UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)
[X] Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year ended July 31, 1997

OR

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission file number 0-20772
CYPROS PHARMACEUTICAL CORPORATION
(Exact name of registrant as specified in its charter)

California	33-0476164
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2714 Loker Avenue West	(Zip Code)
Carlsbad, California	92008
(Address of principal executive offices)	

Registrant's telephone number, including area code:
(760) 929-9500

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value
(Title of class)
Redeemable Class "B" Warrant
(Title of class)

Indicate by mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act 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.
[X] YES [ ] NO

As of October 23,1997, the Registrant had 14,521,121 shares of Common Stock, no par value, outstanding, and the aggregate market value of the shares held by non-affiliates on that date was $69,709,182 based upon the last sales price of the Registrant's Common Stock reported on the National Association of Securities Dealers, Inc. Automated Quotation National Market System.*

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. [X]

* Excludes 1,626,937 shares of Common Stock held by directors, executive officers and shareholders whose beneficial ownership exceeds ten percent of the shares outstanding on October 23,1997. Exclusion of shares held by any person should not be construed to indicate that such person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the Registrant, or that such person is controlled by or under common control with the Registrant.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the Registrant's Proxy Statement for the 1998 Annual Meeting of Shareholders to be filed on or before November 28, 1997 are incorporated by reference into Part III.

PART I.

Item 1. Business.

Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. The Company's actual results

could differ materially from those discussed here. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the description of the Company's business below and the sections entitled "Licenses", "Manufacturing", "Sales and Marketing", "Competition", "Government Regulation", "Patents and Proprietary Rights" and "Management's Discussion and Analysis of Financial Condition and Results of Operations", those discussed in the S-3 Registration Statement File No. 333-25661 filed with U.S. Securities and Exchange Commission, as well as those discussed in any documents incorporated by reference herein or therein.

General

The Company is developing and marketing acute care drugs for the hospital market. The Company's sales and marketing force is currently marketing three products, Glofil and Inulin, two injectable drugs that assess kidney function by the measurement of glomerular filtration rate, and Ethamolin, an injectable drug that treats bleeding esophageal varices. Within its development programs, the Company is currently conducting Phase II clinical trials on CPC-111 and Ceresine (formerly CPC 211), two drugs potentially indicated for a number of major disorders caused by impaired blood flow, known as "ischemia, and is also planning Phase III clinical trials of CPC-111 in coronary artery bypass grafting surgery and Ceresine in closed head injury.

The Company's Acquired Products. The Company has a nine-person sales and marketing force directed at the acute care, hospital market. In advance of the approval of CPC-111 and Ceresine by the U.S. Food and Drug Administration ("FDA"), the Company is acquiring FDA-cleared products; Glofil-125 and Inulin, which it acquired in 1995 and Ethamolin, which it acquired in November 1996 from Schwarz Pharma. The Company will continue to build its sales and marketing force as it completes additional acquisitions. During the fiscal year ended July 31, 1997, the net sales of the Company's three products reached $2,428,000, a 90% increase over the $1,275,000 recorded during the prior fiscal year.

Ischemia-Induced Cell Damage; Phase II Clinical Data Leading to Phase III Decisions. There are several million cases of ischemia induced disorders annually in the United States, resulting in several hundred thousand deaths and several billion dollars in annual costs for physical and mental rehabilitation and ongoing care, and yet there are currently no FDA-approved drugs to avoid or reverse the massive cell damage caused by ischemia (termed "cytoprotective drugs"). Currently approved drugs for treating cardiovascular ischemia, such as "clot busting" drugs, serve to re-establish blood flow but do not have direct cytoprotective benefits. The Company believes that the drugs it is developing, if cleared by the FDA and successfully marketed, should reduce significantly the number of fatalities and the rehabilitation and ongoing care costs associated with ischemic disorders.

Impairment of blood flow reduces the supply of oxygen to body cells, interrupting normal aerobic metabolism and causing depletion of adenosine triphosphate ("ATP"), the cells' primary energy source. Ischemia-induced depletion of ATP produces a myriad of increasingly destructive cellular events known as the "toxic ischemic cascade". The Company believes that all cytoprotective drugs under development by others for treatment of ischemia are focused on treating specific elements of the toxic ischemic cascade, leaving other elements free to cause cell, tissue and organ damage.

The Company's approach, based on preventing or reversing the toxic ischemic cascade, is comprehensive in nature and, the Company believes, potentially more effective. CPC-111 and Ceresine are designed to act during and after ischemia by maintaining cellular ATP levels or accelerating their restoration. CPC-111 (a natural substance) and Ceresine have very low orders of toxicity, making them more amenable to being used early in the patient management process, which is critical in acute care settings.

Further, CPC-111 and Ceresine are small molecules, easily deliverable and inexpensive to produce. Significant human data, available from the Company's own studies and independent, physician-sponsored Investigational New Drug applications

("INDs"), show that each of these drugs is well tolerated when administered at clinically relevant doses to healthy subjects. The minimal side effects associated with CPC-111 and Ceresine will greatly reduce their development risk and may permit their broad, early use in acute care settings, such as emergency rooms, where rapid access to treatment is of utmost importance.

During the fiscal year ended July 31, 1997, the Company's multiple-indication Phase II clinical trials generated substantial amounts of data. Building upon positive interim data released in December 1995, the Company twice released data on its CABG surgery trial of CPC-111, and after evaluating data from its Phase II trials in angioplasty patients and in congestive heart failure patients, has recently concluded that it will pursue the development of CPC-111 in Phase III trials of CABG patients. During the fiscal year, the Company also released data from its Phase II trial of Ceresine in closed head injury patients and recently concluded that it will pursue the development of Ceresine in Phase III trials of these patients. In October 1997, the Company released positive data in its Phase II trial of CPC111 in sickle cell anemia crisis patients.

Pre-clinical Programs. Further implementing its overall strategy of developing drugs that protect cells from ischemic damage, the Company is conducting pre-clinical studies on a number of additional drugs meant to reduce the neurodegeneration associated with stroke and traumatic head injury. The Company believes that these drugs will reduce "excitotoxicity", the excess release of excitatory amino acid ("EAA") neurotransmitters in the brain that stems from ischemically-caused ATP depletion in certain brain cells. Drugs being developed in these studies include: (i) a new class of neuronal calcium channel blockers which block excessive EAA neurotransmitter release; (ii) a patented series of novel compounds which augment levels of adenosine (a naturally occurring substance which inhibits EAA release) in ischemic tissue by inhibiting its metabolism; and (iii) a novel series of compounds which inhibit the release of EAA (especially glutamate) from glial cells in the brain for which the Company received a $100,000 Small Business Innovation Research Phase I grant during the year. The Company is attempting to develop lead compounds from all three of the above pre-clinical programs to treat a variety of ischemic disorders of both the cardiovascular and cerebrovascular systems.

The Company is also pursuing the development of CPC-111 prodrugs with improved pharmacokinetic and pharmacodynamic properties that will permit oral delivery of CPC-111 and also access to the central nervous system. Funding for this program was provided by a $100,000 Small Business Innovation Research Phase I grant received during the previous year.

Acquired Products for the Hospital Market

The Company's strategy includes building near-term sustainability with the cash flow from acquired acute care products for the hospital market with the goal of reducing its overall cash consumption rate and building its sales, marketing and distribution infrastructure in advance of FDA clearance of CPC111 and Ceresine.

Glofil-125 and Inulin

Kidney disease afflicts more than 2 million persons in the United States and is increasing primarily due to the growth in diabetes and systemic lupus erythromatosis cases. Kidney disease results in over $12 billion annually in healthcare costs in the United States. The measurement of kidney function (glomerular filtration rate or GFR) is critical to the understanding of the disease state and its appropriate therapeutic intervention. GFR has historically been estimated by the measurement of endogenous serum creatinine and by 24-hour urinary creatinine clearance. These diagnostic assays overestimate kidney function by as much as 100 percent in patients. The Company believes that the injection of a renal filtration marker, such as Inulin and Glofil125, is the most accurate and direct means of determining GFR.

Glofil-125 and Inulin are FDA-cleared products for the measurement of GFR. Nephrologists and nuclear medicine departments at major medical centers are the primary users of

these products. During the fiscal year ended July 31, 1997, the Company recorded sales from these two products of $1,528,000, a 20% increase over the $1,275,000 recorded during the prior fiscal year. Two customers using Glofil-125 for long-term research studies accounted for 23% and 13%, respectively, of net sales of these products during the most recent fiscal year.

Glofil-125 is an injectable radioactive diagnostic drug, which provides rapid information on GFRs with great accuracy. It is currently sold by the Company in 4ml vials and in prefilled syringes through the 117 nationwide radiopharmacies of Syncor International pursuant to a distribution agreement entered into with the Company in February 1996. Inulin is an injectable diagnostic drug, which provides a measure of GFRs. Inulin is currently sold in 50 ml ampules with actual patient dosing correlated to patient weight.

The Company believes there is substantial opportunity for increased utilization of Glofil-125. Present diagnostic procedures for measuring kidney function include serum creatinine and creatinine clearance tests. These two tests are the most commonly performed methods of measuring kidney function because of their low cost, however both methods significantly overestimate kidney function in the estimated 500,000 patients with severe renal disease. The use of Glofil-125 has been established in published clinical studies as being a more direct, true measure of kidney function yielding much more accurate results than serum creatinines or creatinine clearances. This improved accuracy can be essential to reliably monitoring disease progression and intervention, as well as assessing the immediate state of renal impairment. The biggest impediment to the continued growth in the sales of Glofil-125 would be a change in the ability of the end users to obtain reimbursement for the test or the termination of the research studies being conducted by the Company's two largest customers.

Inulin, which is sold by the Company, and 99mTc-DTPA (which is not sold by the Company and must be prepared onsite by the end user) are alternative agents for GFR measurement, however the preparation and use of these two drugs is difficult and they do not provide the practical advantages of Glofil-125. There are no new diagnostic drugs being introduced or in development that the Company is aware of as a competitive threat to Glofil-125.

Ethamolin

Approximately 75,000 people in the United States have or are approaching end stage liver disease. Liver disease (hepatic cirrhosis) results in approximately 25,000 deaths annually and ranks ninth among the leading causes of death. Hepatic cirrhosis promotes the formation of esophageal varices through development of portal hypertension. When intravenous blood pressure rises, these varicosities may cause a life threatening form of upper gastrointestinal hemorrhage associated with a 35-50% mortality rate. At least 50,000 patients in the United States either have actively bleeding esophageal varices or are at imminent risk of bleeding.

Early and effective treatment of esophageal varices to achieve hemostasis is essential to the outcome of the bleeding patient. The most common pharmaceutical treatment protocol involves the injection of a sclerosing agent into the varix, achieving clot formation and obliteration of the varix. This form of hemostasis is called sclerotherapy and usually requires multiple treatment sessions. Ethamolin is the only sclerotherapy agent cleared by the FDA for the treatment of bleeding esophageal varices and has recently become the market leader in this therapeutic category. However, there is strong competition from another drug, Sotradecol, which is being prescribed off-label, and from band ligation, a form of surgery.

Cytoprotection Market Opportunities

Cytoprotective drugs for acute care settings that treat ischemic injury are not currently available and the market opportunities for the Company's drugs are large, totalling several million cases annually in the United States. The Company believes that its drugs, if approved, could substantially reduce not only the large number of fatalities associated with ischemia-related disorders but also reduce significantly the billions of dollars

spent annually in rehabilitation and ongoing care in the United States of these victims.

The Company's drugs are designed to be administered intravenously in order to speed their delivery to the ischemic tissue. In order to ensure early interventions, they are intended to be standard components in hospital emergency rooms, operating theater suites, endoscopy suites and radiology suites. Their lack of substantial toxicity should suit them for this purpose.

Circulatory System Ischemia

Cardiovascular ischemia can result in a spectrum of clinically significant events ranging from angina (pain) to heart attack and sudden death. In addition to the numerous trauma or disease related causes of ischemia, there are a variety of voluntary surgical procedures which result in ischemia to vital organ systems. Procedures such as coronary artery bypass grafting surgery, which are performed to improve blood flow to the heart, induce temporary ischemia which can result in tissue damage. Thus, CPC-111, if approved, could also be a part of the treatment regimen for these disorders. All of these conditions or procedures represent potential opportunities for use of the Company's drugs to reduce the tissue damage known to be associated with them.

Cerebrovascular ischemia (stroke) can result in temporary loss of consciousness, permanent behavioral and neurologic impairment, coma and death. Traumatic injury to the head is caused by accidents, near drownings and similar incidents. The resultant medical problems are, in large part, caused by ischemia to the brain. The biochemical processes associated with stroke and head trauma are thought to be very similar; thus, the Company expects drugs developed for one indication are expected to be useful for the other.

