TERCICA INC
Form 10-K/A
March 16, 2006
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005

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 No. 000-50461

TERCICA, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**26-0042539**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

2000 Sierra Point Parkway, Suite 400

Brisbane, CA 94005

(650) 624-4900

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, $0.001 par value

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated file in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

The aggregate market value of the registrant s common stock, $0.001 par value, held by non-affiliates of the registrant as of June 30, 2005 was $114,824,133 (based upon the closing sales price of such stock as reported in the Nasdaq National Market on such date). Excludes an aggregate of 18,357,639 shares of the registrant s common stock held by officers and directors and by each person known by the registrant to own 5% or more of the registrant s outstanding common stock as of June 30, 2005. 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.

As of February 24, 2006, there were 37,485,469 shares of the registrant s common stock, $0.001 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Form 10-K are incorporated by reference in Part III, Items 10-14 of this Form 10-K.

Table of Contents

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A (this Amendment) amends the Registrant s Annual Report on Form 10-K for the fiscal year ended December 31, 2005, originally filed on March 16, 2006 (the Original Filing). The Registrant is filing an amended report of its independent registered public accounting firm, Ernst & Young LLP, with respect to its balance sheets as of December 31, 2005 and 2004, and the related statements of operations, stockholders equity (deficit), and cash flows for each of the three years in the period ended December 31, 2005, and for the period from October 1, 2000 (inception) through December 31, 2005, and with respect to the financial statement schedule listed in the Index to the Original Filing at Item 15(a). The amended report corrects a typographical omission in the report included in the Original Filing. In addition, in connection with the filing of this Amendment and pursuant to the rules of the Securities and Exchange Commission, the Registrant is including with this Amendment currently dated management certifications.

Any items in the Original Filing that are not expressly changed hereby shall be as set forth in the Original Filing. All information contained in this Amendment No. 1 and the Original Filing is subject to updating and supplementing as provided in our subsequent periodic reports filed with the Securities and Exchange Commission.

Table of Contents

TERCICA, INC.

AMENDMENT NO. 1 TO FORM 10-K ANNUAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2005

TABLE OF CONTENTS

Table of Contents

Item 8. Financial Statements and Supplementary Data.

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

INDEX TO FINANCIAL STATEMENTS

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

Tercica, Inc.

We have audited the accompanying balance sheets of Tercica, Inc. (a development stage company) as of December 31, 2005 and 2004, and the related statements of operations, stockholders equity (deficit), and cash flows for each of the three years in the period ended December 31, 2005, and for the period from October 1, 2000 (inception) through December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tercica, Inc. at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, and for the period from October 1, 2000 (inception) through December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, In our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Tercica, Inc. s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Palo Alto, California

March 13, 2006

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

Tercica, Inc.

We have audited management s assessment, included in the accompanying Management s Annual Report on Internal Control over Financial Reporting at Item 9A, that Tercica, Inc. (a development stage company) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Tercica, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Tercica, Inc. maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Tercica, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria**.**

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets as of December 31, 2005 and 2004, and the related statements of operations, stockholders equity (deficit), and cash flows for each of the three years in the period ended December 31, 2005, and for the period from October 1, 2000 (inception) through December 31, 2005 of Tercica, Inc. (a development stage company) and our report dated March 13, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Palo Alto, California

March 13, 2006

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2005	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 14,817	$ 14,126
Short-term investments	43,809	37,875
Inventories	1,636	
Prepaid expenses and other current assets	1,673	705
Total current assets	61,935	52,706
Property and equipment, net	4,021	2,266
Restricted cash	340	
Other assets	20	50
Total assets	$ 66,316	$ 55,022
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 2,245	$ 3,967
Accrued expenses	5,750	3,032
Liability for early exercise of stock options	70	165
Total current liabilities	8,065	7,164
Deferred rent	1,429	
Other liabilities	24	181
Total liabilities	9,518	7,345
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value: 5,000,000 shares authorized, no shares issued and outstanding at December 31, 2005 and 2004		
Common stock, $0.001 par value: 100,000,000 shares authorized; 31,578,859 and 24,172,162 shares issued and outstanding at December 31, 2005 and 2004, respectively	32	24
Additional paid-in capital	225,100	173,621
Deferred stock compensation	(2,591)	(6,388)
Accumulated other comprehensive loss	(2)	(72)
Deficit accumulated during the development stage	(165,741)	(119,508)
Total stockholders equity	56,798	47,677
Total liabilities and stockholders equity	$ 66,316	$ 55,022

See accompanying notes.

4

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31,			Period From October 1, 2000 (Inception) Through December 31,
	2005	2004	2003	2005
Costs and expenses:				
Research and development*	$ 21,587	$ 27,918	$ 19,246	$ 71,212
Selling, general and administrative*	25,913	12,552	4,834	45,903
Acquired in-process research and development		1,417	1,670	8,158
Total costs and expenses	(47,500)	(41,887)	(25,750)	(125,273)
Interest expense	(1,080)			(1,186)
Interest and other income, net	2,347	885	327	3,746
Net loss	(46,233)	(41,002)	(25,423)	(122,713)
Deemed dividend related to beneficial conversion feature of convertible preferred stock			(44,153)	(44,153)
Net loss allocable to common stockholders	$ (46,233)	$ (41,002)	$ (69,576)	$ (166,866)
Basic and diluted net loss per share allocable to common stockholders	$ (1.51)	$ (2.12)	$ (38.59)	
Shares used to compute basic and diluted net loss per share allocable to common stockholders	30,590	19,302	1,803	
*** Includes non-cash stock-based compensation expense as follows:**				
Research and development	$ 1,188	$ 1,386	$ 791	$ 3,369
Selling, general and administrative	1,006	1,455	256	2,719
Total	$ 2,194	$ 2,841	$ 1,047	$ 6,088

See accompanying notes.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

(In thousands, except share and per share data)

	Class A and B		Common Stock				Accumulated Other Comprehensive Income (Loss)	Deficit Accumulated During Development Stage	Total Stockholders Equity (Deficit)
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Deferred Stock Compensation			
Balances at October 1, 2000 (inception)		$		$	$	$	$	$	$
Issuance of Tercica Limited Class A shares to founders for cash and intellectual property in March 2001	162,360	67							67
Issuance of Tercica Limited Class B shares to founders for cash and intellectual property in March 2001	725,449	465							465
Comprehensive loss:									
Foreign currency translation adjustment							(5)		(5)
Net loss								(294)	(294)
Comprehensive loss									(299)
Balances at March 31, 2001	887,809	532					(5)	(294)	233
Issuance of Tercica Limited Class B shares at $16.12 per share to founders for cash in July 2001	37,282	601							601
Comprehensive loss:									
Foreign currency translation adjustment							22		22
Net loss								(808)	(808)
Comprehensive loss									(786)
Balances at December 31, 2001	925,091	1,133					17	(1,102)	48
Issuance of common stock to founders at $0.0062 per share in February 2002			1,480,137	1	8				9
Liquidating distribution to shareholders and retirement of all outstanding Tercica Limited shares in March 2002	(925,091)	(1,133)						1,124	(9)
Issuance of common stock to a founder and employee at $0.0062 per share in February and May 2002			333,598	1	1				2
Issuance of stock options to consultants in exchange for services					6				6
Comprehensive loss:									
Reversal of foreign currency translation adjustment upon liquidation of Tercica Limited							(17)		(17)
Net loss								(8,952)	(8,952)
Comprehensive loss									(8,969)
Balances at December 31, 2002 (carried forward)		$	1,813,735	$ 2	$ 15	$	$	$ (8,930)	$ (8,913)

See accompanying notes.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT) (Continued)

(In thousands, except share and per share data)

	Class A and B		Common Stock					Deficit	Total
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Deferred Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated During Development Stage	Stockholders Equity (Deficit)
Balances at December 31, 2002 (brought forward)		$	1,813,735	$ 2	$ 15	$	$	$ (8,930)	$ (8,913)
Vesting of common stock from early exercises of stock options			255,739		102				102
Issuance of common stock			14,267		6				6
Deferred stock compensation					6,888	(6,888)			
Amortization of deferred stock compensation						904			904
Issuance of stock options to consultants in exchange for services					144				144
Beneficial conversion feature related to issuance of Series B convertible preferred stock					44,153				44,153
Deemed dividend related to beneficial conversion feature of convertible preferred stock								(44,153)	(44,153)
Comprehensive loss:									
Unrealized loss on marketable securities							(18)		(18)
Net loss								(25,423)	(25,423)
Comprehensive loss									(25,441)
Balances at December 31, 2003			2,083,741	2	51,308	(5,984)	(18)	(78,506)	(33,198)
Issuance of common stock upon net exercise of warrants			139,750						
Conversion of Series A convertible preferred stock to common stock			6,466,662	7	24,846				24,853
Conversion of Series B convertible preferred stock to common stock			8,830,646	9	43,775				43,784
Issuance of common stock upon initial public offering at $9.00 per share in March and April 2004, net of underwriting discount and offering expenses of $6,905			6,325,000	6	50,014				50,020
Vesting of common stock from early exercises of stock options			258,913		173				173
Issuance of common stock			67,450		260				260
Deferred stock compensation, net of forfeitures					3,138	(3,138)			
Amortization of deferred stock compensation						2,734			2,734
Issuance of stock options to consultants in exchange for services					107				107
Comprehensive loss:									
Unrealized loss on marketable securities							(54)		(54)
Net loss								(41,002)	(41,002)
Comprehensive loss									(41,056)

