hereby amended as follows:

1. CREATION OF SECURITY INTEREST.

This Section I is hereby amended and replaced with the following:

"Debtor grants to Secured Party, its successors and assigns, a security interest in and against all property listed on any collateral schedule now or in the future annexed to or made a part of this Agreement ("COLLATERAL SCHEDULE"), and in and against all additions, attachments, accessories and accessions to such property, all substitutions, replacements or exchanges therefor, and all insurance and/or other proceeds thereof (all such property is individually and collectively called the "COLLATERAL"). The lien is not contemplated to include intellectual property. This security interest is given to secure the payment and performance of all debts, obligations and liabilities of any kind whatsoever of Debtor to Secured Party, now existing or arising in the future, including but not limited to the payment and performance of certain Promissory Notes from time to time identified on any Collateral Schedule (collectively "NOTES" and each a "NOTE"), and any renewals, extensions and modifications of such debts, obligations and liabilities (such Notes, debts, obligations and liabilities are called the "INDEBTEDNESS")."

3. COLLATERAL.

Subsection (b) is hereby amended and replaced with the following:

"(b) Debtor shall (i) use the Collateral only in its trade or business, (ii) maintain all of the Collateral in good operating order and repair, normal wear and tear excepted, (iii) use and maintain the Collateral in a manner that would not violate the manufacturers recommendations and all applicable laws, and (iv) keep all of the Collateral free and clear of all liens, claims and encumbrances (except for Permitted Liens)."

4. INSURANCE.

Subsection (b) is hereby amended and replaced with the following:

"(b) Debtor agrees to keep the Collateral insured against loss or damage by fire and extended coverage perils, theft, burglary, and for any or all Collateral which are vehicles, for risk of loss by collision, and if requested by Secured Party, against such other risks as Secured Party may reasonably require. The insurance coverage shall be in an amount no less than the full replacement value of the Collateral, and deductible amounts, insurers and policies shall be acceptable to Secured Party. Debtor shall deliver to Secured Party policies or certificates of insurance evidencing such coverage. Each policy shall name Secured Party as a loss payee, shall provide for coverage to Secured Party regardless of the breach by Debtor of any warranty or representation made therein, shall not be subject to coinsurance, and shall provide that coverage may not be canceled or altered by the insurer except upon thirty (30) days prior written notice to Secured Party. Debtor appoints Secured Party as its attorney-in-fact to make proof of loss, claim for insurance and adjustments with insurers, and to receive payment of and execute or endorse all documents, checks or drafts in connection with insurance payments. Secured Party shall not act as Debtor's attorney-in-fact unless Debtor is in default. So long as Debtor is not in default under the Agreement, proceeds of insurance less than $50,000 shall be applied at the Debtor's option, to repair or replace the Collateral or to reduce any of the Indebtedness, otherwise insurance proceeds shall be applied, at the option of Secured Party, to repair or replace the Collateral or to reduce any of the Indebtedness."

5. REPORTS.

Subsection (b) is hereby amended and replaced with the following:

"(b) Debtor will deliver to Secured Party financial statements as follows. If Debtor is a privately held company, then Debtor agrees to provide monthly financial statements, certified by Debtor's president or chief financial officer including a balance sheet, statement of operations and cash flow statement within 30 days of each month end and its complete audited annual financial statements, certified by a recognized firm of certified public accountants, within 120 days of fiscal year end or at such time as Debtor's Board of Directors receives the audit. If Debtor is a publicly held company, then Debtor agrees to provide quarterly unaudited statements and annual audited statements, certified by a recognized firm of certified public accountants, within 10 days after the statements are provided to the Securities and Exchange Commission ("SEC"). All such statements are to be prepared using generally accepted accounting principles ("GAAP") and, if Debtor is a publicly held company, are to be in compliance with SEC requirements."

7. DEFAULT AND REMEDIES.

Subsection (a) is hereby amended and replaced with the following:

"(a) Debtor shall be in default under this Agreement and each of the other Debt Documents if.