Sickle Cell Anemia

Sickle cell anemia is an autosomal recessive genetic disease carried by about 8% of African-Americans. Approximately 72,000 African-Americans suffer from the most severe form (homozygous) of the disease, where the red blood cells form "sickle" shapes that can clog up capillaries and result in severe and disseminated ischemia (termed sickle cell "crisis"). Most sickle cell patients undergo multiple crises each year. CPC-111 has been shown pre-clinically to help reduce this "sickling" process and the Company is evaluating it in a Phase II trial of sickle cell anemia crisis patients. This disease qualifies as an orphan indication and may qualify for expedited FDA review.

The Pathology of Ischemia

Metabolic Aspects (All Tissues)

All living animal cells require glucose and oxygen to survive, both of which are supplied to tissues by the blood. Glucose is transformed into carbon dioxide and water with the resultant formation of ATP. ATP is the universal fuel which is required to keep the cell alive. During and after ischemia, the decrease in cellular ATP levels damages the cell and, the Company believes, results in the toxic ischemic cascade, a myriad of celldamaging processes discussed below which cause further cell damage.

ATP generation occurs in two phases. The first phase, called glycolysis or anaerobic metabolism, does not require oxygen. The second phase, called aerobic metabolism or the Krebs cycle, requires oxygen and occurs in mitochondria. Glycolysis is a means of producing cellular energy in ischemic conditions, and therefore, represents the body's natural defense against ischemic damage. For this reason, the facilitation of glycolysis is of interest therapeutically in the prevention of ischemic damage to tissues and organs. When pyruvic acid builds up during ischemia due to the inability of aerobic metabolism to utilize it, an enzyme converts it to lactic acid which blocks glycolysis. The therapeutic principle underlying CPC-111 and Ceresine is to facilitate glycolysis during and after ischemia so the cell continues to produce ATP and the toxic ischemic cascade is pre empted or reversed. Specifically, CPC-111 bypasses the lactic acid block and does not need to be energized

by ATP to be metabolized. Ceresine reduces ischemia induced lactic acid accumulation by removing the cause of the metabolic block, and therefore, allows energy metabolism to continue,

Excitotoxicity (Nerve Tissue)

The destructive impact of ATP depletion in nerve tissue is further complicated by the over-production in nerve cells of various excitatory amino acids, chemicals that transmit nerve impulses from one nerve cell to another. The over-production and release of EAAs (predominately glutamate and aspartate) by nerve cells exposed to ischemia over-stimulates adjacent postsynaptic nerve cells, causing them in time to succumb to metabolic exhaustion and cell death. This ischemia-induced process, called delayed excitotoxicity, is associated with a number of acute (stroke and traumatic head injury) and chronic (Alzheimer's, Parkinson's Disease and Amyotrophic Lateral Sclerosis) neurologic disorders. Controlling delayed excitotoxicity by blocking the postsynaptic EAA receptors has recently attracted the attention of both academic and pharmaceutical scientists. To date, the drugs in development that act by this mechanism have considerable side effects and only block selected receptor subtypes, therefore only dealing with part of the problem since all receptor subtypes appear to cause damage.

Recent evidence has shown that specific presynaptic channels, neuronal calcium channels, regulate the release of neurotransmitters in nerve cells. The Company has shown that compounds which block excessive EAA neurotransmitter release from nerve cells greatly reduce excitotoxicity and post-ischemic tissue damage in animal models of stroke and head trauma. The Company is seeking to develop drugs that specifically block neuronal calcium channels and therefore, if successful, would block the excitotoxic process and reduce the resultant cell damage. These drugs are expected to have a more comprehensive effect on excitotoxicity than the specific postsynaptic EAA receptor blockers, since they will reduce the stimulation of all and not just some EAA receptors.

The Company has also shown that adenosine, a natural compound, has cytoprotective properties. The Company is seeking to develop a series of drugs, called adenosine metabolism inhibitors, which, if successful, would augment adenosine levels in ischemic tissue and have cytoprotective effects in both brain and heart tissue. See "Adenosine Metabolism Inhibitor Program."

Additionally, the Company is developing a novel series of compounds which inhibit the release of EAA (especially glutamate) from glial cells in the brain for which the Company received a $100,000 Small Business Innovation Research Phase I grant during the year.

The Toxic Ischemic Cascade

Ischemia-induced cell damage triggers a number of processes which cause further damage to each affected cell and its surrounding cells. This myriad of destructive processes is facilitated by reperfusion injury, which occurs after blood flow is reestablished. The traumatized, ATP-depleted cell enters into the toxic ischemic cascade, resulting in the release of a host of toxic agents, including damaging reactive chemicals called free radicals, as well as other molecules that are products of cell membrane breakdown, all of which damage cells. Excessive intracellular calcium buildup is also an element of the toxic ischemic cascade and also triggers a host of other damaging processes, such as activation of proteolytic enzymes which break down proteins and digest cells and activation of protein kinases which regulate cell metabolism. The traumatized cell also releases agents which stimulate the immune system, activating various blood cells, such as neutrophils and macrophages which actually eliminate the cell affected by ischemia. Rather than target each of these myriad events, the Company's drugs, CPC-111 and Ceresine, address ATP replenishment so that the cell can correct the ischemic cascade naturally.

There are currently no known FDA-approved cytoprotective drugs. Those under development are, to the Company's knowledge, primarily aimed at specific elements of the toxic ischemic cascade. The Company believes that its approach to

cytoprotective drug development is unique in that it seeks to preempt or reverse the entire cascade by decreasing the initial metabolic trauma which triggers it (i.e., ATP depletion). The Company believes that this approach is preferable to treating specific elements of the cascade, since it more comprehensively addresses the underlying pathology and should therefore result in more efficacious therapy.

Cardiovascular and Cerebrovascular Ischemia Drugs in Development -The Metabolism Program

The Company is conducting two Phase II clinical trials on CPC 111 and two Phase II trials on Ceresine. These drugs are designed to minimize the tissue damage associated with surgically-induced ischemia in the CABG setting, sickle cell anemia crises, and stroke and traumatic head injury. The Company has released substantial amounts of data from its CABG trial of CPC-111 and its traumatic head injury trial of Ceresine and is planning Phase III trials in both of these indications. The Company is finishing a multi-dose cohort in each of these indications before finalizing Phase III protocols.

CPC-111. CPC-111 is a small non-peptide molecule that the Company believes (based on extensive pre-clinical and mechanistic data) stimulates and maintains glycolysis in cells undergoing ischemia by circumventing the ischemia-induced blockage of this process. The drug also appears to inhibit various aspects of immune system activation which underly reperfusion injury. The Company has licensed four issued U.S. patents which cover the use of CPC-111 in several acute ischemic indications, was recently issued a notice of allowance for a U.S. patent on a novel formulation of CPC-111, and has several patents pending in the United States and Europe.

There are several published U.S. and foreign clinical studies with CPC-111, where more than 500 patients were administered the drug, indicating that it is well tolerated in humans with little or no side effects. These studies indicate that the drug improves heart function in various situations where the heart is injured. In addition, more than 250 patients have participated in the four Phase II trials of CPC-111 under the Company's IND and the drug continues to be well tolerated.

More than 115 patients have participated in the double-blind, placebo-controlled Phase II trial in CABG surgery patients, and the interim data released in December 1995, August 1996 and June 1997 demonstrates that in patients receiving the active drug, CPC111 (a) has a cardioprotective effect on heart muscle, (b) improves key parameters of heart function, including cardiac output, left ventricular stroke work index and cardiac index and (c) reduces the need for inotope support post-operatively in the intensive care unit (the "ICU") and results in shorter patient stays in the ICU. The CABG data is superior to the data from the Phase II trials of CPC-111 in angioplasty and congestive heart failure patients and has led the Company to announce that it will pursue the Phase III development of CPC-111 in the CABG indication. The Company is currently finishing a multi-dose cohort in this trial and will then finalize a Phase III protocol.

In October 1997, the Company released positive data from a 47 patient double-blind, placebo-controlled, dose-ranging Phase II clinical trial with CPC-111 in sickle cell anemia crisis patients showing that the drug significantly reduced pain during crisis using two different measures of pain, the visual analog scale and the categorical assessment scale.

Ceresine. Ceresine is also a small non-peptide molecule which acts on glycolysis at a different site from CPC-111. The Company has exclusive rights to an issued U.S. patent covering the use of Ceresine in cerebral ischemia and, during the fiscal year ended July 31, 1997 was issued a U.S. patent on a novel dosing regimen of Ceresine. The Company believes that Ceresine stimulates a specific enzyme which is present in the membrane of mitochondria that removes a precursor of lactic acid (pyruvic acid) from the cytoplasm of the cell by transporting it into the mitochondria, resulting in a reduction of lactic acid in the cell. Increased post-ischemia accumulation of lactic acid is a major causal factor in the cessation of glycolysis, the resultant decrease in cellular ATP levels and eventual cell death. Numerous studies have shown that Ceresine reduces post-

ischemia lactic acid levels in humans subjected to various traumatic events which would otherwise have resulted in increased lactic acid (lactic acidosis).

Ceresine has been employed by clinical investigators in patients on an experimental basis for the intravenous treatment of lactic acidosis. Published clinical studies and the Company's own Phase I data have established that Ceresine reduces serum lactic acid and exhibits no serious side effects. It has also been shown in human studies to permeate the blood-brain barrier and to reduce brain lactic acid levels in congenital lactic acidosis patients.

During the fiscal year ended July 31, 1997, the Company completed a Phase II clinical trial on Ceresine in closed head injury patients, which showed that the drug crosses the blood-brain barrier at high levels and very quickly thereafter reduce lactate levels substantially. This effect lasted for at least 12 hours. Serum lactate levels were also reduced substantially in the drug treated group. Subsequently, the Company amended the protocol for this trial to add multi-dose cohorts and is in the process of finishing them. The strength of this data has led the Company to announce that it will pursue the Phase III development of Ceresine in this indication in 1998. In addition, a Phase II clinical trial on Ceresine in stroke patients is continuing.

Ischemia Drugs in Pre-clinical Research-The Metabolism and Excitotoxicity Programs

The Company is also seeking to develop new drugs for the treatment of ischemia-related disorders involving neurological damage, such as stroke, traumatic head injury, epilepsy and chronic neurodegenerative disorders such as Alzheimer's and Parkinson's disease. These pre-clinical research programs are focused on either the metabolic or the excitotoxicity aspects of ischemia therapeutics, and involve the chemical modification of identified lead molecules that regulate adenosine metabolism, various calcium ion channels on neuronal cells and chloride channels on glial cells.

Adenosine Metabolism Inhibitor Program. The Company is seeking to develop CPC-405 and certain of its derivatives, which are novel small molecules with demonstrated potency as inhibitors of adenosine metabolism. Adenosine is a natural cytoprotective agent which is generated in ischemic tissue and serves to protect cells from a variety of traumatic situations. Naturally generated adenosine is rapidly degraded by enzymes. The Company expects that CPC-405 will increase the level of adenosine in tissue traumatized by ischemia and thereby increase its cytoprotective effect. A U.S. patent has been issued on the composition of the CPC-400 series of drugs. The Company will seek to identify other lead compounds to take forward into clinical development.

Neuronal Calcium Channel Blocker Program. The Company believes that the therapeutic approach to excitotoxicity currently attracting the most commercial attention involves the development of specific EAA receptor blockers which inhibit the excessive postsynaptic EAA action that is triggered by ischemia. Although these EAA receptor blockers have neuroprotective properties in cell culture and animal models of ischemia, their usefulness is hampered by toxic side effects associated with the blockage of EAA receptors and by the fact that there are multiple EAA receptor subtypes, all of which appear to cause post-ischemic damage when they are excessively stimulated.

The Company is seeking to develop new classes of drugs that are designed to remedy excitotoxicity in a potentially more complete and effective manner by reducing EAA release from nerve cells, thereby reducing the over-stimulation of all EAA receptor subtypes. This pre-synaptic approach to neuroprotection is viewed by the Company as potentially more effective than blocking receptors post-synaptically.

Specifically, the Company is seeking to develop separate classes of small-molecule drugs that act as neuronal calcium channel blockers ("NCCB"), which it has labelled as the CPC-300, CPC-800 and CPC-8000 series and has synthesized over 100 compounds in this series. If successful, these drugs would have

the ability to normalize or decrease EAA release and thereby comprehensively reduce the over-stimulation of EAA receptors. Prototype agents such as CPC-8027 have shown the desired effect of acting at the neuronal calcium channels, which controls EAA release. The Company has demonstrated neuroprotection in several pre-clinical models with CPC-304, CPC-317, CPC-877 and CPC-8027 and intends to further modify them structurally with the goal of improved drug delivery to the central nervous system. These modifications will require additional pre-clinical testing.