Balances at December 31, 2004 (carried forward)	$	24,172,162	$	24	$	173,621	$	(6,388)	$	(72)	$	(119,508)	$	47,677

See accompanying notes.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT) (Continued)

(In thousands, except share and per share data)

	Class A and B Shares	Class A and B Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deferred Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Deficit Accumulated During Development Stage	Total Stockholders Equity (Deficit)
Balances at December 31, 2004 (brought forward)		$	24,172,162	$ 24	$ 173,621	$ (6,388)	$ (72)	$ (119,508)	$ 47,677
Issuance of common stock upon initial public offering at $8.00 per share in February 2005, net of underwriting discount and offering expenses of $4,058			6,900,000	7	51,135				51,142
Vesting of common stock from early exercises of stock options			201,373	1	140				141
Issuance of common stock			192,824		806				806
Reversal of deferred stock compensation due to forfeitures					(1,695)	1,695			
Amortization of deferred stock compensation						2,102			2,102
Issuance of stock options to consultants in exchange for services					72				72
Stock-based compensation recognized due to stock option modifications					20				20
Issuance of common stock in connection with senior credit facility, net of issuance costs of $1			112,500		1,001				1,001
Financing cost of warrant issued in connection with committed equity financing facility					(1,196)				(1,196)
Issuance of warrant in connection with committed equity financing facility					1,196				1,196
Comprehensive loss:									
Unrealized gain on marketable securities							70		70
Net loss								(46,233)	(46,233)
Comprehensive loss									(46,163)
Balances at December 31, 2005		$	31,578,859	$ 32	$ 225,100	$ (2,591)	$ (2)	$ (165,741)	$ 56,798

See accompanying notes.

8

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,			Period From October 1, 2000 (Inception) Through December 31,
	2005	2004	2003	2005
Cash flows from operating activities:				
Net loss	$ (46,233)	$ (41,002)	$ (25,423)	$ (122,713)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	707	446	92	1,264
Loss on sale of equipment	76			76
Property and equipment written-off		9		17
Amortization of deferred stock compensation, net of forfeitures	2,102	2,734	904	5,740
(Accretion) / Amortization of (discounts) /premiums relating to available-for-sale securities	(701)	454	471	224
Amortization of debt issuance costs	1,002			1,002
Commitment fee written-off due to termination of senior credit facility	75			75
Stock compensation to consultants in exchange for services	72	107	143	328
Issuance of warrants in connection with convertible note				105
Issuance of stock in exchange for intellectual property				130
Acquired in-process research and development				4,071
Other	23			23
Changes in operating assets and liabilities:				
Prepaid expenses and other assets	(938)	2,101	(2,486)	(1,693)
Inventories	(1,636)			(1,636)
Restricted cash	(340)			(340)
Accounts payable	(1,722)	(1,384)	4,943	2,246
Accrued expenses	2,718	1,818	1,125	5,750
Deferred rent	1,429			1,429
Net cash used in operating activities	(43,366)	(34,717)	(20,231)	(103,902)
Cash flows from investing activities:				
Purchases of property and equipment	(2,838)	(407)	(2,298)	(5,678)
Proceeds received from sale of equipment	300			300
Purchases of available-for-sale securities	(110,641)	(113,184)	(63,653)	(287,478)
Proceeds from maturities and sales of available-for-sale securities	105,475	110,165	27,800	243,440
Net cash used in investing activities	(7,704)	(3,426)	(38,151)	(49,416)
Cash flows from financing activities:				
Net proceeds from issuance of Class A and B shares				1,004
Liquidating distribution to Tercica Limited shareholders				(9)
Net proceeds from issuance of preferred stock			43,784	63,800
Proceeds from issuance of convertible note				500
Proceeds from issuance of Series A convertible preferred stock for exercise of warrants			160	160
Proceeds from issuance of common stock, excluding early exercised options	806	260	6	1,083
Proceeds from early exercised options		40	511	622
Repurchases of unvested early exercised options	(111)			(111)
Payment of commitment fees for senior credit facility	(76)			(76)
Net proceeds from public offerings of common stock	51,142	50,020		101,162
Net cash provided by financing activities	51,761	50,320	44,461	168,135

Net increase (decrease) in cash and cash equivalents		691		12,177		(13,921)		14,817
Cash and cash equivalents, beginning of period		14,126		1,949		15,870		
Cash and cash equivalents, end of period	$	14,817	$	14,126	$	1,949	$	14,817
Supplemental schedule of noncash activities:								
Cash paid during the year for:								
Interest expense	$	75	$		$		$	75
Non-cash investing and financing activities:								
Issuance of stock in exchange for intellectual property	$		$		$		$	129
Issuance of Series A convertible preferred stock to a collaboration partner in exchange for acquired in-process research and development	$		$		$		$	4,071
Issuance of warrants in connection with convertible note	$		$		$		$	106
Issuance of warrants as commissions in connection with Series A preferred stock financing	$		$		$		$	41
Conversion of convertible note into Series A convertible preferred stock	$		$		$		$	500
Issuance of common stock from vesting of early exercises of stock options	$	140	$	173	$	102	$	415
Issuance of common stock for senior credit facility	$	1,001	$		$		$	1,001
Issuance of warrant in connection with committed equity financing facility	$	1,196	$		$		$	1,196
Deferred stock compensation, net of forfeitures	$	(1,695)	$	3,138	$	6,888	$	8,331
Deemed dividend related to beneficial conversion feature of convertible preferred stock	$		$		$	44,153	$	44,153
Conversion of Series A and B convertible preferred stock into common stock	$		$	68,637	$		$	68,637

See accompanying notes.

9

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS

1. Company and Basis of Presentation

Basis of Presentation

Tercica, Inc. (the Company) is a biopharmaceutical company focused on the development and commercialization of new therapeutics for the treatment of short stature and other endocrine disorders. The Company s first commercial product is Increlex , a DNA-derived recombinant human insulin-like growth factor-1 (rhIGF-1). The Company obtained approval for the long-term treatment of growth failure in children with severe primary insulin-like growth factor deficiency, or severe Primary IGFD, or with growth hormone gene deletion who have developed neutralizing antibodies to growth hormone from the U.S. Food and Drug Administration (FDA) in August 2005, and Increlex was granted seven years of orphan drug marketing exclusivity for the long-term treatment of growth failure in children with severe Primary IGFD. In January 2006, the Company launched Increlex in the United States. The Company also submitted a Marketing Authorization application (MAA) in the European Union for the long-term treatment of growth failure in children with severe Primary IGFD or with growth hormone gene deletion who have developed neutralizing antibodies to growth hormone. The Company licensed the rights of Genentech to develop, manufacture and commercialize rhIGF-1 products for a broad range of indications, including short stature, worldwide. The Company s current focus is on marketing and selling Increlex for the treatment severe Primary IGFD, and developing Increlex as a replacement therapy for primary IGF-1 deficiency, or Primary IGFD. The Company defines the indication Primary IGFD to mean a child who has a height standard deviation score (Height SDS) and an IGF-1 standard deviation score (IGF-1 SDS), of less than minus two, and the indication severe Primary IGFD to mean a child who has a Height SDS and IGF-1 SDS of minus three or less, in each case in the presence of normal or elevated levels of growth hormone. The Company is developing Increlex for use in the broad population of children with Primary IGFD. The Company is currently conducting two late-stage clinical trials for the use of rhIGF-1 in Primary IGFD. The Company is also assessing their Increlex development strategy for other indications.

The Company s predecessor, Tercica Limited, a New Zealand Company, was formed in October 2000. Tercica Medica, Inc. was incorporated in Delaware in December 2001, adopted the calendar year as its fiscal year and subsequently changed its name in September 2003 to Tercica, Inc. In early 2002, the Company acquired (at amounts approximating Tercica Limited s historical net book value) an immaterial amount of assets, including intellectual property rights, from Tercica Limited as its operations were moved from New Zealand to California. In March 2002, Tercica Limited made a final, immaterial distribution to its stockholders in connection with its legal liquidation.

These development stage financial statements and accompanying notes include the results of operations from the inception of Tercica Limited in October 2000 as both entities were under common control as evidenced by the following factors: (i) all of the investors of Tercica Limited were founding stockholders of the Company, (ii) substantially all of the employees of Tercica Limited became employees of the Company, (iii) the nearly identical business plans adopted by both entities and (iv) the commencement of negotiations to obtain the license for recombinant human insulin-like growth factor-1 (rhIGF-1) from Genentech, Inc. by Tercica Limited, and the completion of those negotiations by the Company.