(i) Debtor breaches its obligation to pay when due any installment or other amount due or coming due under any of the Debt Documents;

(ii) Debtor, without the prior written consent of Secured Party, attempts to or does sell, rent, lease, license, mortgage, grant a security interest in, or otherwise transfer or encumber (except for Permitted Liens) any of the Collateral;

(iii) Debtor breaches any of its insurance obligations under Section 4;

(iv) Debtor breaches any of its other obligations under any of the Debt Documents and fails to cure that breach within thirty (30) days after written notice from Secured Party;

(v) Any warranty, representation or statement made by Debtor in any of the Debt Documents or otherwise in connection with any of the Indebtedness shall be false or misleading in any material respect;

(vi) Any of the Collateral is subjected to attachment, execution, levy, seizure or confiscation in any legal proceeding or otherwise, or if any legal or administrative proceeding is commenced against Debtor or any of the Collateral, which in the good faith judgment of Secured Party subjects any of the Collateral to a material risk of attachment, execution, levy, seizure or confiscation and no bond is posted or protective order obtained to negate such risk;

(vii) Debtor breaches or is in default under any other agreement between Debtor and Secured Party;

(viii) Debtor or any guarantor or other obligor for any of the Indebtedness (collectively "GUARANTOR") dissolves, terminates its existence, becomes insolvent or ceases to do business as a going concern;

(ix) If Debtor or any Guarantor is a natural person, Debtor or any such Guarantor dies or becomes incompetent;

(x) A receiver is appointed for all or of any part of the property of Debtor or any Guarantor, or Debtor or any Guarantor makes any assignment for the benefit of creditors;

(xi) Debtor or any Guarantor files a petition under any bankruptcy, insolvency or similar law, or any such petition is filed against Debtor or any Guarantor and is not dismissed within forty-five (45) days;

(xii) Debtor's improper filing of an amendment or termination statement relating to a filed financing statement describing the Collateral; or

(xiii) There is a material adverse change in the Debtor's financial condition, other than changes in cash reserves in the ordinary course of business on a stand alone basis, as determined solely by Secured Party."

(xiv) At any time during the term of this Agreement Debtor sells more than 50% of its equity interest in the company to another corporation or business or all or substantially all of its assets without Secured Party's prior written consent.

TERMS USED, BUT NOT OTHERWISE DEFINED HEREIN SHALL HAVE THE MEANINGS GIVEN TO THEM IN THE AGREEMENT. EXCEPT AS EXPRESSLY AMENDED HEREBY, THE AGREEMENT SHALL REMAIN IN FULL FORCE AND EFFECT. IF THERE IS ANY CONFLICT BETWEEN THE PROVISIONS OF THE AGREEMENT AND THIS AMENDMENT, THEN THIS AMENDMENT SHALL CONTROL.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment simultaneously with the Agreement by signature of their respective authorized representative set forth below.

GENERAL ELECTRIC CAPITAL CORPORATION	DISCOVERY LABORATORIES, INC.
By: /s/ John Edel	By: /s/ John G. Cooper
Name: John Edel	Name: John G. Cooper
Title: SVP	Title: Senior VP, CFO

EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to reference to the incorporation by reference in the Registration Statements of Discovery Laboratories, Inc. and subsidiary on Form S-8 (File No. 333-33900) and Form S-3s (Form S-3 No. 333-72614 and No. 333-101666) of our report dated February 25, 2000, on our audit of the consolidated statements of operations, changes in stockholders' equity and cash flows for the period May 18, 1993 (inception) through December 31, 1999 (the consolidated statements of operations and cash flows are not presented separately therein) which report is included in the annual report on Form 10-K for the year ended December 31, 2002. In addition, we consent to the reference to us under the heading "Experts" in the Registration Statements on Form S-3.

/s/ Eisner LLP

New York, New York
March 26, 2003

EXHIBIT 23.2

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-100824) pertaining to the Discovery Laboratories, Inc. Amended and Restated 1998 Stock Incentive Plan and in the Registration Statements (Form S-3 No. 333-101666, Form S-3 No. 333-35206, Form S-3 No. 333-86105, Form S-3 No. 333-72614, and Form S-3 No. 333-82596) pertaining to the registration of shares of common stock of our report dated February 26, 2003, with respect to the consolidated financial statements of Discovery Laboratories, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 2002.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
March 27, 2003

EXHIBIT 99.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002

In connection with the annual report on Form 10-K of Discovery Laboratories, Inc. (the "Company"), for the period ended December 31, 2002, as filed with the Securities and Exchange Commission (the "Commission") on the date hereof (the "Report"), I, Robert J. Capetola, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Commission or its staff upon request.

Date: March 31, 2003

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

EXHIBIT 99.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002

In connection with the annual report on Form 10-K of Discovery Laboratories, Inc. (the "Company") for the period ended December 31, 2002, as filed with the Securities and Exchange Commission (the "Commission") on the date hereof (the "Report"), I, John G. Cooper, Senior Vice President, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Commission or its staff upon request.

Date: March 31, 2003

/s/ John G. Cooper
John G. Cooper
Senior Vice President,
Chief Financial Officer