

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

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

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1997

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_ .

COMMISSION FILE NUMBER 0-14732

ADVANCED MAGNETICS, INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)  
725 CONCORD AVENUE  
CAMBRIDGE, MASSACHUSETTS  
(ADDRESS OF PRINCIPAL EXECUTIVE  
OFFICES)

04-2742593  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)  
02138  
(ZIP CODE)

Registrant's telephone number, including area code: (617) 354-3929

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

Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK, PAR  
VALUE \$.01

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 the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of December 8, 1997, there were 6,729,526 shares of the registrant's Common Stock, \$.01 par value, outstanding. The aggregate market value of the registrant's voting stock held by nonaffiliates as of December 8, 1997 was approximately \$55,883,912.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for its 1997 Annual Meeting of Stockholders, scheduled to be held on February 3, 1998, are incorporated by reference in Part III hereof.

ITEM 1. BUSINESS:

COMPANY OVERVIEW

Advanced Magnetics, Inc., a Delaware corporation ("Advanced Magnetics" or the "Company"), develops, manufactures and markets organ-specific contrast agents to improve the diagnostic capabilities of soft tissue magnetic resonance imaging ("MRI") scans and is developing targeted drug delivery platforms that deliver therapeutics directly to the liver and other organs including lymph nodes. Sales of the Company's liver contrast agent, Feridex I.V., have commenced in Europe and the United States. In September 1997, sales of Feridex I.V. commenced in Japan. GastroMARK, used for marking of the bowel in MRI procedures, has been approved for marketing in several European countries and Canada, and sales commenced in the United States in April 1997. With respect to Combidex, the Company's contrast agent for the liver, spleen, and lymphatic system, the Company has completed Phase III trials for Combidex in the United States for imaging liver lesions and is currently in Phase III trials for lymph node imaging. The Company hopes to submit a New Drug Application ("NDA") to the United States Food and Drug Administration "FDA" for both indications in late 1998 or early 1999. Advanced Magnetics is also applying its liver-targeting technology and expertise to the delivery of therapeutics to the liver.

MRI is a diagnostic imaging technique that is used to identify internal abnormalities and changes in structure. Contrast agents increase the usefulness of MRI by allowing radiologists to differentiate structures and organs with greater diagnostic confidence. The Company believes that MRI studies of the liver and lymph nodes produced with contrast agents are clearer and permit the identification of smaller abnormalities than images produced by MRI studies without contrast agents or imaging using contrast enhanced computed tomography ("CECT"). MRI contrast agents frequently allow for more accurate diagnosis and monitoring of treatment results and may be a cost-effective way to assess medical treatments and to improve patient outcomes. Currently, the primary use of MRI is for studies of the central nervous system. The Company believes that the development of effective contrast agents should increase the use of MRI as a diagnostic imaging technique and allow MRI to be used for a wider range of applications, in turn generating additional demand for MRI contrast agents. However, in an era of increasing cost containment pressures, adoption of new imaging techniques may be slow or may not occur.

Feridex I.V. is the first organ-specific MRI contrast agent designed specifically for the liver and is marketed in the United States, Europe and Japan. The liver and the lymphatic system are among the principal sites for metastasis of many common cancers (including colon, prostate and breast cancer). CECT is currently the primary imaging technique used to confirm a preliminary or suspected diagnosis of liver cancer. With respect to the lymphatic system, there currently are no effective imaging techniques. An MRI contrast agent that localizes to and causes contrast enhancement of the lymph nodes, such as the Combidex product the Company has under development, could allow for more accurate disease diagnosis and monitoring of treatment results. GastroMARK enhances the contrast between the bowel and other abdominal structures, and could ultimately increase the use of MRI as an imaging technology for the abdomen.

To facilitate the marketing and distribution of its contrast agents, the Company has entered into strategic relationships with certain established pharmaceutical companies. These relationships, both in the United States and abroad, include: (i) Guerbet S.A. ("Guerbet"), a leading European producer of contrast agents, in Western Europe and Brazil; (ii) Eiken Chemical Co., Ltd. ("Eiken"), one of Japan's leading medical diagnostics manufacturers, in Japan; (iii) Berlex Laboratories, Inc. ("Berlex"), the leading marketer of MRI contrast agents, in the United States; and (iv) Mallinckrodt Inc. ("Mallinckrodt"), a leading manufacturer of contrast agents, in the United States, Canada and Mexico.

The Company's expertise in organ-specific technology provides it with biopharmaceutical opportunities beyond its core MRI contrast agent products. Advanced Magnetics is developing targeted therapeutics technology for the treatment of liver diseases. The Company believes that arabinogalactan, a naturally-occurring polysaccharide that binds to the asialoglycoprotein ("ASG") receptor found in abundance on hepatocytes, the principal cells comprising the liver, has commercial promise in drug delivery. Advanced

Magnetics hopes to study the efficacy of therapeutic agents combined with arabinogalactan for the treatment of liver diseases through strategic alliances with other pharmaceutical companies that the Company may establish.

Advanced Magnetics' knowledge and experience in diagnostics, combined with the experience of senior management in the diagnostic testing area led to the acquisition of 81% of the capital stock of Kalisto Biologicals, Inc. ("Kalisto") in October 1997. Kalisto is an early-stage food testing and veterinary diagnostics company.

In addition, in September 1997 the Company entered into an option agreement with Cavitation Control Technology, Inc. ("CAV-CON") to purchase the worldwide technology rights to CAV-CON's lipid micro-bubble technology.

The Company was incorporated in Delaware in 1981. The Company's principal offices are located at 61 Mooney Street, Cambridge, Massachusetts 02138, and its telephone number is (617) 497-2070.

