

PRO PHARMACEUTICALS INC

Form 10-Q

August 10, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2007

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. 000-32877

PRO-PHARMACEUTICALS, INC.

Nevada
(State or other jurisdiction

of incorporation)

7 Wells Avenue, Newton, Massachusetts
(Address of Principal Executive Offices)

(617) 559-0033

(Registrant's Telephone Number, Including Area Code)

04-3562325
(I.R.S. Employer

Identification No.)

02459
(Zip Code)

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

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 filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

The number of shares outstanding of the registrant's common stock as of August 10, 2007 was 40,364,792.

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PRO-PHARMACEUTICALS, INC.

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FOR THE QUARTER ENDED JUNE 30, 2007

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(A Development-Stage Company)

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) (dollars in thousands except share and per share data)

| | June 30, 2007 | December 31, 2006 |
|---|------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 2,380 | \$ 773 |
| Prepaid expenses and other current assets | 120 | 163 |
| Certificate of deposit | | 5,000 |
| Total current assets | \$ 2,500 | \$ 5,936 |
| PROPERTY AND EQUIPMENT NET | 91 | 112 |
| RESTRICTED CASH | 69 | 59 |
| INTANGIBLE ASSETS NET | 320 | 256 |
| TOTAL ASSETS | \$ 2,980 | \$ 6,363 |
| LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT) | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 428 | \$ 340 |
| Accrued expenses | 538 | 512 |
| Convertible debt instrument | 434 | 5,137 |
| Total current liabilities | \$ 1,400 | \$ 5,989 |
| WARRANT LIABILITIES | 872 | 371 |
| OTHER LONG TERM LIABILITIES | 33 | 25 |
| Total liabilities | \$ 2,305 | \$ 6,385 |
| CONTINGENCIES (Note 7) | | |
| STOCKHOLDERS EQUITY (DEFICIT): | | |
| Common stock, \$0.001 par value; 100,000,000 shares authorized, 40,364,792 and 32,518,643 issued and outstanding at June 30, 2007 and December 31, 2006 respectively; Undesignated shares, \$.01 par value; 10,000,000 shares authorized, none issued and outstanding | \$ 40 | \$ 32 |
| Additional paid-in capital | 31,900 | 25,673 |
| Deficit accumulated during the development stage | (31,265) | (25,727) |
| Total stockholders equity (deficit) | \$ 675 | \$ (22) |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT) | \$ 2,980 | \$ 6,363 |

See notes to unaudited condensed consolidated financial statements.

Table of Contents**PRO-PHARMACEUTICALS, INC.**

(A Development-Stage Company)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) (dollars in thousands except share and per share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | | Cumulative Period from Inception (July 10, 2000) to June 30, 2007 |
|---|-----------------------------|-------------------|---------------------------|-------------------|---|
| | 2007 | 2006 | 2007 | 2006 | |
| OPERATING EXPENSES: | | | | | |
| Research and development | \$ 668 | \$ 998 | \$ 1,336 | \$ 1,452 | \$ 14,864 |
| General and administrative | 1,104 | 1,101 | 2,360 | 2,371 | 20,413 |
| Total operating expenses | \$ (1,772) | \$ (2,099) | \$ (3,696) | \$ (3,823) | \$ (35,277) |
| OTHER INCOME AND EXPENSE | | | | | |
| Interest income | 18 | 43 | 80 | 70 | 715 |
| Interest expense | (29) | (582) | (325) | (908) | (4,426) |
| Change in fair value of convertible debt instrument | 15 | 526 | (1,096) | (3,233) | (3,490) |
| Change in fair value of warrant liabilities | 1,804 | 2,342 | (501) | (202) | 11,213 |
| Total other income and (expense) | \$ 1,808 | \$ 2,329 | \$ (1,842) | \$ (4,273) | \$ 4,012 |
| NET INCOME (LOSS) | \$ 36 | \$ 230 | \$ (5,538) | \$ (8,096) | \$ (31,265) |
| NET INCOME (LOSS) PER SHARE BASIC | \$ 0.00 | \$ 0.01 | \$ (0.15) | \$ (0.29) | |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING BASIC | 40,364,792 | 27,735,713 | 37,596,303 | 27,525,562 | |
| NET LOSS PER SHARE DILUTED | \$ 0.00 | \$ (0.03) | \$ (0.15) | \$ (0.29) | |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING DILUTED | 40,364,792 | 27,750,263 | 37,596,303 | 27,525,562 | |

See notes to unaudited condensed consolidated financial statements.

Table of Contents**PRO-PHARMACEUTICALS, INC.****(A Development-Stage Company)****CONSOLIDATED STATEMENT OF STOCKHOLDERS (DEFICIT) EQUITY****SIX MONTHS ENDED JUNE 30, 2007 (UNAUDITED) (dollars in thousands except share data)**

| | Common Stock | | | Deficit | |
|--|--------------|--------|------------|-------------|------------------|
| | Number | | Additional | Accumulated | Total |
| | of Shares | Amount | Paid-in | During the | Stockholders |
| | | | Capital | Development | (Deficit) Equity |
| | | | | Stage | |
| BALANCE, JANUARY 1, 2007 | 32,518,643 | \$ 32 | \$ 25,673 | \$ (25,727) | \$ (22) |
| Net loss | | | | (5,538) | (5,538) |
| Common stock issued related to convertible debenture redemptions | 7,846,149 | 8 | 5,907 | | 5,915 |
| Stock-based compensation expense | | | 320 | | 320 |
| BALANCE, JUNE 30, 2007 | 40,364,792 | \$ 40 | \$ 31,900 | \$ (31,265) | \$ 675 |

See notes to unaudited condensed consolidated financial statements

Table of Contents**PRO-PHARMACEUTICALS, INC.**

(A Development-Stage Company)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (dollars in thousands)

| | Six Months Ended June, | | Cumulative Period from Inception (July 10, 2000) to June 30, 2007 |
|---|---------------------------|------------|--|
| | 2007 | 2006 | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net loss | \$ (5,538) | \$ (8,096) | \$ (31,265) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation and amortization | 33 | 34 | 408 |
| Stock-based compensation expense | 320 | 225 | 1,792 |
| Non-cash interest expense | 315 | 908 | 4,261 |
| Change in fair value of convertible debt instrument | 1,096 | 3,233 | 3,490 |
| Change in fair value of warrant liabilities | 501 | 202 | (11,213) |
| Write off of intangible assets | | | 147 |
| Changes in operating assets and liabilities: | | | |
| Prepaid expenses and other current assets | 11 | 28 | (117) |
| Accounts payable and accrued expenses | 114 | (497) | 1,084 |
| Other long term liabilities | 8 | | 33 |
| Net cash used in operating activities | \$ (3,140) | \$ (3,963) | \$ (31,380) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Maturity (purchase) of certificate of deposit | \$ 5,000 | \$ (5,000) | \$ |
| Purchases of property and equipment | (2) | (28) | (416) |
| Increase in restricted cash | (10) | | (69) |
| Increase in patents costs and other assets | (74) | (56) | (441) |
| Net cash provided by (used in) investing activities | \$ 4,914 | \$ (5,084) | \$ (926) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net proceeds from issuance of common stock and warrants | \$ | \$ | \$ 25,309 |
| Net proceeds from issuance of convertible debt instruments | | 9,300 | 10,621 |
| Repayment of convertible debt instruments | (167) | | (1,253) |
| Proceeds from shareholder advances | | | 9 |
| Net cash provided by financing activities | \$ (167) | \$ 9,300 | \$ 34,686 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 1,607 | 253 | 2,380 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 773 | 4,466 | |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 2,380 | \$ 4,719 | \$ 2,380 |
| SUPPLEMENTAL DISCLOSURE Cash paid for interest | \$ 10 | \$ | \$ 107 |
| NONCASH FINANCING ACTIVITIES: | | | |
| Issuance of equity warrants in connection with equity offerings | | | 1,172 |

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| | | | |
|--|-------|-------|--------|
| Conversion of accrued expenses into common stock | | | 303 |
| Cashless exercise of employee stock options | | | 74 |
| Conversion and redemptions of convertible notes and accrued interest into common stock | 5,915 | 2,654 | 12,243 |
| Conversion of extension costs related to convertible notes into common stock | | | 171 |
| Conversion of prepaid interest into common stock | (32) | 49 | |
| Issuance of warrants to induce conversion of notes payable | | | 503 |
| Issuance of stock to acquire Pro-Pharmaceuticals-NV | | | 107 |

See notes to unaudited condensed consolidated financial statements.