The Company is considered to be in the development stage at December 31, 2005, as its primary activities since incorporation have been establishing its facilities, recruiting personnel, conducting research and development, business development, business and financial planning, preparing for the commercialization of Increlex and raising capital.

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

Initial Public Offering

On March 22, 2004, the Company completed its initial public offering of 5,500,000 shares of its common stock, at $9.00 per share. Net cash proceeds of the initial public offering were approximately $43,116,000, after deducting underwriter discounts, commissions and other offering expenses. In conjunction with the closing of the initial public offering, all of the Company s outstanding shares of Series A and Series B convertible preferred stock outstanding at the time of the offering were automatically converted into 15,297,308 shares of common stock.

On March 30, 2004, the underwriters of the Company s initial public offering exercised in full their over-allotment option for 825,000 shares of its common stock. On April 2, 2004, the Company received the net cash proceeds of approximately $6,905,000, after deducting underwriter discounts, commissions and other offering expenses.

In connection with the Company s initial public offering, all outstanding warrants to purchase 146,250 shares of common stock were net exercised resulting in 139,750 shares of common stock issued, with the warrant for the remaining 6,500 shares relinquished as non-cash payment.

Follow-on Public Offerings

On February 11, 2005, the Company completed a follow-on public offering of 6,900,000 shares of its common stock, at a price to the public of $8.00 per share, including the exercise of the over-allotment option by the underwriters. Net cash proceeds from this offering were approximately $51,100,000 after deducting underwriter discounts and other offering expenses.

On September 9, 2005, the Company filed a shelf registration statement with the SEC pursuant to which the Company may, from time to time, offer and sell shares of the Company s common stock and preferred stock, various series of debt securities and/or warrants to purchase any of such securities, either individually or in units, in one or more offerings, with a total value of up to $75,000,000, at prices and on terms to be determined by market conditions at the time of any offering made under the shelf registration statement. The SEC declared the shelf registration statement effective on December 1, 2005. On January 27, 2006, the Company completed the sale of 5,750,000 shares of its common stock under this shelf registration statement, at a price to the public of $6.40 per share, including the exercise of the over-allotment option by the underwriters. Net cash proceeds from this offering were approximately $34,100,000 after deducting underwriter discounts and other offering expenses.

Need to Raise Additional Capital

The Company has incurred significant net losses and negative cash flows from operations since its inception. At December 31, 2005, the Company had an accumulated deficit of $165,741,000. After considering the net cash proceeds obtained in January 2006, as described above, management believes that currently available resources, including cash, cash equivalents and short-term investments and the Committed Equity Financing Facility (See Note 8), will provide sufficient funds to enable the Company to meet its projected operating and capital expenditure requirements through at least the end of 2007 based on the Company s current business plan. If anticipated operating results are not achieved, however, management believes that planned expenditures may need to be reduced, extending the time period over which the currently available resources will be adequate to fund the Company s operations. The Company intends to raise additional funds through the issuance of equity securities, if available on terms acceptable to the Company.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

2. Summary of Significant Accounting Policies

Use of Estimates

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

Concentrations

Financial instruments that potentially subject the Company to credit risk consist of cash, cash equivalents and short-term investments to the extent of the amounts recorded on the balance sheets. The Company s cash, cash equivalents and short-term investments are placed with high credit-quality financial institutions and issuers. The Company believes its established guidelines for investment of its excess cash maintain safety and liquidity through its policies on diversification and investment maturity.

The Company sources all if its bulk manufacturing and fill-finish manufacturing through single-source third-party suppliers and contractors and the Company obtains specific components and raw materials used to manufacture Increlex from either single-source or sole-source suppliers. If these contract facilities, suppliers or contractors become unavailable to the Company for any reason, the Company may be delayed in manufacturing Increlex or may be unable to maintain validation of Increlex, which could delay or prevent the supply of commercial and clinical product, or delay or otherwise adversely affect revenues. The Company believes that it has established guidelines to maintain an adequate level of inventory to mitigate this potential negative impact.

Cash, and Cash Equivalents, Short-Term Investments and Restricted Cash

The Company considers all highly liquid investments with a remaining maturity of 90 days or less at the date of purchase to be cash equivalents. Cash equivalents are carried at cost, which approximates fair value. The Company s cash equivalents include interest-bearing money market funds. The Company s short-term investments primarily consist of readily marketable debt securities with remaining maturities of more than 90 days at the time of purchase.

The Company has classified its entire investment portfolio as available-for-sale. These securities are recorded as either cash equivalents or short-term investments and are carried at fair value with unrealized gains or losses included in accumulated other comprehensive income (loss) in the stockholders equity (deficit). The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion are included in interest and other income, net. Realized gains and losses are also included in interest and other income, net. The cost of all securities sold is based on the specific identification method.

The Company obtained a $340,000 irrevocable letter of credit in conjunction with a lease agreement for its facility. The letter of credit is collateralized for the same amount by cash, cash equivalents and short-term investments held in a Company bank account and has been recorded as restricted cash (see Note 6) in the accompanying balance sheet.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

The following is a summary of available-for-sale securities (in thousands):

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale debt securities maturing within 1 year:				
Auction market preferred	$ 36,150	$	$	$ 36,150
Commercial paper	13,468	3		13,471
Federal agency bonds	5,477		(5)	5,472
Repurchase agreements	3,000			3,000
Total available-for-sale debt securities	$ 58,095	$ 3	$ (5)	$ 58,093

	December 31, 2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale debt securities maturing within 1 year:				
Corporate bonds	$ 5,815	$	$ (14)	$ 5,801
Commercial paper	9,346		(2)	9,344
Federal agency bonds	19,759		(26)	19,733
Municipal bonds	9,753		(30)	9,723
Total available-for-sale debt securities	$ 44,673	$	$ (72)	$ 44,601

The Company s financial instruments are classified as follows (in thousands):

	December 31,	
	2005	2004
Cash	$ 873	$ 7,400
Cash equivalents	13,944	6,726
Cash and cash equivalents	14,817	14,126
Short-term investments	43,809	37,875
Long-term restricted cash	340	
Total	$ 58,966	$ 52,001

Realized losses on the sale of available-for-sale securities for the years ended December 31, 2005 and 2004 were immaterial.

Fair Value of Financial Instruments

The carrying amounts of financial instruments, which include cash equivalents, short-term investments, restricted cash, accounts payable, accrued expenses and long-term obligations approximate their fair values due to the relatively short maturities.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

Inventories

Inventories are stated at the lower of cost or market and consist primarily of contract manufacturing costs for the production of Increlex that were incurred subsequent to the approval for marketing by the FDA. Cost is determined using the first-in, first-out basis. The valuation of inventory requires the Company to estimate obsolete or excess inventory based on analysis of future demand for Increlex. If inventory costs exceed expected market value due to obsolescence or lack of demand, reserves may be recorded as deemed necessary by management for the difference between the cost and the market value. These reserves are determined based on significant estimates by management and will be recorded as a write-down to net realizable value in the period that impairment is first recognized.

Research and Product Development Costs

In accordance with Statement of Financial Accounting Standards (SFAS) No. 2, *Accounting for Research and Development Costs*, research and development costs are expensed as incurred. Research and development expenses consist primarily of contract manufacturing expenses associated with manufacturing development activities, clinical activities, regulatory activities, payroll and related costs, non-cash stock compensation, laboratory supplies and certain allocated costs. Manufacturing development primarily includes costs associated with process development and validation, quality control and assurance activities, analytical services and preparation for current good manufacturing practices (cGMP) in order to provide clinical drug supply.

Acquired In-Process Research and Development

Acquired in-process research and development relates to in-licensed technology, intellectual property and know-how. The nature of the remaining efforts for completion of research and development activities surrounding rhIGF-1 generally include completion of clinical trials, completion of manufacturing validation, interpretation of clinical and preclinical data and obtaining marketing approval from the FDA and other foreign regulatory bodies, the cost, length and success of which are extremely difficult to determine. Numerous risks and uncertainties exist with timely completion of development projects, including clinical trial results, manufacturing process development results, ongoing feedback from regulatory authorities, including obtaining marketing approval. In addition, products under development may never be successfully commercialized due to the uncertainties associated with the pricing of new pharmaceuticals, the cost of sales to produce these products in a commercial setting, changes in the reimbursement environment, or the introduction of new competitive products. As a result of the uncertainties noted above, the Company charges in-licensed intellectual property and licenses for unapproved products to acquired in-process research and development.