## MRI CONTRAST AGENTS

### OVERVIEW

Diagnostic Imaging. Diagnostic imaging is generally a non-invasive method to visualize internal structures, abnormalities or anatomical changes in order to diagnose disease and injury. Today, the most widely accepted imaging techniques include x-rays, ultrasound, nuclear medicine, Computerized Tomography ("CT") and MRI. Since the introduction of x-rays, the need for increasingly accurate and detailed non-invasive visualization of soft tissue has increased. For example, diagnostic imaging frequently is used to determine whether a cancer has metastasized and to assist physicians in determining whether a treated cancer has recurred and the location of metastatic tumors. In addition, diagnostic imaging is used in the diagnosis of disease and injury conditions affecting the cardiovascular and central nervous systems and certain joints, such as the knee and shoulder. In 1994, over 76 million soft tissue and organ imaging procedures were performed in the United States. The choice of diagnostic imaging technique to be used in any particular circumstance depends upon a variety of factors, including the particular disease or condition to be studied, image quality, availability of imaging machines, availability of contrast agents and cost. There is no imaging technique that is considered superior to all others for most or all applications.

Contrast agents play a significant role in improving the quality of diagnostic images by increasing contrast between different internal structures or types of tissues in various disease states and medical conditions of interest. The availability of an effective contrast agent often determines the choice of imaging technique for a particular procedure. Consequently, contrast agents, which are administered intravenously or orally, are widely used when available. Currently available imaging techniques can be of limited usefulness in visualizing certain soft-tissue structures. For example, clinically useful diagnostic imaging of small lesions in lymph nodes, a common site of metastasis for some frequently occurring cancers such as breast cancer, is not currently available because, the Company believes, there are no effective contrast agents for differentiating cancerous lymph nodes from other nodes.

Magnetic Resonance Imaging. Introduced in the 1980's, MRI is the diagnostic imaging technique of choice for the central nervous system and is widely used for the imaging of ligaments and tendons. MRI, which represents the first major advance in imaging since the advent of CT scanning, provides high-quality spatial resolution and does not use radiation. In MRI procedures, the patient is placed within the core of a large magnet where radio frequency signals are transmitted into the patient's body. The interaction of the radio frequency signal with the patient's body produces signals that are processed by a computer to create cross-sectional images. MRI contrast agents currently marketed in the United States are used primarily in imaging the central nervous system.

### TECHNOLOGY

Advanced Magnetics' core imaging agent technology is based on the design and manufacture of extremely small, polysaccharide-coated superparamagnetic iron oxide particles of controlled sizes. The

superparamagnetic particles range in size from approximately one-thousandth to one-twentieth the size of a normal red blood cell. When placed in a magnetic field, superparamagnetic iron oxide particles become strongly magnetic, but do not retain their magnetism once the field is removed. The powerful magnetic properties of the Company's iron oxide particles result in images that show greater soft tissue contrast to increase the information available to the reviewing radiologist. The Company's technology and expertise enable it to synthesize, sterilize and stabilize superparamagnetic particles in a manner necessary for their use in pharmaceutical products as MRI contrast agents to aid in the diagnosis of cancer and other diseases. The Company's rights to its contrast agent technology are derived from and protected by license agreements, patents, patent applications and trade secrets. See "Patents and Trade Secrets."

#### TARGETED DRUG DELIVERY PLATFORM

##### OVERVIEW

Effective treatment of organ-specific diseases is often limited by the inability to deliver sufficient quantities of therapeutic pharmaceuticals to the affected organ without creating unacceptable levels of toxicity in the rest of the body. The Company believes the treatment of liver diseases and other organ-specific diseases would be significantly improved by delivering therapeutics to the organ while limiting the exposure of the rest of the body to the drug. The Company discovered that arabinogalactan, a compound it studied to target contrast agents to the liver, could also be useful in delivering therapeutic agents to hepatocytes through the asialoglycoprotein ("ASG") receptor. Hepatocytes are cells which generally comprise approximately 95% of the total cells of the liver but do not exist in the rest of the body. The Company has developed several drug conjugates that are in the pre-clinical stage for the treatment of liver diseases, including hepatitis B.

##### TECHNOLOGY

The Company's drug delivery technology includes joining a therapeutic agent to a targeting agent, which binds specifically with certain receptors on the surface of cells. Receptors are specialized protein structures that will only bind with specific molecules. Certain receptors are prevalent only or primarily on specific kinds of cells. For example, the ASG receptor exists primarily on hepatocytes. After binding with the receptor, the targeting agent and an attached pharmaceutical are transported into the cell, where the pharmaceutical causes a therapeutic effect. The Company believes that targeted drug delivery based on the binding action of targeting agents to receptors offers the possibility of delivering effective therapeutic doses to affected cells without general distribution of toxic agents throughout the body.

In its first targeted drug delivery proof of principle project, the Company has completed animal testing of a potential therapeutic product for hepatitis B composed of arabinogalactan and vidarabine monophosphate ("AraAMP"). Vidarabine ("AraA"), an antiviral agent which is used in the United States and abroad for the treatment of herpes simplex, has not been approved for treatment of hepatitis B in the United States because, although it is an effective agent against the hepatitis virus, when administered systemically in an unconjugated form, it is often toxic to the bone marrow, blood cells and peripheral nervous system in the dosage regimen necessary to treat the hepatitis B virus. AraA and other nucleoside products must be phosphorylated with three phosphate ions in order to have a therapeutic effect. When AraA is injected directly, however, many molecules of AraA do not become phosphorylated. The Company believes that much of the toxicity associated with AraA results from toxic compounds created when the drug breaks down in the body. The Company has discovered that AraA, when phosphorylated with one phosphate (monophosphate) and chemically linked with arabinogalactan prior to injection, shows far greater therapeutic effect in animals and reduced toxicity. Toxicity is reduced because (i) less therapeutic compound is needed since AraAMP is directed by the arabinogalactan to hepatocytes through the ASG receptor, (ii) the probability of successful triphosphorylation is increased by the targeted delivery of the monophosphate to the cell and (iii) the arabinogalactan AraAMP conjugate does not, the Company believes, metabolize into any toxic product during its short blood half-life.