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PRO-PHARMACEUTICALS, INC.

(A DEVELOPMENT-STAGE COMPANY)

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (dollar amounts in thousands)

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements as reported in this Quarterly Report on Form 10-Q reflect all adjustments which are, in the opinion of management, necessary to present fairly the financial position of Pro-Pharmaceuticals, Inc. (the Company) as of June 30, 2007 and the results of its operations for the three and six months ended June 30, 2007 and June 30, 2006 and the cumulative period from inception (July 10, 2000) through June 30, 2007, the statement of stockholders (deficit) equity for the six months ended June 30, 2007 and its cash flows for the six months ended June 30, 2007 and June 30, 2006 and for the cumulative period from inception (July 10, 2000) to June 30, 2007. All adjustments made to the interim financial statements include all those of a normal and recurring nature. The results for interim periods are not necessarily indicative of results which may be expected for any other interim period or for the full year.

The unaudited condensed consolidated financial statements of the Company should be read in conjunction with its Annual Report on Form 10-K for the year ended December 31, 2006.

As shown in the unaudited condensed consolidated financial statements, the Company incurred net losses of \$31,265 for the cumulative period from inception (July 10, 2000) through June 30, 2007. The Company's net losses have resulted principally from costs associated with (i) research and development expenses, including clinical trial costs, (ii) general and administrative activities and (iii) the Company's financing transactions including interest and the costs related to fair value accounting for the Company's convertible debt instrument and warrant liabilities. As a result of planned expenditures for future research, discovery, development and commercialization activities and potential legal cost to protect its intellectual property, the Company expects to incur additional losses and use additional cash in its operations for the foreseeable future. From inception (July 10, 2000) through June 30, 2007, the Company has raised \$35,930 in capital through sale and issuance of common stock, common stock purchase warrants, and debt securities in public and private offerings. From inception (July 10, 2000) through June 30, 2007, the Company has used \$31,380 of cash in its operations. At June 30, 2007, the Company had \$2,380 of cash and cash equivalents to fund future operations.

In July 2007, in order to conserve cash, employees took a 50% pay reduction and reduced other expenses thereby extending the Company's cash runway. Management believes there is sufficient cash to fund operations through at least September 2007. The Company is actively pursuing additional sources of financing and other strategic alternatives.

On June 22, 2007, the Company received a notice from the American Stock Exchange (Amex) Listing Qualifications Department that it is reviewing the Company's eligibility for continued listing. Specifically, the notice cited that the Company does not comply with the Amex's minimum \$2 million stockholders' equity when combined with losses from continuing operations and/or net losses in two of its last three years set forth in Section 1003 (a) (i) of the Amex Company Guide. To facilitate the review, the Company has been asked to provide a specific plan and timeframe to achieve and sustain compliance with all Amex market listing requirements. The letter states that the Company may be granted up to 18 months to return to compliance with the Amex listing requirements. On July 23, 2007, the Company timely submitted a plan to the Amex to return to compliance within the specified period of time. The Company has not yet received a response from the Amex.

The Company is subject to a number of risks similar to those of other development-stage companies, including dependence on key individuals, uncertainty of product development and generation of revenues, dependence on outside sources of capital, risks associated with clinical trials of products, dependence on third-party collaborators for research operations, need for regulatory approval of products, successful protection of intellectual property, and competition with larger, better-capitalized companies. Successful completion of the Company's development program and, ultimately, the attainment of profitable operations is dependent upon future events, including obtaining adequate financing to fulfill its development activities and achieving a level of revenues adequate to support the Company's cost structure. There are no assurances, however, that the Company will be able to obtain additional financing on favorable terms, or at all, or successfully market its products.

Impact of New Accounting Standards In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. The Company will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2008. Management is currently evaluating the requirements of SFAS

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No. 157 and has not yet determined the impact, if any, on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 provides entities with an option to report selected financial assets and liabilities at fair value, with the objective to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. The Company will be required to adopt SFAS No. 159 in the first quarter of fiscal year 2008. The Company is currently evaluating the requirements of SFAS No. 159 and has not yet determined the impact, if any, of its adoption on its consolidated financial statements.

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The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment (SFAS No. 123(R)), which was adopted January 1, 2006, using the modified prospective transition method. The Company has two stock-based compensation plans where the Company's common stock has been made available for option grants as part of the Company's compensation programs (the Plans). These Plans are described in more detail in the 2006 Form 10-K.

The fair value of the options granted is determined using the Black-Scholes option-pricing model. Key assumptions used to apply this option-pricing model are as follows:

| | Six Months Ended June 30, | | Cumulative Period from Inception (July 10, 2000) to June 30, |
|---|------------------------------|---------|--|
| | 2007 | 2006 | 2007 |
| Risk-free interest rate | 4.45% | 4.81% | 3.16% |
| Expected life of the options | 5 years | 5 years | 3.63 years |
| Expected volatility of the underlying stock | 95% | 65% | 91% |
| Expected dividend rate | None | None | None |

Stock-based compensation expense for both employees and non-employees totaled \$145 and \$94 for the three months ended June 30, 2007 and 2006. For the six months ended June 30, 2007 and 2006, stock-based compensation expense was \$320 and \$225, respectively.

Pursuant to the 2001 Pro-Pharmaceuticals, Inc. Employee Stock Incentive Plan, the Company on March 8, 2007 granted to its employees, as a retention incentive, options to purchase 715,000 shares of its common stock exercisable at \$1.01 per share and to the members of the Board of Directors, in consideration of special services, options to purchase 67,000 shares of its common stock exercisable at \$1.01 per share. Pursuant to the 2003 Pro-Pharmaceuticals, Inc. Non-Employee Director Stock Incentive Plan, on March 8, 2007, the Company granted to each of its non-management directors, in consideration of their service on the Board of Directors in 2006, options to purchase shares of its common stock, exercisable at \$1.01 per share. The grants ranged from 2,500 to 9,000 options per Director and totaled 41,500 stock options.

Members of the Board of Directors receive stock options for each Board and Committee meeting attended. The options are typically granted in the year following service. The Company expenses the value of stock options as earned. In the three and six month periods ended June 30, 2007 Board members earned approximately 22,000 and 36,500 stock options respectively.