Glial Chloride Channel Blockers. The Company has synthesized a series of agents designated as the CPC-700 series. These agents act to inhibit glial cell swelling in the brain which occurs after injury in disorders such as stroke and head injury. These agents inhibit the excess release of EAAs from glial cells and have demonstrated neuroprotective properties. The Company is currently filing patents on these compounds.

Licenses

The Company believes its strategic objectives can best be met by combining its in-house research and development efforts with licenses and research collaborations with scientists at outside academic and clinical research centers.

The principal sources of the Company's existing licenses are:

Angel K. Markov, M.D.

CPC-111. The Company has obtained an exclusive license from Dr. Markov to four U.S. patents covering the use of CPC-111 in a number of ischemic indications. As part of the license, the Company is funding clinical development in Dr. Markov's laboratories at the University of Mississippi Medical Center. In this regard, the Company has undertaken certain development obligations which must be met in order to maintain this license in force. In the event the Company breaches the license agreement, such as by not meeting certain milestones within the specified time periods or by failing to expend certain amounts in connection with clinical trials within specified time periods, the license will automatically terminate and all rights under the license and information acquired by the Company concerning any products based on the licensed technology will revert to Dr. Markov. In the event of such termination, the Company will retain the rights to market products for which sales occurred within the calendar year prior to the termination, and all other products and information related thereto based on the licensed technology will revert to Dr. Markov. To date, the Company has met all milestones.

University of Cincinnati

Ceresine. The Company has an exclusive license from the University of Cincinnati ("UC") to a U.S. patent covering the use of Ceresine in cerebral ischemia. The Company has undertaken certain development obligations which must be met in order to maintain its rights in force. If certain milestones are not met by the Company within specified time periods, UC may, in its sole discretion, elect to continue the agreement, negotiate in good faith with the Company to modify the agreement or terminate the agreement upon 30 days' written notice in which event all rights under the license would revert to UC. To date, the Company has met all milestones.

Elie Abushanab, Ph. D.

Adenosine Metabolism Inhibitor. The Company obtained a license to certain adenosine metabolism inhibiting compounds developed by Dr. Elie Abushanab, which the Company believes will enhance the levels of adenosine in cardiovascular ischemia situations. Composition of matter claims on a patent application covering certain of these compounds have been recently allowed. Under the license, the Company must pay Dr. Abushanab certain milestone payments relating to the development of any drug covered by the license. To date, the Company has met all milestones.

Manufacturing

The Company does not currently manufacture any of its acquired products or its products in development. Glofil is manufactured for the Company by the former owner of the drug, Inulin is manufactured for the Company by one of its existing contract manufacturers, and Ethamolin is manufactured for the Company by the company who manufactured it for Schwarz Pharma. In the case of CPC-111 and Ceresine, there are alternative sources of supply for the bulk drug in existence, and the Company has entered into arrangements with third parties to manufacture and formulate CPC111 and Ceresine for clinical trials. There can be no assurance that any of the Company's contract manufacturers will continue to meet the Company's requirements for quality, quantity and timeliness or the FDA's current Good Manufacturing Practice ("cGMP") requirements or that the Company would be able to find a substitute manufacturer for Glofil, Inulin, CPC-111, Ceresine or any other of its drugs which would meet these requirements or that lots will not have to be recalled with the attendant financial consequences to the Company. The Company's dependence upon others for the manufacture of its drugs may adversely affect the future profit margin, if any, on the sale of those drugs and the Company's ability to develop and deliver products on a timely and competitive basis. In the event the Company is unable to obtain or retain contract manufacturers or to obtain manufacturing on commercially acceptable terms, it may not be able to commercialize its drugs as planned.

Sales and Marketing

The Company currently has a director of sales and marketing, a customer service representative, a product manager and five field sales representatives for Glofil, Inulin and Ethamolin and is hiring additional sales representatives. The Company believes that it will be able to serve the hospital market in North America with a 50 to 70 person sales and marketing staff. There can be no assurance that the Company will be able to establish sales and distribution capabilities or be successful in gaining market acceptance for its drugs.

Competition

The Company faces competition from specialized biotechnology companies, large pharmaceutical companies, academic institutions, government agencies and public and private research organizations, many of which have extensive resources and experience in research and development, clinical testing, manufacturing, regulatory affairs, distribution and marketing. Some of these entities have significant research activities in areas upon which the Company's programs focus. Many of the Company's competitors possess substantially greater research and development, financial, technical, marketing and human resources than the Company and may be in a better position to develop, manufacture and market drugs. These entities may discover and develop drugs competitive with or superior to those developed by the Company.

Government Regulation

The manufacture and sale of drugs are subject to extensive regulation by United States and foreign governmental authorities prior to commercialization. In particular, drugs are subject to rigorous preclinical and clinical testing and other approval requirements by the FDA and comparable foreign regulatory authorities. The process for obtaining the required regulatory approvals from the FDA and other regulatory authorities takes many years and is very expensive. There can be no assurance that any drug developed by the Company will prove to meet all of the applicable standards to receive marketing approval in the United States or abroad. There can be no assurance that any such approvals will be granted on a timely basis, if at all. Delays and costs in obtaining these approvals and the subsequent compliance with applicable federal and state statutes and regulations could materially adversely affect the Company's ability to commercialize its drugs and its ability to receive sales revenues.

The research activities required by the FDA before a drug can be approved for marketing begin with extensive preclinical animal and laboratory testing. The tests include laboratory evaluation of product chemistry and animal studies for the safety and efficacy of the drug. The results of these studies are

submitted to the FDA as part of an IND which is reviewed by the FDA prior to beginning clinical trials, first in normal volunteers and then in patients with the disease.

Clinical trials involve the administration of the investigational new drug to healthy volunteers or to patients, under the supervision of a qualified physician-principal investigator. Clinical trials are conducted in accordance with government-established statutes, regulations and guidelines and under protocols that detail the objectives of the study, the parameters to be used to monitor safety and the efficacy criteria to be evaluated. Each protocol must be submitted to the FDA as part of the IND. Further, each clinical study must be evaluated by an independent Institutional Review Board ("IRB") at the institution at which the study will be conducted. The IRB considers, among other things, ethical factors, the safety of human subjects and the possible liability of the institution, and approves the informed consent to be obtained from all subjects and patients in the clinical trials. The Company will have to monitor the conduct of clinical investigators in performing clinical trials and their compliance with FDA requirements.

Clinical trials are typically conducted in three sequential phases (Phase I, Phase II and Phase III), but the phases may overlap. There can be no assurance that Phase I, Phase II or Phase III testing will be completed successfully within any specified time period, if at all, with respect to any of the Company's drugs. Furthermore, the Company or the FDA may suspend clinical trials at any time if it is felt that the subjects or patients are being exposed to an unacceptable health risk or that the investigational product lacks any demonstrable efficacy.

The results of the pharmaceutical development, preclinical studies and clinical studies are submitted to the FDA in the form of a New Drug Application ("NDA") for approval of the marketing and commercial shipment of the drug. The testing and approval process is likely to require substantial time (frequently five to eight years or more) and expense and there can be no assurance that any approval will be granted on a timely basis, if at all. The FDA may deny an NDA if applicable regulatory criteria are not satisfied, require additional testing or information, or require post-marketing testing and surveillance to monitor the safety of the Company's drugs. Notwithstanding the submission of the NDA and any additional testing data or information, the FDA may ultimately decide that the application does not satisfy its regulatory criteria for approval. Finally, drug approvals may be withdrawn if compliance with labeling and cGMP regulatory standards is not maintained or if unexpected safety problems occur following initial marketing.

Among the conditions for clinical studies and NDA approval is the requirement that the prospective manufacturer's quality control and manufacturing procedures conform to cGMP, which must be followed at all times. In complying with standards set forth in these regulations, manufacturers must continue to expend time, monies and effort in the area of production and quality control to ensure full technical compliance.

Also, the Prescription Drug Act of 1997 requires companies engaged in pharmaceutical development, such as the Company, to pay user fees in the amount of at least $100,000 upon submission of an NDA. In addition to regulations enforced by the FDA, the Company also is subject to regulation under the Occupational Safety and Health Act, the Environmental Protection Act, the Toxic Substances Control Act, the Resource Conservation and Recovery Act and other present and potential future federal, state or local regulations. For marketing outside the United States, the Company is subject to foreign regulatory requirements governing human clinical trials and marketing approval for drugs. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary widely from country to country.

Patents and Proprietary Rights

The Company's success may depend in large measure upon its ability to obtain patent protection for its drugs, maintain confidentiality and operate without infringing upon the

proprietary rights of third parties. The Company has obtained patent coverage, either directly or through licenses from third parties, for certain of its drugs. It has licensed (i) four U.S. patents on CPC-111 which have expiration dates ranging from 2002 to 2008 and (ii) one U.S. patent on Ceresine which has an expiration date of 2003. During the fiscal year ended July 31, 1997, the Company was issued a U.S. patent on a novel dosing regimen for Ceresine and received a notice of allowance on a U.S. patent for a novel formulation of CPC-111 (the "Formulation Patent"). Corresponding applications to the Formulation Patent have been filed in Europe, Japan and Canada.

In addition, during the fiscal year ended July 31, 1997, the Company received a notice of allowance on a U.S. patent covering the use of CPC-111 in the prevention of organ transplant rejection and licensed additional U.S., Australian and European patents from the Australian National University covering the use of CPC-111 in this same area, as well as in the area of inflammatory disorders of the immune system.

The Company has filed patent applications with respect to other programs and expects to file additional applications in the future. There can be no assurance that any of these patent applications will be approved, except where claims have already been examined and allowed, or that the Company will develop additional proprietary products that are patentable. Nor can there be any assurance that any patents issued to the Company or its licensors will provide the Company with any competitive advantages or will not be challenged by third parties or that patents issued to others will not have an adverse effect on the ability of the Company to conduct its business. Furthermore, because patent applications in the United States are maintained in secrecy until issue, and because publication of discoveries in the scientific and patent literature often lag behind actual discoveries, the Company cannot be certain that it was the first chronologically to make the inventions covered by each of its pending U.S. patent applications, or that it was the first to file patent applications for such inventions. In the event that a third party has also filed a U.S. patent application for any of its inventions, the Company may have to participate in interference proceedings declared by the United States Patent and Trademark Office to determine priority of the invention, which could result in substantial cost to the Company, even if the eventual outcome is favorable to the Company. In addition, there can be no assurance that the Company's U.S. patents, including those of its licensors, would be held valid by a court of law of competent jurisdiction. If patents are issued to other companies that contain competitive or conflicting claims which ultimately may be determined to be valid, there can be no assurance that the Company would be able to obtain a license to any of these patents.

Under Title 35 of the United States Code, as amended by the General Agreement on Tariffs and Trade implementing the Uruguay Round Agreement Act of 1994 ("GATT"), patents that issue from patent applications filed prior to June 8, 1995 will enjoy a 17 year period of enforceability as measured from the date of patent issue while those that issue from applications filed on or after June 8, 1995 will enjoy a 20-year period of enforceability as measured from the date the patent application was filed or the first claimed priority date, whichever is earlier. Patents that issue from applications filed on or after June 8, 1995 may be extended under the term extension provisions of GATT for a period up to five years to compensate for any period of enforceability lost due to interference proceedings, government secrecy orders or appeals to the Board of Patent Appeals or the Federal Circuit.

Under the Drug Price Competition and Patent Term Restoration Act of 1984, including amendments implemented under GATT (the "Patent Term Restoration Act"), the period of enforceability of a first or basic product patent or use patent covering a drug may be extended for up to five years to compensate the patent holder for the time required for FDA regulatory review of the product. This law also establishes a period of time following FDA approval of certain drug applications during which the FDA may not accept or approve applications for similar or identical drugs from other sponsors. Any extension under the Patent Term Restoration Act and any extension under GATT are cumulative. There can be no assurance that the Company will be able to take advantage of such patent term extensions or marketing

exclusivity provisions of these laws. While the Company cannot predict the effect that such changes will have on its business, the adoption of such changes could have a material adverse effect on the Company's ability to protect its proprietary information and sustain the commercial viability of its products. Furthermore, the possibility of shorter terms of patent protection, combined with the lengthy FDA review process and possibility of extensive delays in such process, could effectively further reduce the term during which a marketed product could be protected by patents.