The Company believes that the delivery and use enhancements seen when AraAMP is attached to arabinogalactan may be obtained with other therapeutic agents. The attachment of a variety of therapeutic

agents to arabinogalactan, such as ribavirin and acyclovir, is an active area of research for Advanced Magnetix and may lead to a series of arabinogalactan-delivered pharmaceuticals for the treatment of such liver diseases as hepatitis B, hepatitis C, hepatitis D and liver cancer. The Company is attempting to establish strategic alliances with other pharmaceutical companies to exploit the advantages of its drug delivery platform and polysaccharide conjugation technology.

The Company holds three United States patents and a notice of allowance for a European patent covering the delivery of therapeutic agents with arabinogalactan. A fourth patent covering the use of arabinogalactan with radiotherapy has issued in the United States. The Company has also developed a proprietary purification scheme for purifying arabinogalactan that enables it to manufacture a pharmaceutical grade of arabinogalactan suitable for use in therapeutic products. See "Patents and Trade Secrets."

#### PRODUCTS UNDER DEVELOPMENT

The following table summarizes potential applications, marketing partners and the current United States and foreign status for each of the Company's products.

#### ADVANCED MAGNETIX PRODUCTS UNDER DEVELOPMENT

PRODUCT	APPLICATIONS	MARKETING PARTNERS	UNITED STATES STATUS	FOREIGN STATUS
<b>CONTRAST AGENTS</b>				
Feridex I.V.	Diagnosis of liver lesions	Berlex (United States), Eiken (Japan), Guerbet (Western Europe and Brazil)	Marketing of product began in October 1996.	Approved and marketed in most EU countries. Launched in Japan in September 1997.
Combindex	Diagnosis of lesions of the liver, spleen and lymphatic system	Guerbet (Western Europe and Brazil), Eiken (Japan)	Phase III liver/spleen trials completed. Phase III clinical trials for lymph nodes, currently underway, to be completed in early 1998. NDA anticipated late 1998/early 1999.	Phase III clinical trials for lymphatic imaging, currently underway, to be completed in 1998. CFMP filing anticipated in 1999.
GastroMARK	Marking of the bowel in abdominal imaging	Guerbet (Western Europe and Brazil), Mallinckrodt (United States, Canada and Mexico)	Marketing of product began in April 1997.	Approved and marketed in many European countries, including France. Approved in Canada.
<b>TARGETED DRUG DELIVERY PRODUCTS</b>				
AraAMP-arabinogalactan conjugate	Therapeutic for hepatitis B	--	Pre-clinical research completed. Strategic partner being sought.	--
Ribavirin-arabinogalactan conjugate	Therapeutic for hepatitis C	--	Pre-clinical research in progress.	--

"Phase I clinical trials" refers to the first phase of human pharmaceutical clinical trials in which testing for the safety and tolerance of the product is conducted on a small group of normal subjects. "Phase II clinical trials" and "Phase III clinical trials" refer to the second and third phases of human clinical trials, where preliminary dosing and efficacy studies are conducted and where additional testing for efficacy and safety is conducted on an expanded patient group. For a further description of the substantial regulatory requirements subsequent to the completion of preclinical testing, see "Government Regulation and Reimbursement."

#### CONTRAST AGENTS

Feridex I.V. The liver is a principal site for metastasis of primary cancer originating in other parts of the body, particularly cancer of the colon, a common cancer in the United States. Diagnosis of metastasis at an early stage can be difficult because small tumors are frequently not accompanied by detectable physical symptoms. Identification of metastatic tumors in the liver has a significant impact on physicians' treatment plans for cancer. The Company

believes that Feridex I.V. will allow for MRI scans of liver tumors that may not be visible with CT scanning or ultrasound, the most widely used techniques for liver imaging, and that a substantial number of liver scans will now be done using MRI instead of, or in addition to, CT scanning and ultrasound.

Marketing of Feridex I.V. began in October 1996 by Berlex Laboratories in the United States. Feridex I.V. was approved in August 1994 by the European Union's (the "EU") Committee for Proprietary Medicinal Products and most of the member states of the EU have since issued local approvals to market the product. Guerbet has begun marketing the product in Europe. Eiken received approval for marketing the product in Japan in July 1997 and received pricing approval in September 1997. Feridex I.V. was launched in Japan in September 1997 through Eiken's affiliate, Tanabe Seiyaku, Ltd. Berlex Laboratories is the Company's exclusive marketing partner for Feridex I.V. in the United States. See "Licensing and Marketing Arrangements."

Combidex. The Company believes that Combidex will be useful in diagnostic imaging of the liver, spleen and lymph nodes. Lymph nodes are frequently sites for metastases of different types of cancer, particularly breast cancer and prostate cancer, and efficient imaging of lymph nodes could play a major role in determining appropriate courses of treatment. There are currently no available noninvasive methods for distinguishing between lymph nodes enlarged by tumorous infiltration as opposed to inflammation. Since CT, the only imaging modality currently used for imaging lymph nodes, cannot distinguish between inflamed nodes and cancerous nodes, the current practice is to assume that enlarged nodes are cancerous and to perform a biopsy to establish their true status. Nodes less than one centimeter in size are assumed to be normal. The Company believes that Combidex will enable doctors using MRI to distinguish between cancerous and non-cancerous enlarged lymph nodes because its accumulation in normal lymph node tissue permits differentiation between normal and tumor-infiltrated nodes. The Company also believes that Combidex can be used to identify tumors in the liver and spleen because tumors generally are hypovascular when compared to surrounding tissues.