Clinical Trial Expenses

The Company contracts with third-party clinical research organizations to perform various clinical trial activities. The Company recognizes research and development expenses for these contracted activities based upon a variety of factors, including actual and estimated patient enrollment rates, clinical site initiation activities, labor hours and other activity-based factors. The Company matches the recording of expenses in the financial statements to the actual services received and efforts expended. Depending on the timing of payments to the service providers, the Company records prepaid expenses and accruals relating to clinical trials based on the estimate of the degree of completion of the event or events as specified each clinical study or trial contract. The Company monitors each of these factors to the extent possible and adjusts estimates accordingly.

Promotional and Advertising Expenses

The Company expenses the costs of promotional and advertising expenses, as incurred. Promotional and advertising expenses consist primarily of promotional materials and activities, design and layout costs of

14

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

promotional materials, and direct mail advertising. Promotional and advertising expenses were $1,069,000, $75,000 and $0 in the years ended December 31, 2005, 2004 and 2003, respectively.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, but not more than:

Description	Estimated Useful Lives
Computer equipment and software	3 years
Office equipment	5 years
Furniture and fixtures	7 years
Manufacturing equipment	10 years
Leasehold improvements	Shorter of useful life or life of lease

Impairment of Long-Lived Assets

The Company reviews its long-lived assets, including property and equipment, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. Impairment, if any, is assessed using discounted cash flows.

Income Taxes

The Company utilizes the liability method of accounting for income taxes as required by SFAS No. 109, *Accounting for Income Taxes*. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Currently, there is no provision for income taxes as the Company has incurred operating losses to date.

Stock Compensation

Through December 31, 2005, the Company accounted for employee stock options using the intrinsic-value method in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, Financial Accounting Standards Board Interpretation (FIN) No. 44, *Accounting for Certain Transactions involving Stock Compensation*, *an interpretation of APB No. 25*, and related interpretations and adopted the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* as amended.

The information regarding net loss as required by SFAS No. 123 has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

The fair value of each option grant is estimated at the date of grant using the Black-Scholes method with the following weighted-average assumptions:

	Year Ended December 31,		
	2005	2004	2003
Risk-free interest rate	3.8%	2.9%	2.8%
Volatility	0.5	0.8	0.8
Weighted-average expected life of options (years)	3.6	3.8	4.0
Dividend yield	0.0%	0.0%	0.0%

During the period from February 1, 2003 through January 31, 2004, certain stock options were granted with exercise prices that were below the reassessed fair value of the common stock at the date of grant. Total deferred compensation of $6,888,000 was recorded in accordance with APB Opinion No. 25, and is being amortized over the related vesting period of the options. The Company recorded employee stock-based compensation expense of $2,102,000, $2,734,000 and $904,000 for the years ended December 31, 2005, 2004 and 2003, respectively. During the years ended December 31, 2005 and 2004, the Company reversed $1,695,000 and $847,000, respectively, of deferred stock compensation due to forfeitures of unvested stock options resulting from employee terminations.

The following table illustrates the effect on net loss allocable to common stockholders had the Company applied the fair value provisions of SFAS No. 123 to employee stock compensation (in thousands, except per share data):

	Year Ended December 31,			Period From October 1, 2000 (Inception) Through December 31,
	2005	2004	2003	2005
Net loss allocable to common stockholders, as reported	$ (46,233)	$ (41,002)	$ (69,576)	$ (166,866)
Plus: Employee stock compensation expense based on intrinsic value method	2,102	2,734	904	5,740
Less: Employee stock compensation expense determined under the fair value method for all awards	(4,424)	(3,307)	(976)	(8,728)
Pro forma net loss allocable to common stockholders	$ (48,555)	$ (41,575)	$ (69,648)	$ (169,854)
Net loss per share allocable to common stockholders:				
Basic and diluted, as reported	$ (1.51)	$ (2.12)	$ (38.59)	
Basic and diluted, pro forma	$ (1.59)	$ (2.15)	$ (38.63)	

Stock compensation arrangements to non-employees are accounted for in accordance with SFAS No. 123, as amended by SFAS No. 148, and Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Equity Instruments that Are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, using a fair value approach. The compensation costs of these arrangements are subject to remeasurement over the vesting terms as earned.

On December 16, 2004, the FASB issued an amendment to SFAS No. 123, *Share-Based Payment,* (SFAS No. 123R). The Company adopted SFAS No. 123R as of January 1, 2006. SFAS No. 123R addresses the accounting for transactions in which an enterprise receives employee services in exchange for equity instruments

16

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

of the enterprise or liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, and requires instead that such transactions be accounted for using a fair-value-based method. Companies are required to recognize an expense for compensation cost related to share-based payment arrangements including stock options and employee stock purchase plans. The Company has selected the Black-Scholes option-pricing model to be used for valuing share-based payments. The Company has also selected the modified prospective transition method, whereby compensation cost is recognized based on the requirements of SFAS No. 123R beginning with the effective date (a) for all share-based payments granted after the effective date and (b) for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. The Company believes that the adoption of the new standard will have a material impact on the Company s results of operations. The Company expects to continue to grant stock-based compensation to employees. The estimate of the Company s future stock-based compensation expense is affected by the Company s stock price, the number of stock-based awards the Company s board of directors may grant in the future, as well as a number of complex and subjective valuation assumptions and the related tax effect. These valuation assumptions include, but are not limited to, the volatility of the Company s stock price and employee stock option exercise behaviors.

Comprehensive Loss

Comprehensive loss is comprised of net loss, foreign currency translation adjustment and unrealized gains/losses on available-for-sale securities in accordance with SFAS No. 130, *Reporting Comprehensive Income*. The following table presents the calculation of comprehensive loss (in thousands):

	Year Ended December 31,		
	2005	2004	2003
Net loss, as reported	$ (46,233)	$ (41,002)	$ (25,423)
Change in unrealized losses on marketable securities	70	(54)	(18)
Comprehensive loss	$ (46,163)	$ (41,056)	$ (25,441)

Foreign Currency Translation

The functional currency of Tercica Limited was New Zealand Dollars. Accordingly, through December 31, 2001, the Company s assets and liabilities were translated into U.S. dollars using the exchange rates in effect at each balance sheet date, while income and expense items were translated using average rates of exchange during each period. Gains or losses from translation were included in accumulated other comprehensive loss. Net gains and losses resulting from foreign currency transactions were recorded in net loss in the period incurred and were not significant for any period presented.

Reclassifications

Certain other amounts in prior periods have been reclassified to conform to the current period presentation.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

3. Net Loss Per Share

Basic net loss per share allocable to common stockholders is calculated by dividing the net loss allocable to common stockholders by the weighted-average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted net loss per share allocable to common stockholders is computed by dividing the net loss allocable to common stockholders by the weighted-average number of common share equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, common stock subject to repurchase by the Company, preferred stock, options, and warrants are considered to be common stock equivalents and are only included in the calculation of diluted net loss per share allocable to common stockholders when their effect is dilutive.

	Year Ended December 31,		
	2005	2004	2003
	(In thousands, except per share data)		
Historical			
Numerator:			
Net loss allocable to common stockholders	$ (46,233)	$ (41,002)	$ (69,576)
Denominator:			
Weighted-average common shares outstanding	30,619	19,377	1,928
Less: Weighted-average unvested common shares subject to repurchase	(29)	(75)	(125)
Denominator for basic and diluted net loss per share allocable to common stockholders	30,590	19,302	1,803
Basic and diluted net loss per share allocable to common stockholders	$ (1.51)	$ (2.12)	$ (38.59)

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
Historical outstanding dilutive securities not included in diluted net loss per share allocable to common stockholders calculation			
Preferred stock			15,297
Options to purchase common stock	2,851	2,077	1,202
Warrant	260		146
	3,111	2,077	16,645

4. Balance Sheet Details

Inventories consisted of the following (in thousands):

December 31,

		2005
Raw materials	$	319
Work-in-process		1,229
Finished goods		88
Total	$	1,636

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

Property and equipment, net, consists of the following (in thousands):

	December 31,	
	2005	2004
Office equipment	$ 292	$ 292
Furniture and fixtures	628	197
Computer equipment and software	1,683	800
Manufacturing equipment	1,004	
Leasehold improvements	1,450	168
Construction in progress	175	1,352
Less accumulated depreciation and amortization	(1,211)	(543)
Property and equipment, net	$ 4,021	$ 2,266

Depreciation expense was $707,000, $446,000 and $92,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

Accrued liabilities consist of the following (in thousands):

	December 31,	
	2005	2004
Accrued compensation and related liabilities	$ 2,626	$ 1,555
Accrued professional fees	1,577	460
Accrued contract manufacturing expenses	543	946
Clinical trial costs	276	
Other accrued liabilities	728	71
	$ 5,750	$ 3,032

5. License and Collaboration Agreement

On April 15, 2002, the Company entered into a license and collaboration agreement (the U.S. License and Collaboration Agreement) with Genentech under which it obtained licenses to certain technology, know-how, and intellectual property rights to develop and commercialize rhIGF-1 in the U.S.