The Company also relies on trade secrets and proprietary know-how. The Company has been and will continue to be required to disclose its trade secrets and proprietary know-how to employees and consultants, potential corporate partners, collaborators and contract manufacturers. Although the Company seeks to protect its trade secrets and proprietary know-how, in part by entering into confidentiality agreements with such persons, there can be no assurance that these agreements will not be breached, that the Company would have adequate remedies for any breach or that the Company's trade secrets will not otherwise become known or be independently discovered by competitors.

Scientific Advisory and Clinical Trials Advisory Boards

Scientific Advisory Board

The Company currently has a Scientific Advisory Board ("SAB") whose members periodically advise the Company with respect to the Company's scientific research and development programs. The SAB does not meet as a group; rather individual member(s) are contacted for advice on an as-needed basis. The members are compensated through the grant of stock options and, if meetings are held, will receive fees for attending meetings as well as reimbursement for expenses. The Company has hired certain SAB members to perform services for the Company such as assay development and compound preparation.

The members of the Company's SAB are:

Name and Affiliation	Area of Expertise
Chung Hsu, M.D., Ph.D. Director of Stroke Clinical Trials, Washington University, St. Louis School of Medicine	Animal models of stroke/clinical trials
Ronald Hayes, Ph.D. Professor of Neurosurgery, University of Texas, Houston	Animal models of of head trauma
Bruce P. Bean, Ph.D. Professor of Neurobiology, Harvard University	Neuronal ion channels
Robert Parks, M.D., Ph.D. Professor of Pharmacology, Brown University	Biochemical pharmacology
John Olney, M.D. Professor of Psychiatry and Neuropathology, Washington University, St. Louis	Excitotoxicity; animal models of stroke
Edward J. Cragoe, Ph.D. Former Senior Director of Medicinal Chemistry, Merck Sharp & Dohme Research Laboratories	Medicinal chemistry/ion channels
K.C. Nicolaou, Ph.D. Head of Chemistry, The Scripps Research Institute Professor of Chemistry, University of California, San Diego	Medicinal chemistry
Harold Kimelberg, Ph.D. Professor, Division of Neurology, Albany Medical College	Glial cell release of glutamate
Elie Abushanab, Ph.D.	

Professor of Medicinal Chemistry and Chemistry College of Pharmacy University of Rhode Island	Medicinal chemistry/adenosine
Thomas J. Maloney President The Iso-Tex Companies Friendswood, Texas	Radioisotopes/Nuclear Medicine
Claude Wasterlain, M..D. Chief of Neurology Services Sepulveda VA Medical Center/ Professor of Neurology University of California Los Angeles	Stroke and epilepsy

Clinical Trials Advisory Boards

The Company has assembled two Clinical Trials Advisory Boards ("CTABs"), composed of physician "thought leaders" in the cardiology and neurology area, to assist in the planning, design and execution of the Company's clinical trials involving CPC-111 and Ceresine. The individuals who constitute each of the CTABs are paid consultants to the Company and are listed below:

Cardiovascular Clinical Trials Advisory Board

Eric J. Topol, M.D. (Chair)
Chairman, Department of Cardiology,
Director, Center for Thrombosis and Vascular Biology, Cleveland Clinic and Foundation

Robert M. Califf, M.D.
Associate Professor of Medicine,
Duke University Medical Center

David R. Holmes, Jr., M.D.
Associate Professor of Medicine,
Mayo Clinic Medical School

Cerebrovascular Clinical Trials Advisory Board

William G. Barsan, M.D. (Chair)
Director of Emergency Medicine,
University of Michigan Medical School

Randall M. Chestnut, M.D.
Oregon Health Sciences Center
School of Medicine, Division of Neurosurgery Portland, Oregon

Charles F. Contant, Jr., Ph.D.
Baylor College of Medicine
Department of Neurosurgery
Houston, Texas

Patrick M. Kochanek, M.D.
Safar Center for Resuscitation Research
University of Pittsburgh
Pittsburgh, Pennsylvania

Patrick D. Lyden, M.D.
Chief, Stroke Clinic
University of California, San Diego

Anthony Marmarou, Ph.D.
Medical College of Virginia
Division of Neurosurgery
Richmond, Virginia

The members of the SAB and the CTABs may be employed by or have consulting agreements with entities other than the Company, some of which may compete with the Company. These other obligations may limit the availability of the members to the Company. Most are not expected to participate actively in the Company's development. Certain of the institutions with which the members are affiliated may have regulations or policies which are unclear with respect to the ability of such persons

to act as part-time consultants or in other capacities for a commercial enterprise. Regulations or policies now in effect or adopted in the future may limit the ability of the members to consult with the Company. The loss of the services of certain of the members could adversely affect the Company.

Furthermore, inventions or processes discovered by the SAB and CTAB members will not, unless otherwise agreed, become the property of the Company but will remain the property of such persons or of their full-time employers. In addition, the institutions with which the members are primarily affiliated may make available the research services of their scientific and other skilled personnel, including the members, to entities other than the Company. In rendering such services, such institutions may be obligated to assign or license to a competitor of the Company patents and other proprietary information which may result from such services, including research performed by a member for a competitor of the Company.

Scientific and Other Personnel

As of October 24, 1997, the Company had 39 full-time employees, seven of whom hold Ph.D. degrees, one of whom also holds an M.D. degree and one of whom holds a J.D. degree. Eleven of the full-time employees are employed in finance and general administration, twelve in clinical and regulatory affairs and quality assurance, seven in research and development, and nine in sales and marketing, customer service and business development. The Company believes that it maintains good relations with its employees.

Executive Officers of Registrant

Set forth below is certain information with respect to the executive officers of the Company at October 24, 1997:

Name	Age	Position
Paul J. Marangos, Ph.D.	50	Chairman of the Board, President and Chief Executive Officer
Stephen C. Eisold	51	Executive Vice President of Commercial Development and Chief Operating Officer
Zofia E. Dziewanowska, Ph.D, M.D.	57	Senior Vice President, Drug Development and Regulatory Affairs
David W. Nassif, J.D.	43	Senior Vice President, Chief Financial Officer and Secretary

Paul J. Marangos, Ph.D., has been President and Chairman of the Board since he founded the Company in November 1990. In February 1993, he became Chief Executive Officer. From April 1988 to November 1990, he was Senior Director of Research at Gensia Pharmaceuticals, Inc., a biotechnology company. From 1980 to 1988, he was Chief of Neurochemistry in the Biological Psychiatry Branch, National Institute of Mental Health. Dr. Marangos obtained his doctorate in biochemistry from the University of Rhode Island and did his post-doctoral work at the Roche Institute of Molecular Biology. He has published 250 research papers and four books in the field of biochemistry and pharmacology. Dr. Marangos' most recent book, published in July 1992, is entitled Emerging Strategies in Neuroprotection. He is a member of the Society for Neuroscience and the American Academy for the Advancement of Science. Dr. Marangos is the founding editor of the Journal of Molecular Neuroscience published by Humana Press.

Stephen C. Eisold joined the Company in May 1996 as the Executive Vice President of Commercial Development and Chief Operating Officer. From February 1990 to May 1996, he held various executive positions at Gensia Inc., most recently as Vice President and General Manager of the North American Pharmaceuticals Division. Prior thereto, Mr. Eisold held various sales, marketing and commercial development positions in the pharmaceutical industry since 1973. He received his bachelor of science from Springfield College and his masters in business administration from Rockhurst College.

Zofia E. Dziewanowska, Ph.D., M.D., joined the Company in October 1997 as the Senior Vice President of Drug Development and Regulatory Affairs. May 1994 to October 1997, she was the

Senior Vice President, Global Clinical Affairs, of Genta Incorporated ("Genta"), a San Diego-based pharmaceutical company principally engaged in using a proprietary drug delivery technology to develop oral controlled-release formulations for presently marketed drugs which have lost, or will lose, patent protection and/or marketing exclusivity. Prior to joining Genta, Dr. Dziewanowska spent 17 years at Hoffman-La Roche in various research and development positions, including Vice President and Director of International Therapeutic Research and Medical Affairs Advisor. Dr. Dziewanowska is currently holding a faculty appointment at the Cornell University Medical School. She also has held various positions in the Pharmaceutical Research and Manufacturers Association of America, the most recent being a Vice-Chairman of the Medical Section Steering Committee, American Association of Pharmaceutical Physicians and the International Federation of Pharmaceutical Medicine. She received an M.D. degree from the University of Warsaw Medical School and a Ph. D. in physiology from the Institute of Immunology and Experimental Therapeutics, Polish Academy of Science.

David W. Nassif, J.D., joined the Company in August 1993 as Vice President, Chief Financial Officer and Secretary, and was promoted to Senior Vice President in September 1997. From January 1993 to August 1993, he was a consultant to various public and private companies in the areas of capital raising, mergers and acquisitions, investor relations and securities law compliance. From July 1992 to January 1993, he was the Vice President, Chief Financial Officer and Assistant Secretary of 999, Inc., a diversified manufacturing and environmental services company. From December 1987 to July 1992, he was the Vice President and Assistant Secretary of Showscan Corporation, a technology company. Mr. Nassif holds honors finance, management information systems and law degrees from the University of Virginia.

Item 2. Properties.

The Company leases two buildings in Carlsbad, California at a total monthly rental of $36,000. All of the Company's operations are located in 18,339 square feet of space located at 2714 Loker Avenue West (the "2714 Space"). Until April 1997, the Company's pre-clinical research group and laboratories were located in 8,547 square feet at 2732 Loker Avenue West (the "2732 Space"). During that month, these operations were moved into the 2714 Space and the 2732 Space was subleased to another pharmaceutical company (the "Subtenant").

The Company has leases on two floors in the 2714 Space, one of which commenced April 1996 and has a term of 69 months and the other of which commenced November 1996 and has a term of 61 months. The lease on the 2732 Space commenced in December 1993 and has a term of 81 months. Both leases have clauses providing for rent increases at various points in time during the terms of the leases. The Subtenant's lease covers the remainder of the Company's original lease term plus a 36-month option, and the Subtenant's rental payments to the Company exceed the Company's rental payments to the landlord. In addition, the sublease provides for annual rent increases. Under the sublease, the Company is required to spend up to $200,000 on tenant improvements (the "Tenant Improvement Obligation") to the 2732 Space, however, the net present value of the Subtenant's rental
payments over the term of the sublease greatly exceeds the

Tenant Improvement Obligation.

Item 3. Legal Proceedings.

The Company is not a party to any legal proceedings.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of the Company's security holders during the fourth quarter of the fiscal year ended July 31, 1997.

PART II.

Item 5. Market for Registrant's Common Equity and Related Shareholder Matters.

The Common Stock of the Company is quoted on the Nasdaq National Market System under the symbol "CYPR". The Redeemable Class B Warrants of the Company, which expire on November 3, 1997, are also quoted on the Nasdaq National Market System under the symbol "CYPRZ". The following table sets forth for the calendar quarters indicated, the high and low sales prices of the Common Stock on the Nasdaq National Market System, as reported in published financial sources.

Year ended July 31, 1997	High	Low
First Quarter	$5.75	$3.48
Second Quarter	$5.75	$3.63
Third Quarter	$5.88	$4.00
Fourth Quarter	$5.81	$4.00

Year ended July 31, 1996	High	Low
First Quarter	$9.13	$3.00
Second Quarter	$6.13	$3.13
Third Quarter	$6.19	$4.56
Fourth Quarter	$6.13	$3.63

The last sales price of the Common Stock on October 24, 1997 was $5.31.

According to a survey of non-objecting beneficial owners as of October 3, 1997, there were 1,942 beneficial owners of the Common Stock.

The Company has not paid any dividends since its inception and does not intend to pay any dividends on its Common Stock in the foreseeable future.

During March 1997, the Company completed a private placement of 1,075,000 shares of Common Stock to the President and Fellows of Harvard College and another institutional investor under SEC Regulation D (the "Harvard Placement"), which raised gross proceeds of $4,993,375 and netted $4,715,000 to the Company after fees and expenses.

Item 6. Selected Financial Data.

The following table sets forth certain financial data with respect to the Company. The selected financial data should be read in conjunction with the Company's Financial Statements (including the Notes thereto) and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Report.