The Company has completed Phase III studies using Combidex to image the liver. Phase III trials using Combidex to image lymph nodes are currently underway. The Company expects the lymph node trials to be completed in 1998. The Company expects to file an NDA for both indications in late 1998 or early 1999.

Of the approximately 576 patients and subjects who were administered Combidex during its product development, one suffered an allergic reaction and died in January 1996. There can be no assurance that this death or any subsequent death that may occur during the clinical trials for this product would not have an adverse effect on the Company's ability to continue clinical trials or obtain regulatory approvals for Combidex or otherwise have a material adverse effect on the Company's business, financial condition and results of operations. See "Risk Factor-Potential Product Liability; Uncertainties Related to Insurance."

The Company has granted exclusive rights to market and sell Combidex in Western Europe and Brazil to Guerbet. See "Licensing and Marketing Arrangements."

GastroMARK. MRI imaging of organs and tissues in the abdomen without contrast agents is difficult because these organs and tissues cannot be easily distinguished from the loops of the bowel. GastroMARK, the Company's oral contrast agent for marking of the bowel, when ingested, flows through and darkens the bowel. By more clearly identifying the intestinal loops, GastroMARK improves visualization of adjacent abdominal tissues, including the pancreas and pelvis.

In April 1997, the Company's marketing partner, Mallinckrodt, launched GastroMARK in the United States. The Company has licensed the manufacturing and marketing rights to GastroMARK on an exclusive

basis to Guerbet in Western Europe and Brazil. During fiscal 1993, Guerbet received marketing approval for the product in several European countries including France, and marketing of the product in Europe has begun. See "Licensing and Marketing Arrangements."

The Company believes that arabinogalactan will prove useful in delivering therapeutic pharmaceuticals to the liver because of its lack of toxicity and high specificity for hepatocytes. The Company believes that the delivery and use enhancements seen in pre-clinical research using araAMP may be obtainable with other therapeutic agents. The attachment of a variety of therapeutic agents to arabinogalactan, such as ribavirin and acyclovir, is an active area of research for Advanced Magnetix and may lead to a series of arabinogalactan-based pharmaceuticals for the treatment of such liver diseases as hepatitis B, hepatitis C, hepatitis D and liver cancer. The Company is seeking strategic partners in this area.

#### LICENSING AND MARKETING ARRANGEMENTS

**BERLEX.** In February 1995, the Company entered into a license and marketing agreement and supply agreement with Berlex, granting Berlex exclusive marketing rights to Feridex I.V. in the United States. Under the terms of the agreements, Berlex paid a \$5,000,000 license fee upon execution of the agreements and paid an additional \$5,000,000 license fee in October 1996 upon the Company's delivery of FDA-approved product to Berlex. In addition, the Company receives payments for manufacturing the agent and royalties on sales of the agent. These agreements expire in 2010 but can be terminated earlier upon the occurrence of certain specified events.

**GUERBET.** In 1987, the Company entered into a supply and distribution agreement with Guerbet. Under this agreement, Guerbet has been appointed the exclusive distributor of Feridex I.V. in Western Europe (under the tradename Endorem) and Brazil. Guerbet is responsible for conducting clinical trials and securing the necessary regulatory approvals in the countries in its territory. Guerbet paid the Company license fees and is required to pay royalties based on sales. The Company is entitled to receive an additional percentage of Guerbet's sales in return for selling to Guerbet its requirements for the active ingredient used in Endorem. The agreement terminates on the later of (i) the expiration of the last to expire technology patent or (ii) ten years after the date all necessary approvals are obtained in France.

In 1989, the Company entered into a second supply and distribution agreement with Guerbet granting Guerbet an exclusive right in Western Europe (under the tradename Lumirem) and Brazil to manufacture and sell GastroMARK and any future Advanced Magnetix MRI contrast agents that Guerbet decides to market, including Combidex. Under the terms of this second distribution agreement, Guerbet paid the Company a license fee in 1989. In addition, Guerbet will pay the Company both royalties and a percentage of net sales as the purchase price for the active ingredient. The Company is required to sell to Guerbet its requirements for the active ingredient used in the contrast agents. The agreement is perpetual but terminable upon specified events such as nonperformance, insolvency or assignment without consent.

**MALLINCKRODT.** In 1990, the Company entered into a manufacturing and distribution agreement for GastroMARK with Mallinckrodt Medical, Inc. Under this agreement, Mallinckrodt received the exclusive right to manufacture and co-market GastroMARK in the United States, Canada and Mexico. The Company may also sell the product through its own direct sales personnel. Mallinckrodt has paid \$1,850,000 under the contract, including \$500,000 during fiscal year 1997 upon FDA approval of the NDA. Additionally, the Company will receive royalties based on Mallinckrodt's GastroMARK sales and a percentage of sales for supplying the active ingredient. The agreement is perpetual but terminable upon specified events such as nonperformance, insolvency or assignment without consent.

**EIKEN.** In 1988, the Company entered into a manufacturing and distribution agreement with Eiken, granting Eiken the exclusive right to manufacture and distribute Feridex I.V. in Japan. Eiken is responsible for conducting clinical trials and securing the necessary regulatory approval in Japan. Under the terms of the agreement, Eiken paid the Company a license fee of \$1,500,000. In addition, Eiken is required to pay royalties

based upon sales. The agreement terminates on the later of (i) the expiration of the last to expire technology patent or (ii) ten years after the date all necessary approvals are obtained.

In 1990, the Company entered into a manufacturing and distribution

agreement with Eiken, granting Eiken the exclusive right in Japan to manufacture and distribute GastroMARK and Combidex. In addition, for a period of 180 days after the Company files an NDA for any future Advanced Magnetics MRI contrast agents Eiken has the right of first refusal to manufacture and distribute such product in Japan. Upon execution of this agreement, Eiken paid the Company a license fee of \$1,000,000. Additionally, Eiken agreed to pay the Company royalties on sales of all products sold by Eiken under the agreement. The agreement is perpetual but terminable upon specified events such as nonperformance, insolvency or assignment without consent. Due to market conditions in Japan, Eiken has decided not to market GastroMARK.