In connection with the U.S. License and Collaboration Agreement, the Company paid $1,000,000 in cash and issued 1,017,666 shares of Series A convertible preferred stock valued at the time of issuance at $4,071,000. The Company is required to make cash payments based on the achievement of certain milestones and royalties on future sales. Genentech has certain Opt-In rights to participate in the commercialization of certain rhIGF-1 products. If Genentech elects to exercise its Opt-In Right for a particular indication, Genentech will pay the Company more than 50% of the past development costs associated with that indication, which would have a one-time positive impact on the Company s operating results. In addition, after Genentech exercises its Opt-In Right for a particular indication, the Company would share with Genentech the ongoing net operating losses and profits resulting from the joint development and commercialization effort for that indication. Pursuant to this arrangement, the Company would fund less than 50% of such operating losses and the Company would receive less than 50% of any profits. In 2004 and early 2006, the Company paid Genentech cash of $1,100,000 and $100,000, respectively, under this agreement.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

On July 25, 2003, the Company entered into an international license and collaboration agreement (the International License and Collaboration Agreement) with Genentech, obtaining certain rights to develop and commercialize rhIGF-1 for a broad range of indications, including short stature, outside of the United States. The Company paid Genentech cash of $1,670,000 upon the execution of this license in 2003 and $167,000 in 2004. The Company also agreed to pay to Genentech royalties on the sales of rhIGF-1 products and certain one-time payments upon the occurrence of specified milestone events. As the Company was several years away from having an approved product to market, the amount paid for this license was charged to acquired in-process research and development expense.

In addition to the amounts already paid to Genentech, if the Company achieves all of the additional milestones for rhIGF-1 under the U.S. and International License and Collaboration Agreements, the Company will owe Genentech up to an aggregate of approximately $33,000,000 in milestone payments. If the Company develops rhIGF-1 in combination with IGF binding protein-3, the Company would be subject to these same milestone events and, upon achievement of all of the milestones, would owe Genentech up to an additional aggregate of approximately $32,500,000 in milestone payments. In connection with the U.S. License and Collaboration Agreement, the Company paid a $1,000,000 milestone payment to Genentech in the year ended December 31, 2005.

6. Commitments and Contingencies

The Company leases approximately 28,000 square feet of office space in Brisbane, California. The lease expires in October 2011 with an option to renew for five years. This lease agreement includes scheduled rent increases over the lease term and rent abatement for the first 15 months. The Company recognizes rent expense on a straight-line basis over the term that the facility is physically utilized, taking into account the scheduled rent increases, rent abatement, rent holidays and the leasehold improvement reimbursement. In September 2005, the Company received a $1,046,000 reimbursement from the landlord for facility improvements, which was recorded as deferred rent and is being amortized to offset rent expense over the remaining life of the lease. Under the lease agreement, the Company originally provided the landlord with irrevocable letters of credit amounting to $790,000, which were subsequently reduced to $340,000 in September 2005 after the FDA approved Increlex for marketing in late August 2005. The remaining irrevocable letter of credit is collateralized for the same amount by cash, cash equivalents and short-term investments held in a Company bank account. The Company has recorded the collateralized bank account balance as restricted cash.

At December 31, 2005, future minimum lease commitments under operating leases were as follows (in thousands):

Year ending December 31,	
2006	$ 116
2007	710
2008	740
2009	756
2010	789
Thereafter	631
	$ 3,742

Rent expense was $641,000, $453,000 and $238,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

Manufacturing Services Agreement

In December 2002, the Company entered into a development and commercial supply agreement (the Manufacturing Agreement) with Cambrex Bio Science Baltimore, Inc. (Cambrex Baltimore). At that time, the Company began to transfer its manufacturing technology to Cambrex Baltimore in order for them to establish the process for rhIGF-1 fermentation and purification. Further, under the terms of the Manufacturing Agreement, Cambrex Baltimore is obligated to annually provide the Company with certain minimum quantities of bulk rhIGF-1 drug substance. The Company has a non-cancelable obligation to reimburse Cambrex Baltimore on a time and materials and per batch basis in connection with the commercial production of Increlex of approximately $4,482,000 through December 31, 2006. Further, as the Company reaches certain milestones, the Company will be committed to make certain future purchases. Payments under this agreement were $6,887,000, $11,699,000 and $7,203,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

Guarantees and Indemnifications

In November 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others* (FIN No. 45). FIN No. 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligations it assumes under that guarantee.

The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company s request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The Company may terminate the indemnification agreements with its officers and directors upon 90 days written notice, but termination will not affect claims for indemnification relating to events occurring prior to the effective date of termination. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and may enable it to recover a portion of any future amounts paid. The Company believes the fair value of these indemnification agreements is minimal. Accordingly, the Company has not recorded any liabilities for these agreements as of December 31, 2005.

Contingencies

On December 20, 2004, the Company initiated patent infringement proceedings against Avecia Limited and Insmed Incorporated as co-defendants in the High Court of Justice (Chancery Division Patents Court) in the United Kingdom. There is no trial date set for this action. On December 23, 2004, the Company, with Genentech, initiated patent infringement proceedings against Insmed Incorporated in the U.S. District Court for the Northern District of California. The Company initiated these litigations because it believes that Insmed and Avecia are infringing and/or have infringed on the Company s patents that cover Insmed s product s use and manufacture. The trial date is November 6, 2006; however, on March 8, 2006, we filed a motion to accelerate the trial date.

The Company cannot predict the outcome of its litigation against Avecia and Insmed in the United Kingdom or the outcome of its litigation against Insmed in the United States. Moreover, the Company cannot predict the cost of such litigation, which may require a substantial diversion of the Company s financial assets and other resources and consequently prevent the Company from allocating sufficient resources to the development of its rhIGF-1 programs, and which may have a material adverse effect on the Company s business. In addition, if the outcome of the Company s litigation in the United Kingdom is not favorable to the Company, the Company is likely to be found liable for the opposing parties costs incurred in connection with the litigation, and the

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

Company could be found liable for an award of additional damages to the opposing parties if the court decides that the Company s claims of patent infringement are without sufficient merit or not pursued in good faith. If in the Company s litigation in the United States, the court decides that a defendant prevails, and the defendant establishes by clear and convincing evidence that the case is exceptional (e.g., the Company s claims of patent infringement were not pursued in good faith), the Company could be liable for an award of the opposing party s costs and legal fees incurred in connection with the litigation and/or an award of other damages. Any such award or awards to the opposing parties could substantially increase the Company s costs and exacerbate the negative impact that an unfavorable outcome in the case(s) could have on the Company s business. Further, it is not uncommon in cases of this kind for a defendant to assert counterclaims, which could significantly increase the Company s costs, potential liability for damages, and other risks arising from these lawsuits, and a court could find the Company liable for any such damages caused by Genentech as well.

On December 6, 2005, we filed a complaint against Insmed for False Advertising and Unfair Competition, Case No. C-05-5027 SBA, in the U.S. District Court, Northern District of California. The complaint alleges that Insmed made false, misleading and deceptive statements about Increlex and its product. We are seeking monetary and injunctive relief. We filed an amended complaint on December 15, 2005. Defendant Insmed filed a Motion to Dismiss on January 13, 2006. The motion is scheduled to be heard on March 28, 2006. Discovery has not commenced, and no trial date has been set.

From time to time, the Company may become involved in claims and other legal matters arising in the ordinary course of business. Management is not currently aware of any other matters that may have a material adverse affect on the financial position, results of operations or cash flows of the Company.

7. Senior Credit Facility

On January 21, 2005, the Company entered into a Loan Agreement (the Loan Agreement) with Venture Leasing & Lending IV, Inc. (VLL) under which the Company had the option to draw down funds in the aggregate principal amount of up to $15,000,000 through December 31, 2005. The Company paid a $75,000 fee as part of this Loan Agreement and issued a total of 112,500 shares of its common stock to an affiliate of VLL. The 112,500 shares of common stock issued were recorded at fair market value on the dates of issuance of $1,002,000. As of December 31, 2005, the entire amount was recognized as interest expense. The facility expired on December 31, 2005, and the Company did not borrow any funds under this facility.

8. Committed Equity Financing Facility

On October 14, 2005, the Company entered into a committed equity financing facility (CEFF) with Kingsbridge Capital Limited (Kingsbridge), which entitles the Company to sell and obligates Kingsbridge to purchase, a maximum of approximately 6.0 million newly issued shares of the Company s common stock over a period of three years for cash up to an aggregate of $75,000,000, subject to certain conditions and restrictions. The Company may draw down under the CEFF in tranches of up to the lesser of $7,000,000 or 2% of the Company s market capitalization at the time of the draw down of such tranche, subject to certain conditions. The common stock to be issued for each draw down will be issued and priced over an eight-day pricing period at discounts ranging from 6% to 10% from the volume weighted average price of the Company s common stock during the pricing period. During the term of the CEFF, Kingsbridge may not short the Company s stock, nor may it enter into any derivative transaction directly related to the Company s stock. The minimum acceptable purchase price, prior to the application of the appropriate discount for any shares to be sold to Kingsbridge during the eight-day pricing period, is determined by the greater of $3.00 or 90% of the Company s closing share

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

price on the trading day immediately prior to the commencement of each draw down. In connection with the CEFF, the Company issued a warrant to Kingsbridge to purchase up to 260,000 shares of the Company s common stock at an exercise price of $13.12 per share. The exercise term of the warrant is five years beginning on April 14, 2006. The warrant was valued on the date of grant using the Black-Scholes method using the following assumptions: a risk-free interest rate of 4.1%, a life of 5.5 years, no dividend yield and a volatility factor of 0.5. The estimated value of this warrant was $1,196,000 and was recorded as a contra-equity amount in additional paid-in capital in 2005.