The following table summarizes the stock option activity in the equity incentive plans from January 1, 2007 through June 30, 2007:

| | Shares | Exercise Price | | Weighted Average |
|------------------------------|-----------|----------------|------|------------------|
| | | Per Share | | Exercise Price |
| Outstanding, January 1, 2007 | 3,059,354 | \$ 1.90 | 5.80 | \$ 3.60 |
| Granted | 823,500 | | 1.01 | 1.01 |
| Options expired | (85,000) | 5.16 | 5.80 | 5.35 |
| Options cancelled | (45,000) | | 1.01 | 1.01 |
| Outstanding, June 30, 2007 | 3,752,854 | \$ 1.01 | 4.05 | \$ 3.02 |

The following tables summarize information about stock options outstanding at June 30, 2007:

| | | Options Outstanding | | Options Exercisable | | |
|----------------|------------------|---------------------|----------|---------------------|-----------|---------|
| | | Weighted | | | | |
| | | Average | Weighted | Weighted | | |
| | | Remaining | Average | Average | | |
| | | Contractual | Exercise | Number of | Exercise | |
| Exercise Price | Number of Shares | Life (Years) | Price | Shares | Price | |
| \$1.01 | \$2.82 | 1,205,500 | 5.45 | \$ 1.48 | 413,834 | \$ 2.01 |
| \$2.92 | \$4.05 | 2,547,354 | 5.10 | \$ 3.75 | 2,319,023 | \$ 3.75 |
| | | 3,752,854 | 5.22 | \$ 3.02 | 2,732,857 | \$ 3.49 |

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No options were granted during the three month periods ended June 30, 2007 and 2006. The weighted average grant date fair value for options granted during the six month periods ended June 30, 2007 and 2006 and the cumulative period from inception (July 10, 2000) to June 30, 2007 was \$.74, \$2.22 and \$1.83, respectively. No options vested during the three month periods ended June 30, 2007 and 2006. The total fair value of options vested during the six month periods ended June 30, 2007 and 2006 and the cumulative period from inception (July 10, 2000) to June 30, 2007 was \$403, \$158 and \$5,559, respectively. During the three and six month periods ended June 30, 2007, 60,000 and 85,000 options expired respectively. During the three and six month periods ended June 30, 2007 45,000 options were forfeited. During the three and six month periods ended June 30, 2006 15,000 options were forfeited.

As of June 30, 2007 there were 1,019,997 unvested options which will vest as follows: 71,666 in 2007, 390,005 in 2008, 334,995 in 2009 and 223,331 in 2010. Total expected unrecognized compensation cost related to such unvested options is \$950, which is expected to be recognized over a weighted average period of 1.2 years. As of June 30, 2007, there is no intrinsic value of outstanding options, fully vested options or exercisable options based on the Company's closing common stock price of \$0.35 as of June 30, 2007.

There was no cash received from employees as a result of employee stock option exercises during the three and six month periods ended June 30, 2007 and 2006 and during the cumulative period from inception (July 10, 2000) to June 30, 2007. There were no options exercised during the three and six month periods ended June 30, 2007 and 2006 and the intrinsic value of options exercised for the cumulative period from inception was \$74 resulting from the cashless exercise of options in October 2003.

3. ACCRUED EXPENSES

Accrued expenses consist of the following:

| | June 30, 2007 | December 31, 2006 |
|------------------------------|------------------|----------------------|
| Legal and accounting fees | \$ 142 | \$ 215 |
| Scientific and clinical fees | 308 | 198 |
| Accrued payroll and vacation | 79 | 87 |
| Other | 9 | 12 |
| Total | \$ 538 | \$ 512 |

4. CONVERTIBLE DEBT AND WARRANT LIABILITIES

The following table summarizes information with regard to outstanding warrants issued in connection with equity and debt financings as of June 30, 2007. These warrants are classified as warrant liabilities with the exception of the 2001 Placement Agent Warrants which expire on February 1, 2012 and are classified in additional paid-in capital:

| Issued in Connection With | Number Issued | Exercise Price | Exercisable Date | Expiration Date |
|--------------------------------------|------------------|-------------------|-------------------|------------------|
| 2001 Placement Agents | 110,000 | \$ 3.50 | February 1, 2002 | February 1, 2012 |
| October 2003 PIPE Transaction (1) | | | | |
| 2003 Investor Warrants | 657,293 | \$ 4.75 | October 2, 2003 | October 2, 2008 |
| April 2004 PIPE Transaction (2) | | | | |
| April 2004 Investor Warrants | 618,056 | \$ 4.82 | April 7, 2004 | April 7, 2009 |
| August 2004 PIPE Transaction | | | | |
| August 2004 Investor Warrants | 2,000,000 | \$ 4.20 | February 13, 2005 | August 12, 2009 |
| August 2004 Placement Agent Warrants | 100,000 | \$ 4.20 | February 13, 2005 | August 12, 2009 |
| February 2006 PIPE Transaction | | | | |
| 2006 Investor Warrants (3) | 4,493,296 | \$ 1.00 | August 15, 2006 | August 14, 2011 |

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| | | | | |
|-------------------------------|------------------|---------|-----------------|-----------------|
| 2006 Investor Warrants (4) | 149,031 | \$ 3.35 | August 15, 2006 | August 14, 2011 |
| 2006 Placement Agent Warrants | 149,031 | \$ 3.35 | August 15, 2006 | August 14, 2011 |
| Total | 8,276,707 | | | |

-
- (1) The exercise price of the warrants has been adjusted from \$5.29 per share to \$4.75 per share due to the subsequent issuance of equity related instruments.

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- (2) The exercise price of the warrants has been adjusted from \$5.30 per share to \$4.82 per share due to the subsequent issuance of equity related instruments.
- (3) The exercise price of the warrants has been adjusted from \$3.35 per share to \$1.00 per share and an additional 3,152,014 warrants were issued in connection with the Waiver and Exchange Agreement dated March 20, 2007, entered into with certain holders of the 7% Convertible Debentures.
- (4) Original investor warrants not subject to the Waiver and Exchange Agreement dated March 20, 2007.
- October 2003, April 2004, August 2004 PIPE Transactions* In connection with the October 2003, April 2004, and August 2004 PIPE transactions, the Company issued common stock purchase warrants. The warrants were accounted for as freestanding derivative instruments in the consolidated balance sheet under the caption "Warrant Liabilities". Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption "Change in fair value of warrant liabilities".

February 2006 PIPE Transaction In February 2006, the Company issued \$10,000 in aggregate principal amount of convertible debentures (the "Debentures") together with warrants to purchase approximately 1,490,313 shares of the Company's common stock (the "2006 Investor Warrants"). In March 2007, the Company issued an additional 3,152,014 warrants to investors as part of a Waiver and Exchange Agreement more fully described below. The warrants were accounted for as freestanding derivative instruments in the consolidated balance sheet under the caption "Warrant Liabilities". Changes in fair value are recognized as either a gain or loss in the consolidated statement of operations under the caption "Change in fair value of warrant liabilities". Upon issuance, the Company irrevocably elected to initially and subsequently measure the Debentures in their entirety at fair value with changes in fair value recognized as either a gain or loss in the consolidated statement of operations.

The conversion price of the Debentures and exercise price of the 2006 Investor and Placement Agent Warrants are each subject to certain anti-dilution protections, including for stock splits, stock dividends, change in control events and dilutive issuances of common stock or common stock equivalents, such as stock options, at an effective price per share that is lower than the then conversion price. In the event of a dilutive issuance of common stock or common stock equivalents, the conversion price and exercise price would be reduced to equal the lower price per share of the subsequent transaction.