SQUIBB DIAGNOSTICS. In 1991, the Company entered into agreements with Squibb Diagnostics, a division of Bristol-Myers Squibb Co. ("Squibb Diagnostics") covering certain technology and the manufacturing and marketing of certain contrast agents including Combidex, which agreements have since been terminated. Under agreements returning the products and technology rights to Advanced Magnetics, the Company is obligated to pay Squibb Diagnostics up to a maximum of \$2,750,000 in royalties in connection with product sales of Combidex.

#### MANUFACTURING AND SUPPLY ARRANGEMENTS

The Company's Cambridge, Massachusetts facility is registered with the FDA and is subject to "Good Manufacturing Practices" ("GMP") as prescribed by the FDA. The Company currently manufactures Feridex I.V. bulk product for sale to Guerbet, manufactures Feridex I.V. finished product for sale to Berlex and GastroMARK bulk product for sale to Guerbet and Mallinckrodt. The Company also manufactures Combidex for pre-clinical and clinical testing. The Company expects to utilize contract manufacturers from time to time if appropriate.

The manufacture of the Company's therapeutic products currently in research and development would require the continuous availability of commercial grade arabinogalactan, a naturally occurring polysaccharide that is commercially available, which the Company purifies at its Cambridge facility into a pharmaceutical grade material.

#### PATENTS AND TRADE SECRETS

The Company considers the protection of its technology to be material to its business. The Company's policy is to aggressively protect its competitive technological position by a variety of means, including applying for patents in the United States and in appropriate foreign countries. The Company has been granted 26 United States patents and has pending several patent applications. The Company has filed counterpart patent applications in several foreign countries. In addition, the Company is a party to various license agreements, including nonexclusive cross-licensing arrangements covering MRI imaging technology with Nycomed Imaging A.S. of Oslo, Norway ("Nycomed") and Schering AG ("Schering"). The Company's proprietary position depends in part on these licenses, and termination of the licenses for any reason could have a material adverse effect on the Company by limiting or prohibiting the commercial sale of its products. Although the Company believes that further patents will issue on pending applications, no assurance to this effect can be given.

The patent positions of pharmaceuticals and biopharmaceutical firms, including Advanced Magnetics, are generally uncertain and involve complex legal and factual questions. There can be no assurance that any claims which are included in pending or future patent applications will issue, that any issued patents will provide the Company with competitive advantages or will not be challenged by others, or that the existing or future patents of third parties will not have an adverse effect on the ability of the Company to commercialize its products.

The Company believes it has a strong intellectual property position regarding arabinogalactan for use in targeting therapeutic compounds. It has three U.S. patents and a notice of allowance for a European patent covering the delivery of therapeutic agents with arabinogalactan. A fourth patent covering the use of arabinogalactan with radiotherapy has issued in the United States. Additional therapeutic applications are pending, but there is no assurance that any additional patents will issue to the Company.

The Company also intends to rely on its trade secrets, know-how, continuing technological innovations and licensing opportunities to maintain and develop

its competitive position. Although the Company seeks to protect its proprietary information, there can be no assurance that others will not independently develop the same or similar information, design around the patents, obtain unauthorized access to the Company's proprietary information or misuse information to which the Company has granted access. Litigation may be necessary to enforce any patents issued to the Company or to determine the scope of other person's proprietary rights in court or administrative proceedings. Any litigation or administrative proceeding could result in substantial costs to the Company and distraction of the Company's management. An adverse ruling in any litigation or administrative proceeding could have a material adverse effect on the Company's business, financial condition and results of operations.

#### COMPETITION

The pharmaceutical and biopharmaceutical industries are subject to intense competition and rapid technological change. The Company expects competition in the development of new MRI contrast agents to increase substantially. Certain companies, including the Company's collaborators, which have greater human and financial resources dedicated to product development and clinical testing than the Company, are developing MRI contrast agents. The Company's collaborators are not restricted from developing and marketing competing products and as a result of certain cross license agreements among the Company and certain of its competitors (including one of its collaborators), the Company's competitors will be able to utilize certain of the Company's technology in the development of competing products. There can be no assurance that the Company will be able to compete successfully with these companies.

The Company believes that its ability to compete successfully in the MRI contrast agent market will depend on a number of factors including the development of efficacious products, timely receipt of regulatory approvals and product manufacturing at commercially acceptable costs. In addition, the Company's MRI contrast agents represent a new approach to imaging certain organs and market acceptance of both MRI as an appropriate technique for such organs, and the Company's products as part of such imaging is critical to the success of its contrast agent products. Although the Company believes that its contrast agents will offer advantages over competing MRI, CT or X-ray contrast agents, there can be no assurance that there will be greater acceptance of its products over other contrast agents. In addition, to the extent that other diagnostic techniques such as CT and X-ray may be perceived as providing greater value than MRI, any corresponding decrease in the use of MRI could have an adverse effect on the demand for the Company's contrast agent products. There can be no assurance that the Company will be able to successfully develop efficacious products, obtain timely regulatory approvals, manufacture products at commercially acceptable costs, gain satisfactory market acceptance or otherwise successfully compete in the future.

There are several MRI contrast agents for imaging lesions of the liver in various phases of human testing in the United States and abroad. Schering has two products in development, Resovist, a carboxydextran superparamagnetic iron oxide formulation, and Eovist, a chelated gadolinium compound. The Company believes that Resovist is nearing approval in Europe and that Eovist has completed Phase II trials in Europe. The Company does not know the status of Resovist or Eovist in Japan. On December 1, 1997 the FDA approved Teslascan, Nycomed's MnDPDP product for MRI of liver lesions. The Company believes that Bracco S.p.A. is conducting clinical trials in Europe and the United States for Gadolinium BOPTA, a chelated gadolinium compound for MR imaging of liver lesions. The Company does not know the status of this product.