On November 9, 2005 the Company filed a shelf registration statement with the SEC relating to the resale of up to 6,296,912 shares of common stock that the Company may issue to Kingsbridge pursuant to a common stock purchase agreement and warrant agreement noted above. The Company will not sell common stock under this registration statement and will not receive any of the proceeds from the sale of shares by the selling stockholder.

9. Stockholders Equity Tercica Limited

Class A and B Shares

At December 31, 2001, Tercica Limited was authorized to issue 162,360 shares of its Class A shares and 763,952 shares of its Class B shares.

Holders of the Tercica Limited Class A shares were entitled to 20% of dividends, if any, voting rights, and surplus in the event of a liquidation or winding up of the Company. A shareholder with 10% or more of the Class A shares had the right to appoint one director to the Board.

Holders of the Tercica Limited Class B shares were entitled to 80% of dividends, if any, voting rights, and surplus in the event of a liquidation or winding up of the Company.

10. Stockholders Equity (Deficit) Tercica, Inc.

Common Stock

At December 31, 2004 and 2005, the Company was authorized to issue 100,000,000 shares of common stock.

On September 11, 2003, the Company changed the par value of its common stock from $0.0064 per share to $0.001 per share.

Preferred Stock

As of December 31, 2005 and 2004, the Company was authorized to issue 5,000,000 shares of preferred stock. The board of directors has the authority, without action by its stockholders, to designate and issue shares of preferred stock in one or more series. The board of directors may also designate the rights, preferences and powers of each series of preferred stock, any or all of which may be greater than the rights of the common stock including restrictions of dividends on the common stock, dilution of the voting power of the common stock, reduction of the liquidation rights of the common stock, and delaying or preventing a change in control of the Company without further action by the stockholders. To date, the board of directors has not designated any rights, preference or powers of any preferred stock and no shares have been issued.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

Restricted Stock Purchases and Early Exercise of Options

In February 2002, 328,158 restricted shares of common stock were issued to an employee in exchange for $2,000 in cash. As of December 31, 2004 and 2005, 50,623 and 3,895 of these shares, respectively, were subject to repurchase by the Company. These shares are subject to a repurchase option held by the Company at the original issuance price. This right lapses 25% on the first anniversary of the agreement and in 36 equal monthly amounts thereafter.

In December 2002, the Company issued 692,943 shares of its common stock to two employees under restricted stock purchase agreements pursuant to the early exercise of their stock options for $71,000 in cash in December 2002 and $206,000 in cash in January 2003. During 2003, the Company issued 237,500 shares of common stock under restricted stock purchase agreements to three employees pursuant to the early exercises of their stock options in exchange for $305,000 in cash. In January 2004, the Company issued 10,000 shares of common stock under a restricted stock purchase agreement to a director pursuant to the early exercise of stock options in exchange for $40,000 in cash. Under the terms of these agreements, these shares generally vest over a four-year period for employees and over a three-year period for the director. Total unvested shares, which amounted to 93,700 and 425,791 at December 31, 2005 and 2004, respectively, are subject to a repurchase option held by the Company at the original issuance price in the event the optionees employment or director s tenure is terminated either voluntarily or involuntarily. These repurchase terms are considered to be a forfeiture provision and do not result in variable accounting. During the year ended December 31, 2005, the Company repurchased 130,718 shares of its common stock for approximately $111,350 under restricted stock purchase agreements due to employee forfeitures.

In accordance with EITF No. 00-23, *Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25*, and FIN No. 44, the shares purchased by the employees pursuant to the early exercise of stock options are not deemed to be issued until those shares vest. Therefore, amounts received in exchange for these shares have been recorded as liability for early exercise of stock options on the balance sheet, and will be reclassified into common stock and additional paid-in capital as the shares vest. There were 201,374 shares at an original purchase price of $141,000 reclassified into common stock and additional paid-in capital during the year ended December 31, 2005, 258,913 shares at an original purchase price of $173,000 reclassified into common stock and additional paid-in capital during the year ended December 31, 2004 and 255,739 shares at an original purchase price of $102,000 reclassified into common stock and additional paid-in capital during the year ended December 31, 2003.

Warrants

In January 2002, the Company entered into a bridge loan agreement with two investors in which the Company received $500,000 in exchange for a note payable convertible into the Company s Series A convertible preferred stock. The note payable was converted into 125,000 shares of Series A convertible preferred stock in May 2002. The two investors also made available an additional $1,000,000 equity line which expired on July 31, 2002. There was no stated interest associated with the bridge loan. In connection with the bridge loan, the Company issued warrants to purchase an aggregate of 40,000 shares of the Company s Series A convertible preferred stock at an exercise price of $4.00 per share. The warrants were exercised in November 2003. In conjunction with the closing of the Company s initial public offering in March 2004, all outstanding shares of Series A convertible stock were automatically converted into shares of common stock on a one-for-one basis.

In accordance with EITF No. 96-18, these warrants were valued on the date of grant using the Black-Scholes method using the following assumptions: a risk-free interest rate of 3.5%, a life of 5.5 years, no dividend

24

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

yield, and a volatility factor of 0.8. The estimated fair value of the warrants was $106,000 and was recorded as interest expense in the year ended December 31, 2002.

Additionally, in April 2002, the Company issued warrants to purchase an aggregate of 146,250 shares of the Company s common stock at an exercise price of $0.40 per share as commissions for a placement agent in connection with the Series A convertible preferred stock financing. The Company recorded the estimated fair value of the warrants of $41,000 using the Black-Scholes method as an issuance cost of the Series A convertible preferred stock. The assumptions used in calculating the fair value of the warrants were as follows: a risk-free interest rate of 3.5%, a life of five years, no dividend yield, and a volatility factor of 0.8. The warrants are all outstanding as of December 31, 2003. In conjunction with the closing of the Company s initial public offering in March 2004, the outstanding warrants to purchase 146,250 shares of common stock were net exercised resulting in 139,750 shares of common stock issued with the warrant for the remaining 6,500 shares relinquished as non-cash payment.

In connection with the CEFF (see Note 8), the Company issued a warrant to Kingsbridge to purchase up to 260,000 shares of the Company s common stock at an exercise price of $13.12 per share. The exercise term of the warrant is five years beginning on April 14, 2006. This warrant was valued on the date of grant using the Black-Scholes method using the following assumptions: a risk-free interest rate of 4.1%, a life of 5.5 years, no dividend yield and a volatility factor of 0.54. The estimated value of this warrant was $1,196,000 and was recorded as a contra-equity amount in additional paid-in capital in 2005.

Shares Reserved for Issuance

The Company had reserved shares of common stock for future issuance as follows:

	December 31,	
	2005	**2004**
2004 Employee Stock Purchase Plan	152,101	71,706
Stock option plans:		
Shares available for grant	1,338,983	1,597,259
Options outstanding	2,945,163	2,054,666
Stock options outstanding (granted outside of stock plans)		22,500
Shares available for issuance under the CEFF	6,036,912	
Warrant outstanding to purchase common stock	260,000	
	10,733,159	3,746,131

2004 Employee Stock Purchase Plan

The Company s Board of Directors adopted the 2004 Employee Stock Purchase Plan (formerly the 2003 Stock Purchase Plan) in September 2003 and the Company s stockholders approved it in October 2003. The 2004 Employee Stock Purchase Plan (Purchase Plan) became effective on March 16, 2004. The Company has reserved a total of 222,979 shares of common stock for issuance under the Purchase Plan. In addition, the Purchase Plan provides for annual increases in the number of shares available for issuance under the Purchase Plan beginning January 1, 2005. The number of additional shares to be reserved automatically will be equal to the lesser of 125,000 shares, 0.5% of the outstanding shares on the date of the annual increase or such amount as may be determined by the Board of Directors. The Purchase Plan permits eligible employees to purchase

25

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

common stock at a discount through payroll deductions during defined offering periods. The price at which the stock is purchased is equal to the lower of 85% of the fair market value of the common stock at the beginning of an offering period or after a purchase period end. 42,584 and 28,294 shares were issued under the Purchase Plan during the years ended December 31, 2005 and 2004, respectively.