	Years Ended July 31,				
	1993	1994	1995	1996	1997
	(in thousands, except per share data)				
Statement of Operations Data:					
Net sales	$ -	$ -	$ -	$ 1,275	$ 2,428
Gross Profit	-	-	-	870	1,890
Total operating expenses	1,715	2,565	3,910	4,988	7,466
Loss from operations	(1,715)	(2,565)	(3,910)	(4,118)	(5,576)
Other income, net	121	190	797	1,028	(1,099)
Net loss	(1,594)	(2,375)	(3,113)	(3,090)	(6,675)
Net loss per share	(0.28)	(0.32)	(0.32)	(0.27)	(0.54)
Shares used in computing net loss per share	5,637	7,358	9,860	11,518	12,303

	At July 31,				
Balance Sheet Data:	1993	1994	1995	1996	1997
Cash, cash equivalents and					

short-term investments	$ 4,444	$ 5,666	$ 13,442	$ 15,997	$ 14,567
Working capital	4,311	5,284	12,934	15,384	13,053
Total assets	4,900	6,206	14,175	20,266	21,345
Long-term debt	160	240	195	6,624	4,176
Common stock	6,748	9,927	20,945	23,421	32,345
Accumulated deficit	(1,904)	(4,279)	(7,392)	(10,482)	(17,157)
Total shareholders' equity	4,578	5,476	13,366	12,635	15,026

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties, including statements regarding the period of time during which the Company's existing capital resources and income from various sources will be adequate to satisfy its capital requirements. The Company's actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this section, as well as in the sections entitled "Business", "Licenses", "Manufacturing", "Sales and Marketing", "Competition", "Government Regulation", "Patents and Proprietary Rights", those discussed in the S-3 Registration Statement File No. 333-25661 filed with U.S. Securities and Exchange Commission, as well as those discussed in any documents incorporated by reference herein or therein.

The Company was founded in 1990, commenced its research and development activities in 1991, completed an initial public offering (the "IPO") in November 1992, commenced clinical trials in December 1994, acquired two FDA-cleared products, Glofil and Inulin, (the "Acquisitions") in August 1995, and acquired a third FDA-cleared product, Ethamolin, in November 1996. The Company has sustained an accumulated deficit of $17,157,000 from inception through July 31, 1997.
As the Company will not have significant positive net operating cash flow for the next few years and the Company's research and development, clinical testing and regulatory, sales and marketing and general and administrative expenses during these years will be substantial and increasing, the Company expects to incur increasing losses for the foreseeable future.

Results of Operations

Year ended July 31, 1997 compared to year ended July 31, 1996

During the fiscal year ended July 31, 1997, the Company sustained a loss of $6,675,000 (or $.54 per share) compared to a loss of $3,090,000 (or $.27 per share) for the prior fiscal year. The gross profit of $1,890,000 on sales of Glofil, Inulin and Ethamolin and other income of $761,000 (principally interest income) during the current fiscal year were offset by $7,465,000 in expenses in the sales and marketing, general and administrative, clinical testing and regulatory and research and development areas and $1,860,000 in amortization of discount and costs on its mandatorily convertible notes (the "Notes"). During the prior fiscal year, the gross profit of $870,000 on sales of Glofil and Inulin and other income of $1,028,000 (principally interest income) was offset by $4,988,000 in expenses in the sales and marketing, general and administrative, clinical testing and regulatory and research and development areas and depreciation and amortization expenses.

Sales and marketing expense increased by 189% to $994,000 from $343,000 in the prior year, principally as a result of increased payroll expense from the hiring of additional field sales representatives, a product manager and an administrative assistant, and related travel, hotel and meal costs.

General and administrative expense increased by 46% to $2,396,000 from $1,642,000 in the prior year. 38% of the increase was due to the commencement of a comprehensive investor relations program and the remainder reflected the impact of the expansion of the Company's activities on personnel, consulting, business development, investment banking, rent, travel and meals, legal and accounting fees and insurance.

Clinical testing and regulatory expense increased 41.7% to $1,967,000 from $1,389,000 in the prior year, principally as the result of increased site costs and use of data input and management, statistical and other consultants to accelerate, finish and report on the Company's various clinical trials.

Depreciation and amortization expense increased 75.6% to $1,075,000 from $612,000 in the prior year, principally as a result of the acquisition of Ethamolin during the current year and the related amortization of that purchased technology.

During the current year, the Company recognized $1,860,000 of expense related to the amortization of (i) the discount on the Notes and (ii) the deferred financing costs related to the private placements of the Notes. This resulted from the re-classification of the Notes from equity to debt resulting from a review of the Company's various filings under the Securities Exchange Act of 1934 by the Securities and Exchange Commission triggered by the filing of a registration statement during the year pertaining to the resale of the Common Stock underlying some of the Notes.

Year ended July 31, 1996 compared to year ended July 31, 1995

During the fiscal year ended July 31, 1996, the Company sustained a loss of $3,090,000 (or $.27 per share) compared to a loss of $3,113,000 (or $.32 per share) for the prior fiscal year. The gross profit of $870,000 on sales of Glofil and Inulin and other income of $1,028,000 (principally interest income) during the current fiscal year was offset by $4,988,000 in expenses in the sales and marketing, general and administrative, clinical testing and regulatory and research and development areas. During the prior fiscal year, there were no product sales and other income of $797,000 (principally interest income) was offset by $3,910,000 in expenses in the above areas.

During the current year, the Company spent $343,000 on sales and marketing, principally in the hiring of a field sales force and a customer service function and in various marketing and promotional programs. No such expense was recorded in the prior fiscal year as the Company was still in the development stage and had not yet acquired Glofil and Inulin.

Clinical testing and regulatory expense decreased 8.5% to $1,389,000 from $1,517,000 in the prior year, principally due to a decrease of $209,000 in contract research organization costs because of a lower accrual for the Company's Phase II congestive heart failure trial on CPC-111 and a decrease of $177,000 in licensing milestone expenses, offsetting increases in other areas, including a $180,000 increase in salary expense due to additional hiring. During the prior year, the Company recorded a one-time milestone expense from the issuance of a non-qualified stock option grant to the licensor of Ceresine as a milestone payment for the completion of a Phase I trial.

Research and development expense increased 34.4% to $1,002,000 from $745,000 in the prior year due to increases in salary expense, the use of outside collaborators and expense related to the Phase II Small Business Innovation Research Grant for the neuronal calcium channel blocker program (which grant was completed during the year) and the six-month Phase I Small Business Innovation Research Grant for the CPC-111 pro-drug program (which was awarded to the Company during the current year).

Depreciation and amortization expense increased 442% to $612,000 from $113,000 in the prior year, principally as a result of the acquisition of Glofil and Inulin during the current year and the related amortization of that purchased technology.

In addition, net interest and other income for the current year increased 38.5% to $758,000 from $547,000 in the prior year principally due to (i) the interest income from a larger investment portfolio as a result of the various private placements during the year (described below in Liquidity and Capital Resources) and the Class A Warrant Program (also described below in Liquidity and Capital Resources), which was not available for all of the prior-year period because the

program began in November 1994 and was completed in February 1995 and (ii) fees and interest earned on a loan that the Company made during the current year to a financial advisor.

Liquidity and Capital Resources

The Company has principally funded its activities to date through its initial public offering ("IPO") in November 1992, which raised $5,951,000, subsequent exercises of its Redeemable Class A Warrants in 1994 and early 1995, which raised $10,497,000, exercises by the underwriter of the IPO of its unit purchase options (and the Redeemable Class A Warrants within such options), which raised $1,681,000, three private placements of mandatorily convertible notes during July 1996, which raised net proceeds of $7,464,000 (the "Notes") and the Harvard Placement.

During the year, $3,973,000 in principal amount of the Notes was converted into 954,000 shares of Common Stock, no par value, of the Company.

At July 31, 1997, the Company had cash, cash equivalents and short-term investments of $14,567,000, compared to $15,997,000 at July 31, 1996. Also, the Company's working capital at July 31, 1997 declined to $13,053,000 from $15,384,000 at July 31, 1996, principally as a result of the issuance of the $1,200,000 promissory note to Schwarz Pharma as partial consideration for the acquisition of Ethamolin, which is due and payable in November 1997.

The Company expects that its cash needs will increase significantly in future periods due to expansion of its research and development programs, increased clinical testing activity, growth of administrative, clinical and laboratory staff and their related equipment and space needs. Management believes that the Company's working capital will be sufficient to fund the operations of the Company for approximately 24 months dependent, in part, on the timing of the commencement of each phase of the clinical trials on CPC-111 and Ceresine and the funding priorities that it gives its various research programs, the results of clinical tests and research programs; competing technological and market developments; the time and costs involved in obtaining regulatory approvals and in obtaining, maintaining and enforcing patents; the cost of product acquisitions and their resulting cash flows and other factors.

The Company expects to seek additional funds through exercises of its currently outstanding options and warrants, public or private equity financings, collaborations or from other sources. There can be no assurance that funds can be obtained on desirable terms or at all. The Company may seek to raise additional capital whenever conditions in the financial markets are favorable, even if the Company does not have an immediate need for additional cash at that time.

Item 8. Financial Statements and Supplementary Data.

The Financial Statements of the Company and Report of Ernst & Young LLP, Independent Auditors are filed as exhibits hereto, listed under Item 14 of this Report and incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on

Accounting and Financial Disclosure.

None.

PART III.

Item 10. Directors and Executive Officers of the Registrant. The information regarding directors is hereby incorporated by reference to the section entitled "Election of Directors" in the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Company's 1998 Annual Meeting of Shareholders (the "Proxy Statement").

The information regarding executive officers appears under the

section entitled "Executive Officers of Registrant" appearing in Item 1 of Part I of this Report.

Item 11. Executive Compensation.
The information required by this item is hereby incorporated by reference to the section entitled "Executive Compensation" in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management.
The information required by this item is hereby incorporated by reference to the section entitled "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement.

Item 13. Certain Relationships and Related Transactions.
The information required by this item is hereby incorporated by reference to the section entitled "Transactions with Related Parties" in the Proxy Statement.

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.
(a) (1)(2) Financial Statements and Schedules.
The financial statements are incorporated herein by reference from Exhibit 99.1, which begins with the Table of Contents on Page F-1.

(a) (3) Exhibits.

See Exhibit Index on page 30.

The following management compensation plans and arrangements are required to be filed as exhibits pursuant to Item 14(c) of this report.

Exhibit Number	Description
10.1	Forms of Incentive Stock Option and Nonstatutory Stock Option.*
10.2	Amended 1992 Stock Option Plan.**
10.3	Employment Agreement, dated July 10, 1991 as amended and restated September 1, 1992, between the Registrant and Paul J. Marangos, Ph.D. *
10.4	Amendment No. 1 to Employment Agreement, dated May 9, 1994, between the Registrant and Paul J. Marangos, Ph.D.***
10.5	Amendment No. 2 to Employment Agreement, dated March 9, 1995, between the Registrant and Paul J. Marangos, Ph.D.****
10.6	Amendment No. 3 to Employment Agreement, dated October 1, 1996, between the Registrant and Paul J. Marangos, Ph.D.*****
10.7	1993 Non-Employee Directors Stock Option Plan and related form of Nonstatutory Stock Option. ******

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* Filed as an exhibit to the Registrant's Registration Statement on Form S-1, Registration No. 33-51682, and incorporated herein by reference.
** Filed as an exhibit to the Registrant's Form 10-Q for the period ended January 31, 1995, and incorporated herein by reference.
*** Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended July 31, 1994.
**** Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended July 31, 1995.
***** Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended July 31, 1996.
******Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended July 31, 1993.

(b) Reports on Form 8-K.

There were no reports on Form 8-K filed during the fourth quarter of 1997.

(c) Exhibits.

The exhibits required by this Item are listed under Item 14 (a)

(3).

(d) Financial Statement Schedules.

There are no financial statement schedules to the Financial Statements.

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, in the City and County of San Diego, State of California, on the 24th day of October, 1997.