In the area of oral contrast agents, Pharmacyclics, Inc. filed an NDA in late 1995 for GADOLITE, its gadolinium-based product candidate. Bracco S.p.A. has filed an NDA in the United States for Lumenhance,

its liposomal encapsulated oral manganese compound. In October 1997, the FDA approved Ferriselz(R), an oral MRI agent from Oncomenbrane Inc. The Company believes that GastroMARK, being first to market with a safe and effective product should have a competitive advantage. There can be no assurance, however, that these competitive products or other products developed by the Company's competitors will not be more effective than any products developed by the Company or render the Company's technology obsolete.

Many of the Company's competitors have substantially greater capital,

research and development, manufacturing and marketing resources and experience than the Company. Such companies may succeed in developing technologies and products that are more effective or less costly than any that may be developed by the Company and may also prove to be more successful than the Company in production and marketing. There can be no assurance that Advanced Magnetics will successfully develop any proposed drug delivery products, obtain required regulatory approvals or gain satisfactory market acceptance for such products. Furthermore, there can be no assurance that products developed by the Company's competitors will not be more effective than any products developed by the Company, render the Company's technology obsolete or gain greater market acceptance.

#### GOVERNMENT REGULATION AND REIMBURSEMENT

The production and marketing of the Company's products and its ongoing research and development activities are subject to regulation for safety, efficacy and quality by numerous governmental authorities in the United States and other countries. Pharmaceutical products intended for therapeutic use in humans are principally governed by FDA regulations in the United States and by comparable government regulations in foreign countries. Various federal, state and local statutes and regulations also govern or influence the research and development, manufacturing, safety, labeling, storage, record-keeping, distribution and marketing of such products. The process of completing pre-clinical and clinical testing and obtaining the approval of the FDA and similar health authorities in foreign countries to market a new drug product requires a significant number of years and the expenditure of substantial resources. Failure to obtain requisite governmental approvals or failure to obtain approvals of the scope requested will delay or preclude the Company or its licensees or collaborators from marketing the Company's products or limit the commercial use of the products and will have a material adverse effect on the Company's business, financial condition and results of operations.

The steps required by the FDA before a new human pharmaceutical product, including a contrast agent or therapeutic drug, may be marketed in the United States include: (a) pre-clinical laboratory tests, in vivo pre-clinical studies and formulation studies; (b) the submission to the FDA of a request for authorization to conduct clinical trials subject to an Investigational New Drug ("IND") exemption, to which the FDA must not object, before human clinical trials may commence; (c) adequate and well-controlled human-clinical trials to establish the safety and efficacy of the drug for its intended use; (d) submission to the FDA of an NDA; (e) approval and validation of manufacturing facilities and production uses of the pharmaceutical; and (f) review and approval of the NDA by the FDA before the drug product may be shipped or sold commercially.

Pre-clinical tests include the laboratory evaluation of product chemistry and formulation, as well as animal studies to assess the potential safety and efficacy of the product. Pre-clinical test results are submitted to the FDA as a part of the IND. Clinical trials are typically conducted in three sequential phases, although the phases may overlap. Phase I involves the initial administration of the drug to a small group of human beings, either healthy volunteers or patients, to test for safety, dosage tolerance, absorption, distribution, metabolism, excretion and clinical pharmacology and, if possible, early indications of effectiveness. Phase II involves studies in a small sample of the actual intended patient population to assess the preliminary efficacy of the investigational drug for a specific clinical indication, to ascertain dose tolerance and the optimal dose range and to collect additional clinical information relating to safety and potential adverse effects. Once an investigational drug is found to have some efficacy and an acceptable clinical safety profile in the targeted patient population, Phase III studies can be initiated to further establish safety and efficacy of the investigational drug in a broader sample of the target patient population. The results of the clinical trials together with the results of the pre-clinical tests and complete manufacturing information are submitted in an

NDA to the FDA for approval. The FDA may suspend clinical trials at any point in this process if it concludes that patients are being exposed to an unacceptable health risk.

Both before and after approval is obtained, a product, its manufacturer, and the holder of the NDA for the product are subject to comprehensive

regulatory oversight. Violations of regulatory requirements at any stage, including the preclinical and clinical testing process, the approval process, or thereafter (including after approval) may result in various adverse consequences, including the FDA's delay in approving or refusal to approve a product, withdrawal of an approved product from the market, and/or the imposition of criminal penalties against the manufacturer and/or NDA holder. In addition, later discovery of previously unknown problems may result in restrictions on such product, manufacturer, or NDA holder, including withdrawal of the product from the market. Also, new government requirements may be established that could delay or prevent regulatory approval of the Company's products under development.

If an NDA is submitted to the FDA, there can be no assurance that such application will be reviewed and approved by the FDA in a timely manner, if at all. Among the conditions for NDA approval is the requirement that a prospective manufacturer's manufacturing procedures conform to GMP requirements, which must be followed at all times. In complying with those requirements, manufacturers (including a drug sponsor's third-party contract manufacturers) must continue to expend time, money and effort in the area of production and quality control to ensure compliance. Even after initial FDA approval has been obtained, further studies, including post-market studies, may be required to provide additional information. Results of such post-market programs may limit or expand the further marketing of the product. Even if initial marketing approval is granted, such approval may entail limitations on the indicated uses for which a product may be used and impose labeling requirements which may adversely impact the Company's ability to market its products. Finally, product approvals may be withdrawn if compliance with regulatory standards is not maintained or if problems occur following initial marketing.