On March 21, 2007, pursuant to a Waiver and Exchange Agreement (the "Exchange Agreement") entered into on March 20, 2007 with certain holders of the Debentures, the Company redeemed \$3,889 of the remaining \$4,444 principal, and \$16 of accrued interest, for 5,205,348 shares of its common stock at \$0.75 per share and adjusted the exercise price of the 2006 Investor Warrants held by such holders to \$1.00. Giving effect to the anti-dilution provisions of the 2006 Investor Warrants, an additional 3,152,014 shares of stock are issuable if all the warrants are exercised.

The Exchange Agreement also provided that (i) the Company may not redeem any Debentures still outstanding in shares of its common stock unless the trading price per share is at least \$0.85; (ii) the Company may not undertake any offering of its equity or equity equivalent securities at an effective price per share below \$0.75 for 30 calendar days following the March 21, 2007 closing date of the Exchange Agreement; (iii) the investor parties to the Exchange Agreement are entitled to participate in any subsequent equity financing (other than exempt issuances and an underwritten public offering) undertaken by the Company within 6 months of the March 20, 2007 date of the Exchange Agreement; and (iv) if a holder of shares issued upon redemption of the Debentures or exercise of the 2006 Investor Warrants cannot resell or otherwise dispose the shares under Rule 144 under the Securities Act, the Company must register the resale of the shares.

A summary of changes in the Debentures and Warrant Liabilities is as follows:

| | Fair Value of Debentures | Fair Value of Warrant Liabilities | Total |
|--|-----------------------------|---|----------|
| Balance December 31, 2006 | \$ 5,137 | \$ 371 | \$ 5,508 |
| Redemptions, at net carrying amount (1) | (555) | | (555) |
| Redemptions pursuant to the Waiver and Exchange Agreement at net carrying amount (2) | (5,315) | | (5,315) |
| Payments in cash | (167) | | (167) |
| Amortization of debt discount | 238 | | 238 |
| Fair value adjustment | 1,096 | 501 | 1,597 |
| Balance June 30, 2007 | \$ 434 | \$ 872 | \$ 1,306 |

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- (1) Represents redemptions in common stock of principal value of \$480 and a fair value adjustment of \$75. These amounts plus \$29 of accrued interest were credited to common stock and additional paid in capital.

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(2) Represents payments in common stock of principal value of \$3,889, a debt discount charge of \$302 and a fair value credit of \$1,728. These amounts plus \$16 of accrued interest were credited to common stock and additional paid in capital.

The Company uses a binomial financial model to calculate the fair value of the Debentures. The Company uses the Black-Scholes pricing model to calculate fair value of the 2006 Investor Warrants, 2006 Placement Agent Warrants, August 2004 Investor Warrants, August 2004 Placement Agent Warrants, April 2004 Investor Warrants, April 2004 Placement Agent Warrants, 2003 Investor Warrants, and the 2003 Placement Agent Warrants (expired unexercised in 2006).

Key assumptions used to apply these models as of June 30, 2007 and December 31, 2006 are as follows:

| | Warrants | | Debentures | |
|---|-------------------------|-------------------------|------------|---------|
| | 2007 | 2006 | 2007 | 2006 |
| Risk free interest rate | 4.91% - 4.96% | 4.71% - 5.00% | 4.74% | 5.00% |
| Expected life | 1.26 years - 4.13 years | 0.25 years - 5.08 years | 0.50 years | 1 year |
| Expected volatility of common share price | 93% - 95% | 65% - 80% | 170% | 104% |
| Common share price | \$ 0.35 | \$ 0.45 | \$ 0.35 | \$ 0.45 |

5. EARNINGS PER SHARE

Basic loss per share is based on the weighted-average number of common shares outstanding during each period. Diluted loss per share is based on basic shares as determined above plus the incremental shares that would be issued upon the assumed exercise of in-the-money stock options and warrants using the treasury stock method and convertible debenture using the if-converted method. The computation of diluted net loss per share does not assume the issuance of common shares that have an anti-dilutive effect on net loss per share. For the three and six month period ended June 30, 2007 and the six month period ended June 30, 2006, all stock options, warrants and potential shares related to conversion of the convertible debentures were excluded from the computation of diluted net loss per share. For the three month period ended June 30, 2006 all stock options and convertible debentures and 3,722,497 warrants were excluded from the computation of diluted net loss per share. Dilutive shares which could exist pursuant to the exercise of outstanding stock options and warrants at June 30, 2007, and 2006 totaled approximately 12,029,561 and 8,421,195 respectively.

| | Three Months Ended | | | Six Months Ended | |
|--|--------------------|----------|------------|------------------|--|
| | June 30, | | June 30, | | |
| | 2007 | 2006 | 2007 | 2006 | |
| Net Income (loss)-basic | \$ 36 | \$ 230 | \$ (5,538) | \$ (8,096) | |
| Fair value adjustment related to warrant liabilities | | (927) | | | |
| Net Loss-diluted | \$ 36 | \$ (697) | \$ (5,538) | \$ (8,096) | |

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------|------------------|------------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Weighted average common shares outstanding-basic | 40,364,792 | 27,735,713 | 37,596,303 | 27,525,562 |
| Incremental common shares related to warrants | | 14,550 | | |
| Weighted average common shares outstanding-diluted | 40,364,792 | 27,750,263 | 37,596,303 | 27,525,562 |
| Earnings Per Share | | | | |
| -Basic | 0.00 | 0.01 | (0.15) | (0.29) |

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| | | | | |
|----------|------|--------|--------|--------|
| -Diluted | 0.00 | (0.03) | (0.15) | (0.29) |
|----------|------|--------|--------|--------|

6. INCOME TAXES

The Company has established a full valuation allowance equal to the amount of its deferred tax assets as the realization of such assets is uncertain. In addition, the Company's effective tax rate is zero for the periods reserved due to the full valuation allowance and lack of other income tax obligations.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* An Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The impact of uncertain income tax positions taken on the income tax return must be recognized at the largest amount that is more

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likely than not to be sustained upon audit by the relevant taxing authority. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, and accounting for interim periods and requires expanded disclosure with respect to the uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect, if any, of adopting FIN 48 is to be reported as an adjustment to the opening balance of retained earnings in the year of adoption.

The Company adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, the total amount of unrecognized tax benefits was \$1,031, \$880 of which, if recognized, would affect the effective tax rate prior to the adjustment for the Company's full valuation allowance. As a result of the implementation of FIN 48, the Company did not recognize an increase in tax liability for the unrecognized tax benefits because the Company has net operating loss carry forwards and has established a full valuation allowance. There have been no changes in unrecognized tax benefits as a result of tax positions taken during the current period.

The Company is subject to U.S. Federal income tax as well as income tax of certain state jurisdictions. The tax years ranging from 2000 through 2006 remain open to examination by various taxing jurisdictions as the statute of limitations has not expired.

Since the Company's net deferred tax assets and the unrecognized tax benefits determined under FIN 48 would not result in a cash payment, the Company has not accrued for any interest and penalties relating to these unrecognized tax benefits. Should the Company incur interest and penalties related to income taxes, those amounts would be included in income tax expense.