CYPROS PHARMACEUTICAL CORPORATION
By /s/ Paul J. Marangos
- ----------------------
Paul J. Marangos
Chairman of the Board,
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Paul J. Marangos, and David W. Nassif, and each of them, his attorney-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this report, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, 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	Title	Date
/s/ Paul J. Marangos - -------------------- Paul J. Marangos	Chairman of the Board, President and Chief Executive Officer and Director (Principal Executive Officer)	October 24,1997
/s/ David W. Nassif - -------------------- David W. Nassif	Senior Vice President, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)	October 24,1997
/s/ Robert F. Allnutt - ---------------------- Robert F. Allnutt	Director	October 24,1997
/s/ Digby W. Barrios - ---------------------- Digby W. Barrios	Director	October 24,1997
/s/ Virgil Thompson - -------------------- Virgil Thompson	Director	October 24,1997
/s/ Robert A. Vukovich ---------------------- Robert A. Vukovich	Director	October 24,1997

Exhibit Index

Exhibit Number	Description	Page No.
2.1 (1)	Pharmaceutical Products Purchase and Distribution Support Agreement as of August 9, 1995 by and among Iso-Tex Diagnostics, Inc., Cypros Pharmaceutical Corporation and Thomas J. Maloney. (2)	
2.2 (1)	Glofil Contract Manufacturing and Royalty Agreement as of August 9, 1995 by and among Iso-Tex Diagnostics, Inc., Cypros Pharmaceutical Corporation and Thomas J. Maloney. (2)	
2.3 (1)	Merger Agreement as of August 9, 1995 among Cypros Pharmaceutical Corporation, Iso-Tex Diagnostics "B", Inc. and Jean and Thomas Maloney. (2)	
2.4 (3)	Asset Purchase Agreement by and among Cypros Pharmaceutical Corporation and Schwarz Pharma, Inc. dated as of October 31, 1996.	
2.5 (3)	Note and Security Agreement by and among Cypros Pharmaceutical Corporation and Schwarz Pharma, Inc. dated November 4, 1996.	
2.6 (3)	Assumption Agreement by and among Schwarz Pharma,Inc.	

and Cypros Pharmaceutical Corporation dated November 4, 1996.
2.7 (3) Trademark Assignment by and among Schwarz Pharma, Inc. and Cypros Pharmaceutical Corporation dated November 4, 1996.
2.8 (3) Trademark Agreement by and among Schwarz Pharma, Inc. and Cypros Pharmaceutical Corporation dated November 4, 1996.
3.1 (4) Restated Articles of Incorporation of the Registrant.
3.2 (5) Amendment to Restated Articles of Incorporation.
3.3 (4) Bylaws, as amended.
4.1 (4) Specimen stock certificate.
4.3 (4) Specimen Redeemable Class B Warrant.
4.5 (4) Form of Warrant Agreement.
4.6 Reference is made to Exhibits 3.1 and 3.2.
10.1 (4) Forms of Incentive Stock Option and Nonstatutory Stock Option.
10.2 (5) Amended 1992 Stock Option Plan.
10.3 (4) Employment Agreement, dated July 10, 1991 as amended and restated September 1, 1992, between the Registrant and Paul J. Marangos, Ph.D.
10.4 (6) Amendment No. 1 to Employment Agreement, dated May 9, 1994, between the Registrant and Paul J. Marangos, Ph.D.
10.5 (7) Amendment No. 2 to Employment Agreement, dated March 9, 1995, between the Registrant and Paul J. Marangos,Ph.D.
10.6 (8) Amendment No. 3 to Employment Agreement, dated October 1, 1996, between 31 the Registrant and Paul J. Marangos, Ph.D.
10.7 (9) 1993 Non-Employee Directors Stock Option Plan and related form of Nonstatutory Stock Option.
10.8 (4) License Agreement, dated as of August 20, 1992, between the Registrant and Angel K. Markov, M.D. (with certain confidential infomation in brackets deleted). (8)
10.9 (4) License Agreement, dated as of August 27, 1992, between the Registrant and University E..M., Inc. (with certain confidential information in brackets deleted). (9)
10.10 (5) Assignment of and Amendment to License Agreement by and between University E.M., Inc., University of Cincinnati and the Registrant.
10.11 (7) License and Support Agreement, dated as of February 18, 1993, between the Registrant and Elie Abushanab, Ph.D. (with certain confidential information in brackets deleted). (10)
10.12 (11) Note Purchase Agreement dated July 11, 1996 by and among Cypros Pharmaceutical Corporation and Paresco, Inc.
10.13 (11) Note Purchase Agreement dated July 31, 1996 by and among Cypros Pharmaceutical Corporation and Cameron Capital Ltd.

Exhibit Number	Description	Page No.
23.1	Consent of Ernst & Young LLP, Independent Auditors.	33
24.1	Power of Attorney. Reference is made to page 29.	
99.1	Financial Statements.	35

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(1) Filed as an exhibit to the Registrant's Form 8-K dated August 10, 1995 and incorporated herein by reference.

(2) Certain confidential portions deleted pursuant to an application for Order Granting Confidential Treatment Under the Securities Exchange Act of 1934 and Rule 24b-2 Thereunder filed concurrently with the Form 8-K.

(3) Filed as an exhibit to the Registrant's Form 8-K dated November 4, 1996 and incoroporated herein by reference.

(4) Filed as an exhibit to the Registrant's Registration Statement on Form S-1, Registration No. 33-51682, and incorporated herein by reference.

(5) Filed as an exhibit to the Registrant's Form 10-Q for the period ended January 31, 1995, and incorporated herein by reference.

(6) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended July 31, 1994.

(7) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended July 31, 1993.

(8) Filed as an exhibit to the Registrant's Form 10-K for fiscal year ended July 31, 1996.
(9) Certain confidential portions deleted pursuant to

Order Granting Application Under the Securities Act of 1933 and Rule 406 Thereunder Respecting Confidential Treatment, dated November 3, 1992.

(10) Certain confidential portions deleted pursuant to Order Granting Application Pursuant to Rule 24B-2 Under the Securities Exchange Act of 1934 Respecting Confidential Treatment, dated December 20, 1993.

(11) Filed as an exhibit to the Registrant's Form 8-K dated September 20, 1996 and incorporated herein by reference.

EXHIBIT 23.1

CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements (Form S-3 and S-8) of our report dated August 21, 1997 (except Note 5, as to which the date is October 9, 1997), with respect to the financial statements of Cypros Pharmaceutical Corporation included in the Annual Report (Form 10-K) for the year ended July 31, 1997.

ERNST & YOUNG LLP

San Diego, California
October 27, 1997

5

This schedule contains summary financial information extracted from Cypros' 1997 Audited Financial Statements and is qualified in its entirety by reference to such Financial Statements.

12-MOS
JUL-31-1997
JUL-31-1997
5,101,710
9,465,561
355,425
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93,177
15,090,911
7,853,903
1,600,098
21,344,716
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32,344,793
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(6,674,703)
(0.54)
0

EXHIBIT 99.1

Form 10-K Items 14(a) (1) and (2)

Cypros Pharmaceutical Corporation

Years ended July 31, 1997, 1996 and 1995
with Report of Independent Auditors

Cypros Pharmaceutical Corporation

Form 10-K Items 14(a) (1) and (2)

Contents

Financial Statement Schedules (Item 14(a) (2)):

All financial statement schedules are omitted because the information described therein is not applicable, not required or is furnished in the financial statements or notes thereto.

Report of Independent Auditors

The Board of Directors and Shareholders
Cypros Pharmaceutical Corporation

We have audited the accompanying balance sheets of Cypros Pharmaceutical Corporation as of July 31, 1997 and 1996, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended July 31, 1997. 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.

We conducted our audits in accordance with generally accepted auditing standards. 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 overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cypros Pharmaceutical Corporation at July 31, 1997 and 1996, and the results of its operations and its cash flows for each of the three years in the period ended July 31, 1997 in conformity with generally accepted accounting principles.

ERNST & YOUNG LLP

August 21, 1997,
except for Note 5, as to which the date is
October 9, 1997

San Diego, California

Cypros Pharmaceutical Corporation
Balance Sheets

	July 31, 1997	1996
Assets		
Current assets:		
Cash and cash equivalents (Note 3)	$ 5,101,710	$9,068,614
Short-term investments, held to maturity (Note 3)	9,465,561	6,928,435
Accounts receivable	355,425	149,626
Inventories (Note 3)	93,177	63,386
Other current assets	75,038	61,409
Total current assets	15,090,911	16,271,470
Property, equipment and leasehold improvements, net (Note 3)	675,686	608,206
Purchased technology, net of accumulated amortization of $1,220,838 and $438,238 at July 31, 1997 and 1996 (Note 2)	5,060,875	2,629,427
Deferred financing costs, net of accumulated amortization of $260,884 at July 31, 1997 (Note 1)	259,127	520,011
Licenses and patents, net of accumulated amortization of $118,376 and $87,277 at July 31, 1997 and 1996, respectively (Note 1)	162,592	111,231
Other assets	95,525	126,180
Total assets	$21,344,716	$20,266,525
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$365,386	$119,092
Accrued compensation	121,605	155,748
Other accrued liabilities	131,800	231,864
Purchased asset obligations (Note 2)	1,272,000	200,000
Current portion of long-term debt (Note 4)	41,367	99,282
Current portion of capital lease obligations (Note 5)	106,206	81,035
Total current liabilities	2,038,364	887,021
Long-term debt (Note 4)	-	41,367
Capital lease obligations (Note 5)	148,787	187,265
Deferred rent (Note 4)	104,196	120,411
Mandatorily convertible notes(Note 5)	4,027,461	6,395,574
Shareholder's equity: (Note 6)		
Common stock, 30,000,000 shares authorized, 13,650,405 and 11,613,748 shares issued and outstanding as of July 31, 1997 and 1996 respectively	32,344,793	23,421,428
Deferred compensation	(161,950)	(304,309)
Accumulated deficit	(17,156,935)	(10,482,232)
Total shareholder's equity	15,025,908	12,634,887
Total liabilities and shareholders' equity	$21,344,716	$20,266,525

See accompanying notes.

Cypros Pharmaceutical Corporation
Statements of Operations

	Years ended July 31,		
	1997	1996	1995
Net Sales	$2,428,348	$1,275,240	$ -
Cost of Sales	538,725	405,142	-
Gross Profit	1,889,623	870,098	-
Operating expenses:			
Sales and Marketing	993,765	343,054	-
General and administrative	2,396,465	1,642,152	1,535,540
Clinical testing and regulatory	1,967,334	1,389,128	1,516,947
Research and development	1,032,486	1,002,226	744,608
Depreciation and amortization	1,075,431	611,848	112,713
Total operating expenses	7,465,481	4,988,408	3,909,808
Loss from operations	(5,575,858)	(4,118,310)	(3,909,808)
Research grant income	98,785	270,510	250,000
Interest and other income, net	662,421	757,692	547,107
Amortization of discount and costs on mandatorily Convertible notes (Note 5)	(1,860,051)	-	-
Net loss	$(6,674,703)	$(3,090,108)	$(3,112,701)
Net loss per share	$(0.54)	$(0.27)	$(0.32)
Shares used in computing net loss per share	12,303,274	11,518,169	9,859,857

See accompanying notes.

Cypros Pharmaceutical Corporation
Statements of Shareholder's Equity
For each of the three years ended July 31, 1997, 1996 and 1995

CAPTION>

	Common stock		Deferred
	Shares	Amount	Compensation
Balance at July 31, 1994	8,019,780	9,926,561	$(170,940)
Exercise of Class A warramts (program II)	2,605,180	8,205,215	-
Exercise of Unit Purchase Option and underlying Class A warrants	543,745	1,681,266	-
Exercise of stock options	183,312	528,924	-
Deferred compensation related to grant of stock options and warrants	-	603,029	(110,842)
Amortization of			

deferred compensation	-	-	94,789
Net loss	-	-	-
Balance at July 31, 1995	11,352,017	20,944,995	(186,993)
Discount on mandatorily convertible notes	-	1,582,935	-
Issuance of Common Stock, net of offering costs	162,500	940,956	-
Issuance of Common Stock in business acquisitions	169,231	1,032,309	-
Issuance of Common Stock for services	200,000	284,375	(284,375)
Common stock repurchased	(280,000)	(1,540,000)	-
Exercise of stock options	10,000	35,163	-
Deferred Compensation related to grant of stock options	-	140,695	(140,695)
Amortization of deferred compensation	-	-	307,754
Net loss	-	-	-
Balance at July 31, 1996	11,613,748	23,421,428	(304,309)
Conversations of mandatorily convertible notes	953,907	3,972,538	-
Issuance of Common Stock,net of offering costs	1,075,000	4,714,507	-
Exercise of stock options	7,750	21,963	-
Forfeitures of stock options	-	(52,568)	52,568
Deferred compensation related to grant of stock options	-	266,925	(266,925)
Amortization of deferred compensation	-	-	356,716
Net loss	-	-	-
Balance at July 31, 1997	13,650,405	$32,344,793	$(161,950)

CAPTION>

	Accumulated Deficit	Total Shareholders' Equity
Balance at July 31, 1994	$(4,279,423)	$5,476,198
Exercise of Class A warrants (program II)	-	8,205,215
Exercise of Unit Purchase options and underlying Class A warrants	-	1,681,266
Exercise of stock options	-	528,924
Deferred compensation related to grant of		

stock options and warrants	-	492,187
Amortization of deferred compensation	-	94,789
Net loss	(3,112,701)	(3,112,701)
Balance at July 31, 1995	(7,392,124)	13,365,878
Discount on mandatorily convertible notes	-	1,582,935
Issuance of Common Stock,net of offering costs	-	940,956
Issuance of Common Stock in business acquisitions	-	1,032,309
Issuance of Common Stock for services	-	-
Common stock repurchased	-	(1,540,000)
Exercise of stock options	-	35,163
Deferred compensation related to grant of stock options	-	-
Amortization of deferred compensation	-	307,754
Net loss	(3,090,108)	(3,090,108)
Balance at July 31, 1996	(10,482,232)	12,634,887
Conversations of mandatorily convertible notes	-	3,972,538
Issuance of Common Stock, net of offering costs		4,714,507
Exercise of stock options	-	21,963
Forfeitures of stock options	-	-
Deferred compensation related to grant of stock options	-	-
Amortization of deferred compensation	-	356,716
Net loss	(6,674,703)	(6,674,703)
Balance at July 31, 1997	$(17,156,935)	$15,025,908