Among the conditions for NDA approval is the requirement that a prospective manufacturer's manufacturing procedures conform to GMP requirements, which must be followed at all times. In complying with those requirements, manufacturers (including a drug sponsor's third-party contract manufacturers) must continue to expend time, money and effort in the area of production and quality control to ensure compliance. Domestic manufacturing establishments are subject to periodic inspections by the FDA in order to assess, among other things, GMP compliance. To supply product for use in the United States, foreign manufacturing establishments must comply with GMP and are subject to periodic inspection by the FDA or by regulatory authorities in certain of such countries under reciprocal agreements with the FDA. Failure to maintain compliance with GMP regulations and other applicable manufacturing requirements of various regulatory agencies could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company is also subject to foreign regulatory requirements governing development, manufacturing and sales of pharmaceutical products that vary widely from country to country. Approval of a drug by applicable regulatory agencies of foreign countries must be secured prior to the marketing of such drug in those countries. The regulatory approval process may be more or less rigorous from country to country and the time required for approval may be longer or shorter than that required in the United States.

The Company is subject to regulation under local, state and Federal law regarding occupational safety, laboratory practices, handling of chemicals, environmental protection and hazardous substances control. The Company possesses a Byproduct Materials License from the Nuclear Regulatory Commission ("NRC") for receipt, possession, manufacturing and distribution of radioactive materials. The Company holds Registration Certificates from the United States Drug Enforcement Administration and the Commonwealth of Massachusetts Department of Public Health for handling controlled substances. The Company is registered with the United States Environmental Protection Agency ("EPA") as a generator of hazardous waste. All hazardous waste disposal must be made in accordance with EPA and NRC requirements. The Company is subject to the regulations of the Occupational Safety and Health Act and has in effect a safety program to assure compliance with these regulations.

In both the United States and foreign markets, the Company's ability to commercialize its products successfully also depends in part on the extent to which reimbursement for the costs of such products and related treatments will be available from government health administration authorities, private health insurers and other third-party payors. Significant uncertainty exists as to the

reimbursement status of newly approved health care products and products used for indications not approved by the FDA. If adequate reimbursement levels are not maintained by government and other third-party payors for the Company's products and related treatments, the Company's business, financial condition and results of operations may be materially adversely affected.

#### MAJOR CUSTOMERS

One customer accounted for approximately 54% of the Company's revenues in fiscal 1997. Revenues in fiscal 1997, 1996 and 1995, from customers and licensees outside of the United States, principally in Europe, accounted for 6%, 3% and 23%, respectively, of the Company's total revenues.

#### YEAR 2000 COMPLIANCE

The Company does not expect that Year 2000 issues will have a material effect on the Company's results of operations or financial condition.

#### EMPLOYEES

As of December 8, 1997, the Company had approximately 59 full-time employees, 49 of whom were engaged in research and development. The Company's success depends in part on its ability to recruit and retain talented and trained scientific personnel. The Company has been successful to date in obtaining such personnel, but there can be no assurance that such success will continue.

None of the Company's employees is represented by a labor union, and the Company considers its relations with its employees to be excellent.

#### PRODUCT LIABILITY INSURANCE

The use of any of the Company's potential products in clinical trials and the sale of any approved products may expose the Company to liability claims resulting from the use of products or product candidates. These claims might be made by customers (including corporate partners), clinical trial subjects, patients, pharmaceutical companies or others. At this time, the Company is a defendant in a lawsuit arising from the death of a clinical trial subject who was administered Combidex and suffered an allergic reaction. The Company maintains product liability insurance coverage for claims such as this arising from the use of its products in clinical trials, as well as claims arising from FDA-approved commercial usage. However, coverage is becoming increasingly expensive and no assurance can be given that the Company will be able to maintain insurance at a reasonable cost. There can be no assurance that the Company's insurance will provide sufficient amounts to protect the Company against losses due to liability that could have a material adverse effect on the Company's business, financial conditions and results of operations. The Company maintains product liability insurance covering the sale of its products approved for commercial marketing but there can be no assurance that the Company will be able to obtain commercially reasonable product liability insurance for any product approved for marketing in the future or that insurance coverage and the resources of the Company would be sufficient to satisfy any liability resulting from product liability claims. A product liability claim or series of claims brought against the Company could have a material adverse effect on its business, financial condition and results of operations, whether or not the plaintiffs in such claims ultimately prevail.

#### ITEM 2. PROPERTIES:

The Company's principal pharmaceutical manufacturing and research and development operations are located in a modern Company-owned building of approximately 25,000 square feet in Cambridge, Massachusetts. The Company has leased two additional premises in Cambridge of approximately 18,000 total square feet to be used for manufacturing, warehousing and executive office space. One lease expires on October 31, 2000 and the other lease expires on November 30, 2000. In addition, the Company has leased premises of approximately 5,200 square feet in Princeton, New Jersey used by the Company's clinical development group as a general business and administrative office. This lease expires on September 5, 1998. Kalisto Biologicals, Inc. has leased approximately 12,000 square feet of space through October 31, 2001. The

Company believes these facilities are adequate for its current and anticipated short-term needs and that it will be able to enter into lease extensions or to lease comparable space, if necessary. However, the acquisition and required regulatory approvals for additional pharmaceutical manufacturing space can be time consuming and expensive. There is no assurance that if the Company desired to expand its manufacturing capacity it would be able to do so on a timely basis, if at all.