7. CONTINGENCIES

In January 2004, Dr. Platt, the Company's Chairman and Chief Executive Officer, filed a lawsuit in Massachusetts Superior Court against GlycoGenesys, Inc. for various claims including breach of contract. In its filing in February 2004, GlycoGenesys asserted counterclaims against the Company and Dr. Platt alleging tortious interference and misappropriation of proprietary rights. The counterclaims seek monetary damages and injunctive relief related to the Company's intellectual property. In March 2004, the Company and Dr. Platt answered the counterclaims and denied any liability. In June 2004, the Court allowed, without opposition, a motion of GlycoGenesys for leave to file a supplemental counterclaim against the Company for defamation and unfair competition. On February 2, 2006, GlycoGenesys filed a voluntary petition for protection under Chapter 11 of the U.S. Bankruptcy Code, which stayed the counterclaim litigation proceedings. On June 1, 2006, the bankruptcy court approved a motion by GlycoGenesys to convert the proceeding to Chapter 7 liquidation. On October 23, 2006, the judge issued an order allowing the liquidation sale of certain GlycoGenesys assets to Marlborough Research and Development, Inc. including the counterclaim lawsuit. Marlborough Research and Development, Inc. has changed its name to Prospect Therapeutics, Inc. and is continuing the counterclaim lawsuit against the Company and Dr. Platt. The Company believes these claims are without merit and intends to contest them vigorously. Additionally, the Company believes that any impact on the financial statements is neither probable nor reasonably estimable and therefore no amounts have been recorded as of June 30, 2007.

Pursuant to Board approval, the Company has agreed to indemnify Dr. Platt for the expenses of his defense of the counterclaims. In the three and six month periods ended June 30, 2007 the Company incurred no expenses in connection with this defense. Through June 30, 2007 the Company has incurred cumulative expenses of approximately \$438 in connection with this defense.

On January 28, 2005, the Company filed a request with the U.S. Patent and Trademark Office (USPTO) for an inter partes re-examination of U.S. Patent No. 6,680,306 owned by GlycoGenesys, Inc. because the Company believes that the invention claimed in this patent is anticipated by other inventions (technically, prior art), including the Company's U.S. Patent No. 6,645,946 for DAVANAT[®]. On October 18, 2005, the USPTO agreed with the Company's argument that all claims stated in the 306 patent are anticipated by prior art. On December 19, 2005, GlycoGenesys filed a response to the USPTO, and on January 18, 2006, the Company responded to the GlycoGenesys submission. The matter is now before the USPTO for a final decision. The Company believes that the USPTO actions to date support its belief that the invention claimed in the DAVANAT[®] patent is prior art relative to the GlycoGenesys patent.

In the ordinary course of business, the Company may from time to time be involved in other legal matters that in the Company's estimation will not have a material adverse impact on it. The Company records accruals for such contingencies to the extent that the Company concludes that their occurrence is probable and the related damages are estimable.

* * * * *

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollar amounts in thousands)

In addition to historical information, the following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements as defined under federal securities laws and is subject to the safe harbor created therein for forward-looking statements. Such statements include, but are not limited to, statements concerning our anticipated operating results, research and development, clinical trials, and financial resources, and can be identified by use of words such as, for example, anticipate, estimate, expect, project, intend, plan, believe and would, should, could or may. Forward-looking statements are based on current expectations, estimates and projections about the industry and markets in which Pro-Pharmaceuticals operates, and management's beliefs and assumptions. These statements are not guarantees of future performance and involve certain known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. Such risks and uncertainties are related to, without limitation, our early stage of development, our dependence on outside capital, uncertainties of our technology and clinical trials, intellectual property litigation, risk of default on our debt securities, uncertainties of regulatory approval requirements for our products, competition and stock price volatility in the biotechnology industry, limited trading volume for our stock, concentration of ownership of our stock, and other risks detailed herein and from time to time in our SEC reports. The following discussion should be read in conjunction with the accompanying consolidated financial statements and notes thereto of Pro-Pharmaceuticals appearing elsewhere herein.

Dollar amounts are presented in thousands throughout this document.

Overview

We are a development-stage company engaged in research and development of carbohydrate-based therapeutic compounds. We believe our compounds offer numerous opportunities to provide advanced disease treatments. Our initial focus is on the target delivery of chemotherapy drugs for the treatment of cancer. We believe our initial carbohydrate compound DAVANA[®] may increase the body's tolerance to these toxic drugs by targeting the delivery directly to cancerous cells and increasing the efficacy, thereby creating a preferable treatment to existing oncology regimens. For additional information, please see Item 1. Business - Business of Pro-Pharmaceuticals included in our Annual Report on Form 10-K for the year ended December 31, 2006.

All of our product candidates are in preclinical and clinical development. We currently have one product candidate DAVANA[®] in clinical development. In general, in order to commercialize our present and future product candidates, we are required to successfully complete preclinical studies and clinical trials and obtain regulatory approvals. The requirements for regulatory approval include:

preclinical toxicology, pharmacology and metabolism studies, as well as in-vivo efficacy studies in relevant animal models of disease;

manufacturing of drug products for use in preclinical studies and clinical trials and ultimately for commercial supply;

submission of the results of preclinical studies and information regarding manufacturing and control and proposed clinical protocol to the U.S. Food and Drug Administration (FDA) in an investigational new drug application (IND), or similar filings with regulatory agencies outside the United States;

conduct of clinical trials designed to provide data and information regarding the safety and efficacy of the product candidate in humans; and

submission of all the results of testing to the FDA in a new drug application (NDA), or similar filings with regulatory agencies outside the United States.

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Upon approval by the appropriate regulatory authorities we may commence commercial marketing and distribution of the product. This process typically takes several years to complete and requires the expenditure of substantial resources. Any delay in obtaining or failure to obtain required approvals will materially adversely affect our ability to generate revenues from commercial sales relating to our drug candidates. We do not expect to file an NDA for a drug candidate before 2008. We anticipate our source of funding for the next several years to come from either financing transactions or collaborations with other pharmaceutical companies.

We are devoting substantially all of our efforts toward product research and development, and raising capital. We have no source of revenue and have incurred significant losses to date. We have incurred net losses of \$31,265 for the cumulative period from inception (July 10, 2000) through June 30, 2007. Our losses have resulted principally from costs associated with research and development expenses, including clinical trial costs, general and administrative activities and costs related to our debt financings, including interest and changes in debt carried at fair value. As a result of planned expenditures for future research, discovery, development and commercialization activities, we expect to incur additional operating losses for the foreseeable future.

We are currently dosing patients in two Phase II clinical trials. The first trial is a Phase II line 1 trial for colorectal cancer patients with DAVANAT[®], 5-FU, Leucovorin and Avastin[®]. The second trial is a Phase II line 1 trial with DAVANAT[®] and 5-FU.

On April 12, 2007, we announced that we received comments from the FDA related to our plans for submitting DAVANAT[®], as a functional excipient, under Section 505 (b)(2), to be administered intravenously in combination with 5-FU for cancer applications. We are using Section 505 (b)(2) to obtain more timely and efficient marketing approval of new formulations of previously approved therapeutics. Excipients are the materials, other than active pharmaceutical ingredients, incorporated into dosage forms for specific functional purposes, including modulating solubility, increasing stability and bio-availability, and play critical roles in the effectiveness, safety, potency, purity and stability of a product. In complex products such as chemotherapeutics, the functional role of an excipient is also important when used as a drug delivery system to reduce toxicity and/or increase efficacy.

On June 22, 2007, we received a notice from the American Stock Exchange Listing Qualifications Department that it is reviewing our eligibility for continued listing. Specifically, the notice cited that we do not comply with the Amex's minimum \$2 million stockholders' equity when combined with losses from continuing operations and/or net losses in two of its last three years set forth in Section 1003 (a) (i) of the Amex Company Guide. To facilitate the review, we have been asked to provide a specific plan and timeframe to achieve and sustain compliance with all Amex market listing requirements. The letter states that we may be granted up to 18 months to return to compliance with the Amex listing requirements. On July 23, 2007, we timely submitted a plan to the Amex to return to compliance within the specified period of time. We have not yet received a response from the Amex.