See Accompany notes

Cypros Pharmaceutical Corporation
Statements of Cash Flows

	Years ended July 31,		
	1997	1996	1995
Operating activities			
Net loss	$(6,674,703)	$(3,090,108)	$(3,112,701)
Adjustments to reconcile net loss to net cash used in operating activities:			
Amortization of deferred compensation	356,716	307,754	94,789
Depreciation and amortization	1,075,431	611,848	112,713
Amortization of			

discount and costs on mandatorily convertible notes	1,860,051	-	-
Expense related to warrant issuance	-	-	492,187
Deferred rent	(16,215)	39,892	10,889
Write-off of patent	-	-	14,000
Changes in operating assets and liabilities, net of effects from acquisitions:			
Accounts receivable	(205,799)	(149,626)	-
Inventories	(29,791)	18,829	-
Other current assets	(13,629)	18,536	(41,897)
Accounts payable	246,294	(19,445)	(138,572)
Accrued liabilities	(56,948)	114,305	233,909
Net cash flows used in operating activities	(3,458,593)	(2,148,015)	(2,334,683)
Investing activities			
Short-term investments	(2,537,126)	1,486,815	(3,957,538)
Investments in purchased technology	(2,014,048)	(1,835,356)	-
Installment payment for purchased technology	(200,000)	(82,215)	-
Purchase of property, equipment and leasehold improvements	(239,941)	(100,770)	(193,689)
Increase in licenses and patents	(82,460)	(37,499)	(10,863)
Decrease in other assets	21,375	6,197	16,673
Net cash flows used in investing activities	(5,052,200)	(562,828)	(4,145,417)
Financing activities			
Issuance of Common Stock, net	4,736,470	976,119	10,415,405
Issuance of mandatorily convertible notes	-	7,458,498	-
Repurchase and retirement of Common Stock	-	(1,540,000)	-
Repayment of long-term debt	(99,282)	(99,283)	(99,282)
Repayments of capital leases/obligations	(93,299)	(42,622)	(17,439)
Net cash flows provided by financing activities	4,543,889	6,752,712	10,298,684
Increase in cash and cash equivalents	(3,966,904)	4,041,869	3,818,584
Cash and cash equivalents at beginning of year	9,068,614	5,026,745	1,208,161
Cash and cash equivalents at end of year	$5,101,710	$9,068,614	$5,026,745
Supplemental disclosures of cash flow information:			
Cash paid for interest	$123,997	$47,953	$39,170
Noncash investing and financing activities:			

Mandatorily convertible notes converted into Common Stock	$3,972,538	$ -	$ -
Equipment financed under capital leases	$79,992	$234,256	$89,549
Purchased asset obligations	$1,200,000	$200,000	$ -
Common stock issued for acquisitions	$ -	$1,032,309	$ -

See accompanying notes.

1. Organization and Summary of Significant Accounting Policies

Organization and Business Activity

Cypros Pharmaceutical Corporation (the "Company") was incorporated in San Diego, California on November 2, 1990. The Company develops and markets acute-care, hospital-based products. The Company is currently marketing three products, Ethamolin, Glofil and Inulin, and developing two drugs, CPC-111 and Ceresine (formerly CPC-211). The Company's pre-clinical and clinical development programs focus on cytoprotective drugs designed to reduce ischemia (low blood flow) induced tissue damage in acute-care settings. The Company's two clinical programs are currently in five Phase II trials, which include three for CPC-111 (coronary artery bypass grafting surgery, congestive heart failure and sickle cell anemia crises), and two for Ceresine (stroke and head injury).

Cash, Cash Equivalents and Short-term Investments

The Company considers highly liquid investments with remaining maturities of three months or less when acquired, primarily money market funds, to be cash equivalents. Short-term investments consist of certificates of deposit, money market funds, U.S. government obligations and investment grade corporate debt securities. The Company has established guidelines relative to diversification and maturities that maintain safety and liquidity. The Company has not experienced any losses on its cash equivalents or short-term investments. Management believes the credit risk associated with these investments is limited due to the nature of the investments.

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designations as of each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity Held-to-maturity securities are carried at cost, adjusted for amortization of premiums and accretion of discounts. Interest, dividends and amortization on the securities classified as held-to-maturity are included in interest income.

Concentration of Credit Risk

The Company extends credit to its customers, primarily hospitals and large pharmaceutical companies conducting clinical research, in connection with its product

1. Organization and Summary of Significant Accounting Policies (continued)

sales. The Company has not experienced significant credit losses on its customer accounts. Two customers individually accounted for 23% and 13% of current year sales.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Depreciation and Amortization

Property and equipment are stated at cost and depreciated over the estimated useful lives of the assets (generally five years) using

the straight-line method. Leasehold improvements are amortized over the lesser of the estimated useful lives (seven years) or the remaining term of the lease.

Purchased Technology

Purchased technology associated with the acquisitions of Glofil, Inulin and Ethamolin is stated at cost and amortized over the period estimated to be benefited (seven years).

Deferred Financing Costs

The Company has deferred banking, legal and accounting fees associated with the issuance of $8 million in principal amount of mandatorily convertible notes in 1996. These costs are amortized over the term of the notes, which is three years, using the effective interest method commencing with the closing of the transactions.

License and Patent Costs

The Company capitalizes certain costs related to license rights and patent applications. Accumulated costs are amortized over the estimated economic lives of the license rights and patents (generally six years) commencing at the time the license rights are granted or the patents are issued.

1. Organization and Summary of Significant Accounting Policies (continued)

Revenue Recognition

Revenues from product sales of Ethamolin and whole vials of Glofil and Inulin are recognized upon shipment. Revenues from Glofil unit dose sales are recognized upon receipt by the Company of monthly sales reports from its third-party distributor. The Company is not obligated to accept returns of products sold that have reached their expiration date.

Net Loss Per Share

Net loss per share is computed using the weighted average number of common shares outstanding during the periods.

Reclassifications

Certain previously reported amounts have been reclassified to conform with the 1997 presentation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and disclosures made in the accompanying notes to the financial statements. Actual results could differ from those estimates.

Accounting Standard on Impairment of Long-Lived Assets

Effective August 1, 1996, the Company adopted Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (SFAS No. 121), which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. SFAS No. 121 also addresses the accounting for long-lived assets that are expected to be disposed of. The adoption of this standard had no impact on the Company's financial statements.

1. Organization and Summary of Significant Accounting Policies (continued)

Accounting Standard on Stock Based Compensation

Effective August 1, 1996, the Company adopted Statement of Financial Accounting Standards No. 123 ("FAS 123"), Accounting and Disclosure of Stock-Based Compensation. As allowed under FAS 123, the Company elected to continue to account for stock option grants

in accordance with Accounting Principles Board Opinion No. 25 ("APB 25"), Accounting for Stock Issued to Employees, and related interpretations.

Newly Issued Accounting Standards

Effective December 15, 1997, the Company will adopt Statement of Financial Accounting Standards No. 128 ("FAS 128"), Earnings Per Share. Under FAS 128, primary earnings per share will be replaced by basic earnings per share, which will exclude the dilutive effect of common stock equivalents, such as stock options or warrants. Diluted earnings per share, which will replace fully diluted earnings per share, will continue to include the dilutive effect to all common stock equivalents. The Company does not believe the adoption of FAS 128 will have a material effect on its calculation of net loss per share.

Effective December 15, 1997, the Company will adopt Statement of Financial Accounting Standards No. 130 ("FAS 130"), Reporting Comprehensive Income. The Company does not believe the adoption of FAS 130 will have a material effect on its financial position or results of operations.

2. Acquisitions

On August 9, 1995, the Company acquired two businesses, including (i) the New Drug Application for Glofil and finished goods inventory of Glofil on hand at the time of closing from Iso-Tex Diagnostics, Inc., a Texas corporation, (the "Glofil Acquisition") and (ii) the New Drug Application for Inulin and the raw material and finished goods inventory of Inulin on hand at the time of closing from Iso-Tex Diagnostics "B," Inc. ("ITDB"), a Texas corporation (the "Inulin Acquisition"). The Glofil Acquisition was accomplished in an arms' length negotiation through a purchase of assets and the Inulin Acquisition was accomplished through a merger of ITDB with and into the Company (the "Merger"). The total purchase price was $3,149,880, of which $1,582,215 in cash and 169,231 newly issued shares of restricted Common Stock of the Company (the "Restricted Shares") were paid at closing. The Company used its working capital to make the cash payments for the acquisitions at closing.

2. Acquisitions (continued)

Both acquisitions were accounted for using the purchase method and, accordingly, the financial statements include the operations of the businesses from the date of acquisition. As part of the Glofil Acquisition, the Company made an additional cash payment of $200,000 on January 15, 1996 and a final cash payment of $200,000 on August 9, 1996. As part of the Inulin Acquisition, the Company agreed to register the Restricted Shares, upon the request of the sole stockholder of ITDB, at any time after one year from the date of closing and if the registration statement has not become effective within 90 days of the date of the holder's request, the Company is obligated to repurchase the Restricted Shares at their market value based upon the closing bid price of the Company's Common Stock on such date. If the holder requests the Company to Register the Restricted Shares, the Company intends to and has the ability to register them within 90 days of such request.

On November 4, 1996, the Company acquired the New Drug Application, the U.S. trademark for Ethamolin Injection (the "Ethamolin Assets") and the finished goods inventory on hand at closing from Schwarz Pharma, Inc., a Delaware corporation. The total purchase price was $3,286,642, of which the Company paid $2,086,642 in cash and issued a $1,200,000 note (the "Schwarz Note") bearing interest at 8% per annum at closing. The principal and interest on the Schwarz Note is secured by the Ethamolin Assets. The Company used its working capital to make the cash payment at closing. The note is due November 3, 1997.

The following unaudited pro forma data reflects the combined results of operations of the Company as if the Glofil and Inulin acquisitions had occurred on August 1, 1994 and the Ethamolin acquisition had occurred on August 1, 1995:

	Years end July 31,		
	1997	1996	1995
Net Sales	$2,752,691	$2,402,006	$1,031,486

Net loss	(6,394,987)	(2,679,376)	(2,993,386)
Net loss per share	(0.52)	(0.23)	(0.30)

3. Financial Statement Details

Short-Term Investments

All short-term investments of the Company are classified as held-to-maturity. The following is a summary of held-to-maturity investments at amortized cost as of July 31:

	1997	1996
Corporate debt securities	$10,465,202	$6,902,848
Money market funds	2,723,458	7,987,946
U.S. government obligations	995,770	749,780
Certificates of deposit	-	37,669
	14,184,430	15,678,243
Less: amounts classified as cash equivalents	(4,718,869)	(8,749,808)
Short-term investments	$9,465,561	$6,928,435

As of July 31, 1997, the difference between cost and estimated fair value of the held-to-maturity investments was not significant. Of the above-referenced 1997 investments, $8,905,005 mature at various dates through July 31, 1998 and $5,279,425 will mature at various dates after July 31, 1998 through December 14, 2001.

Inventories

Inventories consist of the following at July 31:

	1997	1996
Raw materials	$ 4,252	$ 3,437
Finished goods	88,925	59,949
	$ 93,177	$ 63,386

3. Financial Statement Details (continued)

Property, Equipment and Leasehold Improvements

Property, equipment and leasehold improvements consist of the following as of July 31:

	1997	1996
Laboratory equipment	$ 785,573	$570,865
Office equipment, furniture and fixtures	284,902	224,932
Leasehold improvements	134,772	89,517
	1,205,247	885,314
Less accumulated depreciation and amortization	(529,561)	(277,108)
	$ 675,686	$608,206

Depreciation expense was of $252,453, $138,471 and $83,313 for the years ended July 31, 1997, 1996 and 1995, respectively.

Other Accrued Liabilities

At July 31, 1997 and 1996, other accrued liabilities consist primarily of clinical costs related to the Phase II clinical trials of CPC-111.

4. Long-Term Debt

As of July 31, 1997, the Company had an installment note payable to a financial institution of $41,367, all of which was classified as current. The outstanding balance was collateralized by $84,048 of the Company's short-term investments as of July 31, 1997. The installment note bears interest at the prime rate plus 1.6% (or 10.10% at July 31, 1997) and is being repaid in monthly installments through December 1997. Interest expense incurred on the installment note was $9,524, $19,897 and $29,947 for the years ended July 31, 1997, 1996, and 1995, respectively.