2004 Stock Plan

The Company s Board of Directors adopted the 2004 Stock Plan (formerly the 2003 Stock Plan) in September 2003 and the Company s stockholders approved it in October 2003. The 2004 Stock Plan became effective on March 16, 2004. The 2004 Stock Plan provides for the grant of incentive and nonstatutory stock options to employees, directors and consultants. Shares reserved under the 2004 Stock Plan include (a) shares reserved but unissued under the 2002 Executive Stock Plan and the 2002 Stock Plan, (b) shares returned to the 2002 Executive Stock Plan and the 2002 Stock Plan as the result of termination of options or the repurchase of shares issued under the 2002 Executive Stock Plan and the 2002 Stock Plan, and (c) annual increases in the number of shares available for issuance on the first day of each year beginning on January 1, 2005, equal to the lesser of:

4% of the outstanding shares of common stock on the first day of the Company s fiscal year,

1,250,000 shares, or

an amount the Company s board may determine.

Under the 2004 Stock Plan, employees, directors, and consultants of the Company are able to participate in the Company s future performance through awards of nonqualified stock options, incentive stock options and restricted stock.

Incentive stock options may be granted with exercise prices not less than 100% of estimated fair value, and nonqualified stock options may be granted with an exercise price of not less than 85% of the estimated fair value of the common stock on the date of grant, as determined by the Board of Directors. Options granted to individuals owning over 10% of the total combined voting power of all classes of stock are exercisable up to five years from the date of grant. The exercise price of any option granted to a 10% stockholder will not be less than 110% of the estimated fair value of the common stock on the date of grant, as determined by the Board of Directors. Options granted under the 2004 Stock Plan expires no later than 10 years from the date of grant. Options granted under the 2004 Stock Plan vests over periods determined by the Board of Directors, generally over four years. The 2004 Stock Plan terminates automatically 10 years after the adoption by the Board of Directors.

2002 Stock Plan and 2002 Executive Stock Plan

The terms of the 2002 Stock Plan and 2002 Executive Stock Plan (the Plans) are similar to those of the Company s 2004 Stock Plan. The shares reserved but unissued under the Plans as of March 15, 2004 were reserved for issuance under the 2004 Stock Plan (see 2004 Stock Plan above). In addition, any shares returned to the Plans as a result of termination of options or repurchases of shares after March 16, 2004 that were issued under the Plans are added to the shares reserved for the 2004 Stock Plan. Effective March 16, 2004, no additional stock options are issuable under these Plans.

In January 2004, the Board of Directors increased the number of shares of common stock available for future grant under the 2002 Executive Stock Plan to 2,080,000 from 1,330,000, and decreased the number of shares of common stock available for future grant under the 2002 Stock Plan to 2,140,000 from 2,890,000.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

A summary of activity of all options are as follows:

	Shares Available for Grant	Options Outstanding: Number of Shares	Options Outstanding: Weighted-Average Exercise Price
Balances at December 31, 2001			$
Shares authorized	1,750,000		
Options granted	(777,662)	777,662	0.40
Balances at December 31, 2002	972,338	777,662	0.40
Shares authorized	2,470,000		
Options granted	(694,750)	694,750	0.94
Options exercised		(270,006)	0.40
Options canceled	625	(625)	0.40
Balances at December 31, 2003	2,748,213	1,201,781	0.71
Options granted	(1,284,000)	1,284,000	7.38
Option granted outside of Plans		22,500	4.00
Options exercised		(298,069)	0.72
Options canceled	133,046	(133,046)	3.25
Balances at December 31, 2004	1,597,259	2,077,166	4.72
Shares authorized	983,834		
Option granted	(1,959,200)	1,959,200	9.13
Options exercised		(351,613)	1.76
Options canceled	586,372	(586,372)	8.18
Options canceled outside of Plans		(22,500)	4.00
Options Repurchased	130,718	(130,718)	0.85
Balances at December 31, 2005	1,338,983	2,945,163	$ 7.49

Options presented as exercised in the table above for the years ended December 31, 2003, 2004 and 2005 includes the exercise of vested options and the vesting of early exercised options in previous periods.

The following table summarizes information concerning total outstanding and vested options as of December 31, 2005:

Range of Exercise Prices	Options Outstanding: Number Outstanding	Options Outstanding: Weighted-Average Remaining Contractual Life	Options Outstanding: Weighted Average Exercise Price	Options Exercisable: Number Exercisable	Options Exercisable: Weighted Average Exercise Price

$0.40	302,981	7.1	$	0.40	294,857	$	0.40
$1.00 $1.60	132,283	7.3	$	1.55	110,511	$	1.59
$4.00	304,334	8.0	$	4.00	223,947	$	4.00
$7.24 $9.99	1,575,596	9.2	$	8.49	1,242,752	$	8.60
$10.05 $12.65	629,969	9.2	$	11.35	270,066	$	11.18
	2,945,163				2,142,133		

The weighted-average fair value per share of options granted during the years ended December 31, 2005, 2004 and 2003 were $3.94, $6.13 and $10.23, respectively.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

Stock Options Granted to Non-Employees

During the year ended December 31, 2004, the Company granted 24,000 options to purchase shares of its common stock to non-employees. The Company did not grant any stock options to non-employees during the year ended December 31, 2005. These have been accounted for in accordance with SFAS No. 123 and EITF No. 96-18. Compensation expense of $72,000, $107,000 and $143,000 was recorded for the years ended December 31, 2005, 2004 and 2003, respectively.

The following table illustrates the weighted average assumptions for the Black-Scholes model used in determining the fair value of options granted to non-employees:

	Year ended December 31,		
	2005	2004	2003
Risk-free interest rate	4.23%	4.28%	4.36%
Volatility	0.5	0.6	0.8
Maximum contractual life (years)	10.0	10.0	10.0
Dividend yield	0.0%	0.0%	0.0%

Deferred Stock Compensation

In connection with the grant of certain stock options to employees during the year ended December 31, 2003, the Company recorded deferred stock compensation within stockholders equity (deficit) of $6,888,000, representing the difference between the reassessed fair value of the common stock and the option exercise price at the date of grant. Such amount is being amortized over the vesting period of the applicable options on a straight-line basis.

During the period from February 1, 2003 through January 31, 2004, certain stock options were granted with exercise prices that were below the reassessed fair value of the common stock at the date of grant. Deferred compensation was recorded in accordance with APB Opinion No. 25, and is being amortized over the related vesting period of the options. The deferred compensation balance was $2,591,000 and $6,388,000 as of December 31, 2005 and 2004, respectively. The Company recorded amortization of employee stock-based compensation expense of $2,102,000, $2,734,000 and $904,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

The total unamortized deferred stock compensation recorded for all option grants through January 31, 2004, net of the amounts reversed associated with forfeited stock options, will be amortized as follows: $1,681,000 for the year ending December 31, 2006; $903,000 for the year ending December 31, 2007 and $7,000 for the year ending December 31, 2008.

28

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

11. Income Taxes

There is no provision for income taxes because the Company has incurred losses. Deferred income taxes reflect the tax effects of net operating loss and tax credit carryovers and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred tax assets are as follows (in thousands):

	December 31,	
	2005	2004
Net operating loss carryforwards	$ 30,403	$ 20,855
Research tax credit carryforwards	3,948	2,753
Orphan drug credits	5,881	3,464
Capitalized license fees	3,168	3,043
Capitalized start-up costs	531	2,619
Other	2,029	1,383
Total deferred tax assets	45,960	34,117
Valuation allowance	(45,960)	(34,117)
Net deferred tax assets	$	$

Realization of the deferred tax assets is dependent upon the generation of future taxable income, if any, the amount and timing of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance. The valuation allowance increased by approximately $11,843,000, $19,040,000 and $11,379,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

As of December 31, 2005, the Company had federal net operating loss carryforwards of approximately $99,919,000. The Company also had California net operating loss carryforwards of approximately $76,146,000. The federal net operating loss carryforwards will expire at various dates beginning in 2022, if not utilized. The California net operating loss carryforwards expire beginning in 2013. The Company also has federal research, state research and federal orphan drug credit carryforwards of approximately $2,115,000, $2,821,000 and $5,881,000, respectively. The federal research and orphan drug credits expire beginning in 2022 and the state research credits have no expiration date.

Utilization of the net operating loss carryforwards may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

12. 401(k) Plan

Effective January 2005, the Company began sponsoring a 401(k) plan, which covers all eligible employees. Under this plan, employees may contribute specified percentages of their eligible compensation, subject to certain Internal Revenue Service restrictions. The plan does not currently allow for matching contributions by the Company.

Table of Contents

TERCICA, INC.

(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS (Continued)

13. Quarterly Financial Data Unaudited

The following table presents unaudited quarterly financial data of the Company. The Company s quarterly results of operations for these periods are not necessarily indicative of future results of operations.