Through June 30, 2007, we have raised approximately \$35,930 in capital principally through the sale and issuance of common stock, common stock warrants and debt securities in public and private offerings. From inception (July 10, 2000) through June 30, 2007, we used cash of \$31,380 for our operations. At June 30, 2007, we had \$2,380 of cash and cash equivalents available to fund future operations, which we believe is sufficient to fund our operations through at least September 2007.

Because we lack revenue and must continue our research and development, we must continually identify new sources of capital and complete financing transactions in order to continue our business. We must continually monitor the monthly burn rate of our capital resources.

Results of Operations

Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

Research and Development Expenses. Research and development expenses were \$668 during the three months ended June 30, 2007, or a 33% decrease as compared to \$998 incurred in during the three months ended June 30, 2006. We generally categorize research and development expenses as either direct external expense, comprised of amounts paid to third party vendors for services, or all other expenses, comprised of employee payroll and general overhead allocable to research and development. We subdivide external expenses between clinical programs and preclinical activities. We consider a clinical program to have begun upon acceptance by the FDA, or similar agency outside of the United States, to commence a clinical trial in humans, at which time we begin tracking expenditures by the product candidate. We have one product candidate DAVANAT[®] in clinical trials at this time. Clinical program expenses comprise payments to vendors related to preparation for, and conduct of, all phases of the clinical trial, including costs for drug manufacture, patient dosing and monitoring, data collection and management, oversight of the trials and reports of results. Pre-clinical expenses comprise all

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research and development amounts incurred before human trials begin, including payments to vendors for services related to product experiments and discovery, toxicology, pharmacology, metabolism and efficacy studies, as well as manufacturing process development for a drug candidate.

Our research and development expenses for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 were as follows:

| | Three Months Ended June 30, | |
|---|--------------------------------|--------|
| | 2007 | 2006 |
| Direct external expenses | | |
| Clinical programs | \$ 309 | \$ 570 |
| Pre-clinical activities | 129 | 197 |
| All other research and development expenses | 230 | 231 |
| | \$ 668 | \$ 998 |

Clinical trial expenses decreased by approximately \$261. The decrease is due principally to clinical trial start-up costs for the Phase II biliary and Phase III European colorectal cancer trials incurred in the second quarter of 2006 which did not occur in the second quarter of 2007. Pre-clinical expenses decreased by \$68 to \$129 versus \$197 in the second quarter of 2006 due to lower activity related to basic research. All other research and development expense is unchanged. In 2006, \$23 of stock compensation expense has been reclassified from pre-clinical activities to all other research and development expenses for consistency of presentation with 2007 expenses. In July 2007, employees took salary reductions of 50% and reduced other cash research and development expenses significantly so that we may extend our cash runway as further discussed in the liquidity section of this report. As a result we expect cash research and development expense to decrease by greater than 30% in the third quarter of 2007 as compared to the second quarter of 2007. We expect total year research and development expenses to decrease in 2007 as compared to 2006.

We expect to file with the FDA under Rule 505(b)(2) for approval to sell DAVANAT[®] as a functional excipient in either the fourth quarter of 2007 or the first quarter of 2008. We plan to focus our research and development spending on preparing this filing and on our Phase II biliary cancer trial.

Both the time required and costs we may incur in order to commercialize a drug candidate that would result in material net cash inflow are subject to numerous variables, and hence we are unable at this stage of our development to forecast useful estimates. Variables that make estimates difficult include the number of clinical trials we may undertake, the number of patients needed to participate in the clinical trial, patient recruitment uncertainties, trial results as to the safety and efficacy of our product, and uncertainties as to the regulatory agency response to our trial data prior to receipt of marketing approval. Moreover, the FDA or other regulatory agencies may suspend clinical trials if we or an agency believes patients in the trial are subject to unacceptable risks, or find deficiencies in the conduct of the clinical trial. Delays or rejections may also occur if governmental regulation or policy changes during our clinical trials or in the course of review of our clinical data. Due to these uncertainties, accurate and meaningful estimates of the ultimate cost to bring a product to market, the timing of costs and completion of our program and the period during which material net cash inflows will commence are unavailable at this time.

General and Administrative Expenses. General and administrative expenses were \$1,104 during the three months ended June 30, 2007, resulting in a \$3 increase as compared to \$1,101 incurred during the three months ended June 30, 2006. General and administrative expenses consist primarily of salaries including stock based compensation, legal and accounting fees, insurance, investor relations, business development and other office related expenses. Payroll expenses decreased by approximately \$100 in 2007 as compared to 2006 due principally to the elimination of an accrual for incentive compensation in 2007. This decrease was offset by an increase in legal and accounting expenses of approximately \$70 due to expenses related to financings and restatements of financial statements previously filed. All other general and administrative expenses increased by approximately \$33 due to a combination of higher space lease and all other expenses. In July 2007 employees took salary reductions of 50% and reduced other cash general and administrative expenses so that we may extend our cash runway as further discussed in the liquidity section of this document. As a result we expect cash general and administrative expense to decrease by approximately 30% in the third quarter of 2007 as compared to the second quarter of 2007. We expect total year general and administrative expenses to decrease in 2007 as compared to 2006.

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Other Income and Expense. Other income and expense for the three months ended June 30, 2007 was income of \$1,808 as compared to income of \$2,329 for the three months ended June 30, 2006. Of the \$521 decrease in other income, \$1,049 is due to lower non-cash fair value charges associated with our convertible debenture and warrant liabilities and \$25 is due to lower interest income. This was offset by a decrease in interest expense of \$553 due to the lower outstanding convertible debenture balance resulting from redemptions and conversions.

Table of Contents**Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006**

Research and Development Expenses. Research and development expenses were \$1,336 during the six months ended June 30, 2007 a decrease of \$116 or 8%, as compared to \$1,452 incurred during the six months ended June 30, 2006. Please see explanation above contained in the three month analysis for a description of what is included in research and development expenses.

Our research and development expenses for the six months ended June 30, 2006, as compared to the six months ended June 30, 2005 were as follows:

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2007 | 2006 |
| Direct external expenses | | |
| Clinical programs | \$ 592 | \$ 681 |
| Pre-clinical activities | 206 | 293 |
| All other research and development expenses | 538 | 478 |
| | \$ 1,336 | \$ 1,452 |

Clinical trial costs decreased by approximately \$89. This was due to reduction of approximately \$227 in expenses related to the late stage patient Phase II DAVANAT[®]/5-FU Colorectal Cancer trial and the Phase I DAVANAT[®]/5-FU Colorectal Cancer trial which have been completed. In addition a reduction of approximately \$191 in 2007 as compared to 2006 is due to lower expenses related to our Phase III European colorectal cancer trial which we have put on hold so that we may focus our resources on our two current Phase II trials as they present an opportunity to provide results more quickly and more cost effectively. These reductions have been offset by an increase in expenses of approximately \$329 associated with our two current Phase II trials (Phase II line 1 colorectal trial with DAVANAT[®]/5-FU Leucovorin and Avastin[®] and Phase II line 1 biliary cancer trial with DAVANAT[®]/5-FU). Pre-clinical expenses in 2007 decreased by approximately \$87 versus 2006 due to lower research activity. Other research and development costs increased by approximately \$60 due to a combination of higher space lease expense and higher stock compensation expense. In 2006, \$62 of stock compensation expense has been reclassified from pre-clinical activities to all other research and development expenses for consistency of presentation with 2007 expenses.