5. Commitments

Leases

The Company leases its office and research facilities under operating lease agreements and certain equipment under capital lease agreements. A security deposit of $64,260 under one of the facilities lease agreements is included in deposits and other assets.

5. Commitments (continued)

Minimum future obligations under both operating and capital leases as of July 31, 1997 are as follows:

	Operating Leases	Capital Leases
1998	$442,736	$130,982
1999	464,942	94,284
2000	491,649	62,734
2001	418,356	8,048
2002	127,310	-
	$1,944,993	296,048
Less amounts representing interest		(41,055)
Present value of net minimum lease payments		254,993
Current portion of capital lease obligations		(106,206)
Long-term capital lease obligations		$ 148,787

Rent expense totaled $420,697, $193,880 and $107,952 for the years ended July 31, 1997, 1996 and 1995, respectively. Equipment acquired under capital leases totaled $228,878 and $277,669 (net of accumulated amortization of $181,347 and $52,564) at July 31, 1997 and 1996, respectively.

Rent expense comprises the cost associated with two buildings leased by the Company, its current headquarters located at 2714 Loker Avenue West in Carlsbad, California and its former headquarters located at 2732 Loker Avenue West. In April 1996, the Company subleased its former headquarters for the remainder of the original lease plus an additional 36-month option. Total lease income included in other income totals $62,870 for the year ended July 31, 1997. Scheduled aggregate future income at July 31, 1997 is approximately $1,318,900. The Company is obligated to expend up to $200,000 in improvements for the sublessee but is receiving a rental rate that substantially exceeds the Company's rent expense on the building plus the amortization of these improvements.

Mandatorily Convertible Notes

During the year ended July 31, 1996, the Company issued $8 million

in principal amount of non-interest bearing mandatorily convertible notes (the "Notes") to institutional investors in private placements under the provisions of the Securities and Exchange Commission (the "SEC") Regulation D. The Notes are convertible at the option of the investors into shares of the Company's Common Stock at various dates from January 31, 1997 through July 31, 1999 at a discount to the market price of the stock immediately

5. Commitments (continued)

preceding conversion, ranging from 15% to 25%, with the actual discount depending on the length of time each investor has held the note being converted. The Notes must be converted at various dates through July 31, 1999. The Company is required to register with the SEC the shares of Common Stock issuable upon conversion of the Notes on or prior to the expiration of the allowable conversion periods. The Notes were originally classified as a component of shareholders' equity for several reasons, including the fact that they are non-interest-bearing and convertible only into Common Stock of the Company, absent unusual circumstances. However, on August 26, 1997, in conjunction with an SEC review of a registration statement filed by the Company and in consideration of certain positions formally adopted by the SEC in March 1997, the Company reclassified the Notes to long-term debt. The Notes were recorded net of the $1,582,935 discount available upon conversion (assuming full conversion at the earliest possible dates), and the discount represents an effective interest rate of 33%. The discount has been added to Common Stock and was amortized to expense during fiscal 1997.

As of July 31, 1997, $3,972,538 in principal amount of the Notes had been converted into 953,907 shares of Common Stock. Through October 9, 1997, $2,413,062 in principal amount was converted into 725,789 shares of Common Stock and $1,614,399 of Notes remain to be converted as of that date.

License Agreements

The Company has licenses to various patents for CPC-111 and Ceresine, its two clinical development programs, for the remaining term of the patents. The license agreements require payments of cash, warrants or the issuance of stock options to the licensers upon accomplishment of various milestones and the payment of royalties to the licensers upon the commercial sale of products incorporating the licensed compound. Under the agreement for Ceresine, the Company issued a warrant to the licensor in fiscal 1995 exercisable into 43,750 shares of the Company's Common Stock at an exercise price of $1.60 per share, as a result of completion of Phase I trials of that compound. The only remaining significant development milestone under these agreements is the requirement that the Company pay the licensor of CPC-111 $250,000 upon the filing of a New Drug Application with the Food and Drug Administration (the "FDA") for the approval to market that compound. In the event milestone or royalty payments to the licensor of CPC-111 are not made by the Company within specified time periods, that licensor may elect to terminate the license agreement and all rights thereunder. Such a termination could have a significant adverse impact upon the Company.

6. Shareholders' Equity

Preferred Stock

The Company has authorized 1,000,000 shares of convertible preferred stock. As of July 31, 1996 and 1997, no such shares were issued or outstanding.

Common Stock

During the year ended July 31, 1996, the Company purchased and retired 280,000 shares of its outstanding Common Stock at $5.50 per share in a privately negotiated transaction.

Warrants

In connection with the Company's initial public offering in 1992 (the "Offering"), the Company issued 2,875,000 Redeemable Class A and Class B Warrants. During fiscal years 1994 and 1995, the Company initiated special programs designed to encourage holders of Redeemable Class A Warrants to exercise their warrants

immediately (the "Special Class A Warrant Special Programs"). Under the Special Class A Warrant Programs, the Company received net proceeds of $10,497,005 from the exercise of 2,847,037 Redeemable Class A Warrants and the concurrent issuance of 3,345,236 shares of Common Stock and 1,423,512 Redeemable Class B Warrants.

Subsequent to the end of the Special Class A Warrant Programs, the Company issued a notice of mandatory redemption to the remaining holders of Class A Warrants. The holders of 20,250 Class A Warrants exercised their warrants under their original terms, resulting in $63,787 proceeds to the Company and the issuance of 20,250 shares of Common Stock. The Company repurchased all of the unexercised Class A Warrants outstanding at the end of the 30-day mandatory redemption period for $0.02 per warrant. As of July 31, 1997, there were no Redeemable Class A Warrants outstanding.

During the course of the Special Class A Warrant Programsthis period, all of the 250,000 Unit Purchase Options issued to the underwriter of the Offering were also exercised at $3.02 per option, and the 250,000 Redeemable Class A Warrants within such units were immediately exercised resulting in aggregate net proceeds of $1,681,266 and the concurrent issuance of 543,745 shares of Common Stock and 375,000 Redeemable Class B Warrants. The Company repurchased all of the remaining Class A Warrants outstanding at $0.05 per share. As of July 31, 1995, there were no Redeemable Class A Warrants outstanding.

The Company issued an additional warrant in 1995 exercisable into 312,500 shares of the Company's Common Stock at a purchase price of $5 per share to a firm as consideration for financial advisory services. In January 1996,the Company canceled the warrant and issued 200,000 shares of Common Stock at $3.39 in lieu of the canceled warrant.

6. Shareholders' Equity (continued)

As of July 31, 1997, 4,673,512 Redeemable Class B Warrants were outstanding. Warrant holders are entitled to purchase one share of Common Stock at $5.50 per share for each warrant until November 3, 1997. The Company is entitled to redeem the warrants on not less than 30 days written notice at $0.02 per warrant when the average closing bid price of the Common Stock exceeds $9.60 per share over a period of 20 consecutive trading days, ending within 15 days of the date of notice of redemption.

Stock Option Plans

The Company has elected to follow APB 25 in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided under FAS 123 requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma information regarding net loss and loss per share is required by FAS 123, and has been determined as if the Company has accounted for its employee stock options under the fair value method set forth in FAS 123. The fair value of these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for 1997 and 1996: risk-free interest rates of 6.0%; dividend yields of 0%; volatility factors of the expected market price of the Company's Common Stock of 84%; and the weighted-average life of the options of eight years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a single reliable measure of the fair value of its employee stock options. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The

Company's pro forma net loss for the years ended July 31, 1997 and 1996 is as follows:

	1997	1996
Pro forma net loss	$(7,658,837)	$(3,943,018)
Pro forma loss per share	$ (0.62)	$ (0.34)

6. Shareholders' Equity (continued)

The results above are not likely to be representative of the affects of applying FAS 123 on reported net income or loss for future years as these amounts reflect the expense for only one or two years of vesting. As of July 31, 1997, 2,266,288 shares of Common Stock were reserved for issuance under the 1992 Stock Option Plan (the "1992 Plan"). The 1992 Plan provides for the grant of incentive and nonstatutory stock options with various vesting periods, generally four years, to employees, directors and consultants. The exercise price of incentive stock options must equal at least the fair market value on the date of grant, and the exercise price of nonstatutory stock options may be no less than 85% of the fair market value on the date of grant. The maximum term of options granted under the 1992 Plan is ten years.

In June 1993, the Company adopted the 1993 Non-Employee Directors' Stock Option Plan (the "1993 Plan"), under which 250,000 shares of Common Stock were reserved for issuance. The 1993 Plan provides for the granting of 25,000 options to purchase Common Stock upon appointment as a non-employee director and an additional 3,000 options each January thereafter, beginning January 1, 1994. Options vest over four years. The exercise price of the options is 85% of the fair market value on the date of grant. The maximum term of options granted under the 1993 Plan is ten years.

The following table summarizes stock option activity under the 1992 and 1993 Plans:

	Options Outstanding	Weighted Average Exercise Price
Balance at July 31, 1994	946,625	$3.19
Granted	292,500	$5.28
Exercised	(183,312)	$2.89
Canceled	(37,813)	$4.33
Balance at July 31, 1995	1,018,000	$3.83
Granted	360,000	$5.30
Exercised	(10,000)	$3.52
Canceled	(12,188)	$5.40
Balance at July 31, 1996	1,355,812	$4.21
Granted	309,499	$4.33
Exercised	(7,750)	$2.83
Canceled	(219,215)	$4.47
Balance at July 31, 1997	1,438,346	$4.25

6. Shareholders' Equity (continued)

At July 31, 1997, options to purchase 1,009,152 shares of Common Stock were exercisable and there were 1,077,852 shares available for future grant under the 1992 and 1993 Plans.

The weighted average grant-date fair value for the options granted during 1997 and 1996 were $3.40 and $4.39, respectively.

Exercise prices and weighted average remaining contractual life for the options outstanding under the 1992 and 1993 Plans as of July 31, 1997 are as follows:

Options Outstanding				Options Exercisable	
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$1.44	97,500	5.00	1.44	97,500	$1.44
$2.20-$2.46	93,000	6.00	2.22	91,177	$2.22
$3.06-$4.00	440,500	7.17	3.50	322,789	$3.47
$4.05-$4.95	365,750	7.65	4.50	240,789	$4.54
$5.00-$5.75	320,437	7.22	5.42	179,844	$5.37
$6.00-$6.80	76,249	6.64	6.26	55,439	$6.22
$7.86-$8.50	45,000	8.00	8.04	21,614	$8.05
	1,438,436			1,009,152	

The Company has recorded deferred compensation for the difference between the price of options granted and the fair value of the Company's Common Stock. Deferred compensation is amortized to expense during the vesting period of the related stock or options.

7. Income Taxes

The Company accounts for income taxes using the liability method under Financial Accounting Standards Board Statement No. 109, Accounting for Income Taxes. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

7. Income Taxes (continued)

Significant components of the Company's deferred tax assets and liabilities as of July 31, 1997 and 1996 are as follows:

	1997	1996
Deferred tax assets:		
Net operating loss carryforwards	$4,554,000	$3,358,000
Capitalized research and development costs	547,000	404,000
Research and development tax credit carryforwards	530,000	378,000
Other - net	820,000	212,000
Total deferred tax assets	6,451,000	4,352,000
Valuation allowance	(6,451,000)	(4,352,000)
Net deferred tax assets	$ -	$ -

At July 31, 1997, the Company has federal and California tax net operating loss carryforwards of approximately $12,635,000 and $2,305,000, respectively. The federal and California tax loss carryforwards will begin and have begun to expire in 2007 and 1997, respectively, unless previously utilized. The Company also has federal and California research and development tax credit carryforwards of $413,000 and $183,000, respectively, which will begin expiring in 2007 unless previously utilized. The above carryforwards were determined as if the Company were filing a tax return at July 31, 1997; however, for tax return purposes the Company uses a calendar year end.

Use of the Company's net operating loss and credit carryforwards may be limited upon cumulative changes in ownership of more than 50%. However, the Company does not believe such limitations will have a material impact upon the Company's ability to utilize these carryforwards.

The valuation allowance increased $2,099,000 from July 31, 1996 to July 31, 1997 due principally to the increase in deferred tax assets resulting from the increase in tax net operating loss

carryforwards. Realization of deferred tax assets is dependent on future earnings, the timing and amount of which will be dependent on scientific success, results of clinical trials and regulatory approval of the Company's products currently under development. Accordingly, the full valuation reserve has been established to reflect these uncertainties.