	Net Loss	Net Loss Allocable to Common Stockholders	Basic and Diluted Net Loss Per Share Allocable to Common Stockholders
	(In thousands, except per share data)		
Year ended December 31, 2005			
Fourth Quarter	$ (13,206)	$ (13,206)	$ (0.42)
Third Quarter	$ (11,518)	$ (11,518)	$ (0.37)
Second Quarter	$ (12,401)	$ (12,401)	$ (0.40)
First Quarter	$ (9,108)	$ (9,108)	$ (0.32)
Year ended December 31, 2004			
Fourth Quarter	$ (11,189)	$ (11,189)	$ (0.46)
Third Quarter	$ (10,677)	$ (10,677)	$ (0.45)
Second Quarter	$ (11,447)	$ (11,447)	$ (0.48)
First Quarter	$ (7,690)	$ (7,690)	$ (1.47)

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules
(a) Documents filed as part of this report

1. Financial Statements

See Index to Financial Statements in Item 8 of this Annual Report on Form 10-K, which is incorporated herein by reference.

2. Financial Statement Schedules

The following schedule is filed as part of this Form 10-K:

Schedule II- Valuation and Qualifying Accounts for the years ended December 31, 2005, 2004 and 2003.

All other financial statement schedules are omitted because the information is inapplicable or presented in the Notes to Financial Statements.

3. The following exhibits are included herein or incorporated herein by reference:

Exhibit Number	Description
3.1	Certificate of Incorporation(2)
3.2	Bylaws(1)
4.1	Form of Specimen Stock Certificate(1)
4.3	Warrant issued to Kingsbridge Capital Limited, dated October 14, 2005(10)
10.1A	2002 Stock Plan, as amended(1)*
10.1B	Form of Stock Option Agreement under the 2002 Stock Plan(1)*
10.2A	2002 Executive Stock Plan, as amended(1)*
10.2B	Form of Stock Option Agreement under the 2002 Executive Stock Plan(1)*
10.3A	2004 Stock Plan(1)*
10.3B	Form of Stock Option Agreement under the 2004 Stock Plan(1)*
10.4A	2004 Employee Stock Purchase Plan(1)*
10.4B	Form of Subscription Agreement under the 2004 Employee Stock Purchase Plan(1)*
10.5	Form of Indemnification Agreement(1)*
10.6A	Sublease Agreement dated June 24, 2002 between Elan Pharmaceuticals, Inc. and the Registrant(1)
10.6B	Sublease Agreement dated March 21, 2003 between Elan Pharmaceuticals, Inc. and the Registrant(1)
10.6C	Lease Agreement dated July 24, 2003 between Gateway Center, LLC and the Registrant(1)
10.6D	First Amendment to Lease Agreement dated September 24, 2003 between Gateway Center, LLC and the Registrant(1)
10.6E	Second Amendment to Lease Agreement dated June 28, 2004 between Gateway Center, LLC and the Registrant(3)
10.6F	Lease Agreement dated March 7, 2005 between 2000 Sierra Point, LLC and the Registrant(4)

31

Table of Contents

Exhibit Number	Description
10.7A	License and Collaboration Agreement, between Genentech, Inc. and the Registrant, dated as of April 15, 2002(1)
10.7B	First Amendment to the License and Collaboration Agreement, between Genentech, Inc. and the Registrant, dated as of July 25, 2003(1)
10.7C	International License and Collaboration Agreement, between Genentech, Inc. and the Registrant, dated as of July 25, 2003(1)
10.7D	Second Amendment to the License and Collaboration Agreement, between Genentech, Inc. and the Registrant, dated as of November 25, 2003(9)
10.8	Manufacturing Services Agreement between the Registrant and Cambrex Bio Science Baltimore, Inc., dated as of December 20, 2002(1)
10.9A	Key Employment Agreement for John A. Scarlett, M.D. dated February 27, 2002(1)*
10.9B	Amendment to Key Employment Agreement for John A. Scarlett, M.D. dated May 15, 2002(1)*
10.9C	Key Employment Agreement for Ross G. Clark dated May 15, 2002(1)*
10.9D	Intentionally omitted
10.9E	Intentionally omitted
10.9F	Intentionally omitted
10.9G	Employment Letter to Andrew Grethlein dated March 5, 2003(1)*
10.9H	Intentionally omitted
10.9I	Intentionally omitted
10.9J	Intentionally omitted
10.9K	Intentionally omitted
10.9L	Employment Letter to Stephen Rosenfield dated June 23, 2004(3)*
10.9M	Employment Letter to Thorsten von Stein dated December 3, 2004(5)*
10.9N	Amendment to Key Employment Agreement for John A. Scarlett, M.D. dated February 22, 2005(4)*
10.9O	Amendment to Key Employment Agreement for Ross G. Clark dated February 22, 2005(4)*
10.9P	Amendment to Employment Letter for Thomas H. Silberg dated February 22, 2005(4)*
10.9Q	Amendment to Employment Letter for Timothy P. Lynch dated February 22, 2005(4)*
10.9R	Amendment to Employment Letter for Stephen N. Rosenfield dated February 22, 2005(4)*
10.9S	Executive Officer Compensation Arrangements(6)*
10.9T	Non-Employee Director Compensation Arrangements(7)
10.9U	Employment Letter to Christopher E. Rivera, dated March 31, 2005(8)*
10.9V	Separation Agreement and Release, dated May 13, 2005, between Thomas H. Silberg and the Registrant(9)*
10.9W	Tercica, Inc. Incentive Compensation Plan(6)
10.10	Amended and Restated Investors Rights Agreement dated July 9, 2003(1)
10.11	Amendment to Amended and Restated Investors Rights Agreement dated February 27, 2004(1)

32

Table of Contents

Exhibit Number	Description
10.12A	Loan Agreement, dated January 21, 2005, between Venture Lending & Leasing IV, Inc. and the Registrant(5)
10.12B	Common Stock Purchase Agreement, dated January 21, 2005, between Venture Lending & Leasing IV, LLC and the Registrant(5)
10.13A	Common Stock Purchase Agreement, by and between Kingsbridge Capital Limited and the Registrant, dated October 14, 2005(10)
10.13B	Registration Rights Agreement, by and between Kingsbridge Capital Limited and the Registrant, dated October 14, 2005(10)
23.1	Consent of Independent Registered Public Accounting Firm
24.1	Power of Attorney (included on the signature pages hereto)
31.1	Certification of Chief Executive Officer of Tercica, Inc., as required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification of Chief Financial Officer of Tercica, Inc., as required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	Certification by the Chief Executive Officer, as required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).
32.2	Certification by the Chief Financial Officer, as required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).

---

* Management contract or compensation plan or arrangement.

Confidential treatment has been granted with respect to certain portions of this exhibit. This exhibit omits the information subject to this confidentiality request. Omitted portions have been filed separately with the SEC.

(1) Incorporated by reference to the Registrant s registration statement on Form S-1 (File No. 333-108729) and amendments thereto, declared effective on March 16, 2004.

(2) Incorporated by reference to the Registrant s quarterly report on Form 10-Q (File No. 000-50461) filed on May 13, 2004.

(3) Incorporated by reference to the Registrant s quarterly report on Form 10-Q (File No. 000-50461) filed on August 16, 2004.

(4) Incorporated by reference to the Registrant s annual report on Form 10-K (File No. 000-50461) filed on March 24, 2005.

(5) Incorporated by reference to the Registrant s registration statement on Form S-1 (File No. 333-122224) and amendments thereto, declared effective on February 7, 2005.

(6) Incorporated by reference to the information under the heading, Item 1.01. Entry into a Material Definitive Agreement in the Registrant s current reports on Form 8-K (File No. 000-50461) filed on February 28, 2005, March 18, 2005, August 22, 2005 and February 28, 2006.

(7) Incorporated by reference to the information under the heading Executive Compensation Compensation of Directors in the Registrant s definitive proxy statement filed pursuant to Regulation 14A (File No. 000-50461) on April 29, 2005.

(8) Incorporated by reference to the Registrant s quarterly report on Form 10-Q (File No. 000-50461) filed on May 16, 2005.

(9) Incorporated by reference to the Registrant s quarterly report on Form 10-Q (File No. 000-50461) filed on August 4, 2005.

(10) Incorporated by reference to the Registrant s quarterly report on Form 10-Q (File No. 000-50461) filed on November 4, 2005.

Table of Contents

SIGNATURES

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

TERCICA, INC.

By: /s/ JOHN A. SCARLETT, M.D.
John A. Scarlett, M.D.

President, Chief Executive Officer and Director

Dated: March 16, 2006

34

Table of Contents

Schedule II

TERCICA, INC.

VALUATION AND QUALIFYING ACCOUNTS

Years Ended December 31, 2005, 2004 and 2003

(In thousands)

	Balance at Beginning of Period	Addition Charged to Cost and Expenses	Deductions(1)	Balance at End of Period
Inventory reserves:				
Year Ended December 31, 2005:	$	$ 45	$	$ 45
Year Ended December 31, 2004:	$	$	$	$
Year Ended December 31, 2003:	$	$	$	$

(1) Represents amounts written off or returned against the allowance or reserves, or returned against earnings.

35