General and Administrative Expenses. General and administrative expenses were \$2,360 during the six months ended June 30, 2007, a decrease of \$11 as compared to \$2,371 incurred during the six months ended June 30, 2006. Please see explanation above contained in the three month analysis for a description of what is included in general and administrative expenses. Payroll expenses decreased by approximately \$124 due principally to the elimination of an accrual for incentive compensation in 2007. Legal expenses decreased by approximately \$244. Legal expenses associated with the GlycoGenesys litigation decreased by approximately \$365 and were offset by an increase in legal expenses of approximately \$170 associated with our convertible debenture redemption and related share registration initiatives and our financing initiatives. All other legal expense, principally associated with general corporate matters decreased by \$49. Accounting expense increased approximately \$182 due principally to restatement of financial statements previously filed and stock-based compensation expense increased by approximately \$65. All other general and administrative expense increased by approximately \$110 due to an increase in filing fees associated with our convertible debenture, an increase in rent expense and modest increases in other areas of spending.

Other Income and Expense. Other income and expense for the six months ended June 30, 2007 was \$1,842 of expense compared to \$4,273 of expense for the six months ended June 30, 2006 or a decrease in expense of \$2,431. Of this decrease in expense, \$1,838 was due to a non-cash gain for fair value accounting associated with our convertible debenture and our warrant liabilities. Interest expense decreased by \$583 due to the lower outstanding convertible debenture balance resulting from redemptions and conversions and interest income increased by \$10.

Liquidity and Capital Resources

As described above in the Overview and elsewhere in this Quarterly Report on Form 10-Q, we are in the development stage and have not generated any revenues. Since our inception on July 10, 2000, we have financed our operations from proceeds of public and private offerings of debt and equity. As of June 30, 2007, we had raised a total of \$35,930 from these offerings and had \$2,380 of available cash and cash equivalents.

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Net cash used in operations decreased by \$823 to \$3,140 for the six months ended June 30, 2007 from \$3,963 for the six months ended June 30, 2006. This is due to a decrease in working capital needs of \$602 and a decrease in cash operating expenses of \$221.

Net cash provided by investing activities was \$4,914 as compared to a \$5,084 use of cash in the same period for 2006. A \$5,000 certificate of deposit was invested in the 2006 period and matured in the 2007 period. Fixed asset purchases decreased by \$26 and were offset by increased patent expenditures of \$18 in the six months ended June 30, 2007 versus the six months ended June 30, 2006 and restricted cash increased by \$10.

On March 21, 2007, pursuant to a Waiver and Exchange Agreement entered into with certain holders of the Debentures, we redeemed \$3,889 of the remaining \$4,444 principal, and \$16 of accrued interest, for 5,205,348 shares of our common stock at \$0.75 per share and adjusted the exercise price of the 2006 Investor Warrants held by such holders to \$1.00. Giving effect to the anti-dilution provisions of the 2006 Investor Warrants, an additional 3,152,014 shares of stock are issuable if all the warrants are exercised.

Cash of \$167 was used to repay our convertible debenture in the six months ended June 30, 2007. At June 30, 2007 \$389 of principal remains outstanding on our convertible debenture. This amount will be repaid in monthly payments of \$56 of principal plus accrued interest in accordance with the terms of the debenture agreement and will be fully repaid on January 1, 2008. In accordance with the terms of the Waiver and Exchange Agreement these payments may be made in shares if our stock is at or above \$0.85 per share. Net cash provided by financing activities in the first half of 2006 was \$9,300 which we raised in a private placement of 7% Convertible Debentures and common stock purchase warrants.

At June 30, 2007 our cash and cash equivalents on hand were \$2,380. In July of 2007, in order to conserve cash, employees took salary reductions of 50% and significantly reduced other cash expenses. As a result of these reductions, we believe our cash operating expense in the third quarter will be approximately \$1.2 million. We have implemented these reductions to provide additional time for us to raise cash through a debt or equity based financing or through partnerships with bio-pharmaceutical companies. We believe there is sufficient cash to fund operations through at least September 2007. We believe we will be able to obtain additional financing. However, there can be no assurance that we will be successful in obtaining such new financing or, if available, that such financing will be on terms favorable to us.

Payments Due Under Contractual Obligation

The following table summarizes the payments due under our contractual obligations at June 30, 2007, and the effect such obligations are expected to have on liquidity and cash flow in future periods:

| Contractual Obligations | Total | Payments due by period | | | |
|---|-----------------|------------------------|---------------|--------------|----------------------|
| | | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Convertible debt instrument | \$ 398 | \$ 398 | \$ | | |
| Operating leases | 1,063 | 247 | 785 | 31 | |
| Total payments due under contractual obligations | \$ 1,461 | \$ 645 | \$ 785 | \$ 31 | \$ |

The convertible debt instrument consists of scheduled principal and interest payments on our 7% Convertible Debentures. Remaining principal of \$389 is payable in monthly installments through January 1, 2008 (November 30, 2007 if repaid in shares). Interest accrues at the rate of 7% and is payable monthly. Remaining interest due is \$9. Principal and interest may be paid, at our option, in cash or shares of our common stock. Under the March 20, 2007 Waiver and Exchange Agreement with investors who redeemed their outstanding principal, we may not make payments in shares unless our share price is at or above \$0.85. Because investors may convert principal into common stock, at any time, at their option, the timing of principal and interest payments may accelerate relative to this schedule.

On May 1, 2006 we entered into an operating lease for office space. The lease commenced on August 11, 2006 and extends for five years and terminates on September 30, 2011. The lease provides for annual base rental payments of \$235 in the first year increasing in each subsequent lease year to \$244, \$253, \$263 and \$273 respectively. In addition to base rental payments included in the contractual obligations table above, we are responsible for our pro-rata share of increases in the operating expenses for the building after calendar year 2006 and taxes for the building after fiscal year 2007. We have the option to extend the term of the lease for an additional five year period at the prevailing market rate at the time of exercise. In connection with this lease, a commercial bank has issued a letter of credit collateralized by cash we have on deposit with the bank of approximately \$59. Additionally, we have a non-cancellable lease for a car which expires in October 2007.

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We have engaged outside vendors for certain services associated with our clinical trials. These services are generally available from several providers and, accordingly, our arrangements are typically cancellable on 30 days notice.

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Off-Balance Sheet Arrangements

We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating parts of our business that are not consolidated into our financial statements. We do not have any arrangements or relationships with entities that are not consolidated into our financial statements that are reasonably likely to materially affect our liquidity or the availability of capital resources.

Application of Critical Accounting Policies and Estimates

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to intangible assets, income taxes, accrued expenses, stock-based compensation, convertible debt instrument and warrant liabilities, contingencies and litigation. We base our estimates on historical experience, terms of existing contracts, our observance of trends in the industry, information available from other outside sources and on various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are those policies that affect our more significant judgments and estimates used in preparation of our consolidated financial statements. We believe our critical accounting policies include our policies regarding stock-based compensation, accrued expenses, income taxes and convertible debt instrument and warrant liabilities. For a more detailed discussion the first three of our critical accounting policies, please refer to our 2006 Annual Report on Form 10-K.

Effects of Recently Adopted Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* An Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The impact of uncertain income tax positions taken on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, and accounting for interim periods and requires expanded disclosure with respect to the uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect, if any, of adopting FIN 48 is to be reported as an adjustment to the opening balance of retained earnings in the year of adoption.

We adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, the total amount of unrecognized tax benefits was \$1,031, \$880 of which, if recognized, would affect the effective tax rate prior to the adjustment for our full valuation allowance. As a result of the implementation of FIN 48, we did not recognize an increase in tax liability for the unrecognized tax benefits because we have recorded a full valuation allowance against net operating loss carry forwards and has established a full valuation allowance. There have been no changes in unrecognized tax benefits as a result of the tax positions taken during the current period.

We are subject to U.S. Federal income tax as well as income tax of certain state jurisdictions. The tax years ranging from 2000 through 2006 remain open to examination by various taxing jurisdictions as the statute of limitations has not expired.

Since our net deferred tax asset and the unrecognized tax benefits determined under FIN 48 would not result in a cash payment, we have not accrued for any interest and penalties relating to these unrecognized tax benefits. Should we incur interest and penalties related to income taxes, those amounts would be included in income tax expense.

Effects of Recently Issued Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. We will be required to adopt SFAS No. 157 in the first quarter of fiscal year 2008. We are currently evaluating the requirements of SFAS No. 157 and have not yet determined the impact, if any, on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides entities with an option to report selected financial assets and liabilities at fair value, with the objective to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. We will be required to adopt SFAS No. 159 in the first quarter of fiscal year 2008. We are currently evaluating the requirements of SFAS

No. 159 and have not yet determined the impact, if any, of its adoption on our consolidated financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial position, operating results or cash flows due to changes in the U.S. interest rates. The primary objective of our investment activities is to preserve cash until it is required to fund operations. To minimize risk, we maintain our portfolio of cash and cash equivalents in operating bank accounts and money market funds. Since our investments are short-term in duration, we believe that we are not subject to any material market risk exposure. As of June 30, 2007, we had \$872 of outstanding warrant liabilities. We account for the warrant liabilities on a fair value basis, and changes in share price and market interest rates will affect our earnings but will not affect our cash flows.

Item 4. Controls and Procedures

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures and internal control over financial reporting (as defined in the SEC rules promulgated under the Securities Exchange Act of 1934). Based on this evaluation, our CEO and CFO concluded that (i), as of June 30, 2007, our disclosure controls and procedures were effective, and (ii) during the quarter ended June 30, 2007, no change in our internal control over financial reporting has materially affected, or is likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION (dollars in thousands)****Item 1. Legal Proceedings**

In January 2004, Dr. Platt, our Chairman and Chief Executive Officer, filed a lawsuit in Massachusetts Superior Court against GlycoGenesys, Inc. for various claims including breach of contract. In its filing in February 2004, GlycoGenesys asserted counterclaims against us and Dr. Platt alleging tortious interference and misappropriation of proprietary rights. The counterclaims seek monetary damages and injunctive relief related to our intellectual property. In March 2004, we and Dr. Platt answered the counterclaims and denied any liability. In June 2004, the Court allowed, without opposition, a motion of GlycoGenesys for leave to file a supplemental counterclaim against us for defamation and unfair competition. On February 2, 2006, GlycoGenesys filed a voluntary petition for protection under Chapter 11 of the U.S. Bankruptcy Code, which stayed the counterclaim litigation proceedings. On June 1, 2006, the bankruptcy court approved a motion by GlycoGenesys to convert the proceeding to Chapter 7 liquidation. On October 23, 2006, the judge issued an order allowing the liquidation sale of certain GlycoGenesys assets to Marlborough Research and Development, Inc. including the counterclaim lawsuit. Marlborough Research and Development, Inc. has changed its name to Prospect Therapeutics, Inc. and is continuing the counterclaim lawsuit against us and Dr. Platt. We believe these claims are without merit and intend to contest them vigorously. We believe that any impact on the financial statements is neither probable nor reasonably estimable and therefore no amounts have been recorded as of June 30, 2007.

Pursuant to Board approval, we agreed to indemnify Dr. Platt for the expenses of his defense of the counterclaims. No expenses have been incurred during the six month period ended June 30, 2007 in connection with this defense. Through June 30, 2007, we have incurred cumulative expenses of approximately \$438 in connection with this defense.

On January 28, 2005, we filed a request with the U.S. Patent and Trademark Office (USPTO) for an inter partes re-examination of U.S. Patent No. 6,680,306 owned by GlycoGenesys, Inc. because we believe that the invention claimed in this patent is anticipated by other inventions (technically, prior art), including our U.S. Patent No. 6,645,946 for DAVANAT. In an October 18, 2005 action, the USPTO agreed with our argument that all claims stated in the 306 patent are anticipated by prior art. On December 19, 2005, GlycoGenesys filed a response to the USPTO, and on January 18, 2006 we responded to the GlycoGenesys submission. The matter is now before the USPTO for a final decision. We believe that the USPTO actions to date support our belief that the invention claimed in our DAVANAT patent is prior art relative to the GlycoGenesys patent.

Item 1A. Risk Factors

Our 2006 Annual Report on Form 10-K includes a detailed discussion of our risk factors at Item 1A of Part I. The risks we face have not changed materially during the six month ended June 30, 2007 except as listed below.

Risks Related to Our Stock.

We Are Not in Compliance with the Continuing Listing Requirements of the American Stock Exchange. On June 22, 2007, we received a notice from the American Stock Exchange (Amex) Listing Qualifications Department that it is reviewing our eligibility for continued listing. Specifically, the notice cited that we do not comply with the Amex's minimum \$2 million stockholders' equity when combined with losses from continuing operations and/or net losses in two of its last three years set forth in Section 1003 (a) (i) of the Amex Company Guide. To facilitate the review, we timely provided The Amex a specific plan and timeframe to achieve and sustain compliance with all Amex market listing requirements. The Amex could, however, reject our plan and begin delisting proceedings. If we are delisted, our ability to raise capital may be diminished.

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

The following matters were submitted to a vote of our stockholders at our Annual Meeting of Stockholders held on May 24, 2007.

1. Stockholders who voted elected for one year terms the eight persons nominated by management to serve on our Board of Directors. The votes were as follows:

| Name of Director | Votes For | Votes Withheld |
|-------------------------------|------------------|-----------------------|
| Mildred S. Christian, Ph.D. | 24,793,207 | 11,643,497 |
| Dale H. Conaway, D.V.M. | 24,814,619 | 11,622,085 |
| Henry S. Esber, Ph.D. | 24,811,619 | 11,625,085 |
| James T. Gourzis, M.D., Ph.D. | 24,791,207 | 11,645,497 |
| S. Colin Neill | 24,808,275 | 11,628,429 |
| David Platt, Ph.D. | 24,718,710 | 11,717,994 |
| Steven Prelack | 24,785,453 | 11,651,251 |
| Jerald K.Rome | 24,785,453 | 11,651,251 |

2. Stockholders who voted ratified the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the year ending December 31, 2007. The vote was as follows: 35,543,047 votes in favor; 636,904 votes against; and 256,753 abstentions.

3. Stockholders who voted approved a proposal to change the present articles of incorporation to allow shareholders to nominate directors directly that are qualified. The voting was as follows: 11,030,778 votes in favor; 8,798,986 votes against; 1,141,262 abstentions; and 14,465,678 broker non-votes.

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Item 6. Exhibits

| Exhibit Number | Description of Document |
|-----------------------|--|
| 31.1* | Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 |
| 31.2* | Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 |
| 32.1** | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2** | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

* Filed herewith.

** Furnished herewith and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on August 10, 2007.

PRO-PHARMACEUTICALS, INC.

By: /s/ David Platt
Name: David Platt, Ph.D.
Title: Chief Executive Officer

/s/ Carl L. Lueders
Name: Carl L. Lueders
Title: Chief Financial Officer