ITEM 3. LEGAL PROCEEDINGS:

The Company and certain of its officers were sued in an action entitled David D. Stark, M.D. v. Advanced Magnetics, Inc., Jerome Goldstein, Ernest V. Groman, and Lee Josephson, Civil Action No. 92-12157-WGY, in the United States District Court for the District of Massachusetts on September 3, 1992. The plaintiff, a former consultant to the Company, claims that he was incorrectly omitted as an inventor or joint inventor on certain of the Company's patents and on pending applications, and seeks injunctive relief and unspecified damages. In addition, the complaint also alleges state law claims for breach of contract, breach of good faith and fair dealing, breach of implied contract, misappropriation of trade secrets, conversion, negligent misrepresentation, misrepresentation, unjust enrichment and unfair trade practices. While the outcome of the action cannot be determined, the Company believes the action is without merit and intends to defend the action vigorously. There can be no assurance, however, that the Company will be able to defend successfully this action and the failure by the Company to prevail for any reason could have an adverse effect on the Company's future business, financial condition and results of operations.

The Company and certain of its officers were sued in David D. Stark v. Advanced Magnetics, Inc., Jerome Goldstein, Ernest V. Groman and Lee Josephson, Civil Action No. 93-02846-C, in the Superior Court Department of the Massachusetts Trial Court for Middlesex County. This case involves claims of breach of contract, breach of good faith and fair dealing, breach of implied contract, unjust enrichment and unfair trade practices that were originally dismissed by, but later remanded to, the Federal Court in the above-mentioned action, as well as a new count alleging tortious interference with contractual or advantageous relations. The Superior Court granted partial summary judgment in the Company's favor and dismissed the unfair trade practices and tort counts. The Superior Court has stayed the action. While the outcome of the action cannot be determined, the Company believes the action is without merit and intends to defend the action vigorously. There can be no assurance, however, that the Company will be able to defend successfully this action and the failure by the Company to prevail for any reason could have an adverse effect on the Company's future business, financial condition and results of operations.

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

No matters were submitted to a vote of the Company's security holders during the quarter ended September 30, 1997.

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS:

The Company's common stock is listed on the American Stock Exchange under the symbol AVM.

The table below sets forth the high and low sales price of the Company's common stock on the American Stock Exchange for the fiscal quarters of 1997 and 1996.

	FISCAL QUARTER			
	FIRST	SECOND	THIRD	FOURTH
1997 High.....	\$17 5/8	\$19 1/2	\$13 3/4	\$12 5/16
Low.....	\$14 1/2	\$12 3/4	\$10 1/2	\$10
1996 High.....	\$29 1/2	\$30	\$23	\$19 7/8
Low.....	\$24	\$19 1/2	\$16 1/8	\$16 1/4

On December 8, 1997 there were approximately 302 shareholders of record. The Company believes that the number of beneficial holders of Common Stock

exceeds 2,145. The last reported sale price of the Common Stock on December 8, 1997 was \$9.25 per share. The Company has never declared or paid a cash dividend on its capital stock.

ITEM 6. SELECTED FINANCIAL DATA:

SELECTED FINANCIAL DATA

	FOR THE YEARS ENDED SEPTEMBER 30,				
	1997	1996	1995	1994	1993
Statement of Operations Data:					
Revenues:					
License fees.....	\$5,500,000	\$ --	\$5,000,000	\$5,505,000	\$1,010,000
Royalties.....	363,445	50,000	189,493	15,924	906,138
Product sales.....	1,580,357	12,762	2,120,457	280,975	3,836,300
Contract research and development.....	62,920	6,810	--	--	402,911
Interest, dividends and net gains and losses on sales of securities.....	3,495,049	1,761,450	2,287,311	1,845,005	2,823,102
Total revenues.....	11,001,771	1,831,022	9,597,261	7,646,904	8,978,451
Costs and Expenses:					
Cost of product sales.....	311,678	2,550	425,187	54,983	1,525,564
Contract research and development expenses.....	8,815	--	--	--	193,391
Company-sponsored research and development expenses.....	9,304,327	9,671,897	8,601,791	6,621,929	6,863,229
Charge (credit) for purchase of in-process research and development*.....	--	--	(380,000)	760,000	--
Selling, general and administrative expenses.....	1,437,599	1,871,568	1,759,348	1,963,480	2,777,840
Total cost and expenses.....	11,062,419	11,546,015	10,406,326	9,400,392	11,360,024
Other Income:					
Other income.....	264,800	--	--	--	--
Gain on sale of in vitro product line**.....	--	--	3,404,527	2,649,580	--
Income (loss) before provision for income taxes.....	204,152	(9,714,993)	2,595,462	896,092	(2,381,573)
Income tax (benefit) provision.....	(379,022)	--	400,000	8,000	--
Income (loss) before cumulative effect of accounting change.....	583,174	(9,714,993)	2,195,462	888,092	(2,381,573)
Cumulative effect of accounting change.....	--	--	117,540	--	--
Net income (loss).....	\$ 583,174	\$ (9,714,993)	\$2,313,002	\$ 888,092	\$ (2,381,573)
Net income (loss) per share before cumulative effect of accounting change.....					
	\$ 0.09	\$ (1.44)	\$ 0.32	\$ 0.13	\$ (0.36)
Cumulative effect of accounting change.....					
	--	--	0.02	--	--
Income (loss) per share.....	\$ 0.09	\$ (1.44)	\$ 0.34	\$ 0.13	\$ (0.36)
Weighted average number of common and common equivalent shares.....					
	6,805,232	6,762,748	6,870,839	6,806,525	6,651,061

\* In August 1994, the Company reacquired the development and marketing rights to the MRI contrast agent Combidex previously licensed to Squibb Diagnostics, a Division of Bristol Myers Squibb Company, Inc., and recorded a related \$760,000 charge for the purchase of in-process research and development. In the first fiscal quarter of 1995, a credit for \$380,000 was recorded to the purchase of in-process research and development.

\*\* On October 15, 1993, the Company sold its in vitro product line to PerSeptive Biosystems, Inc.

	AT SEPTEMBER 30,				
	1997	1996	1995	1994	1993
Balance sheet data:					
Working capital.....	\$37,422,235	\$33,605,818	\$41,985,100	\$38,891,406	\$37,547,326
Total assets.....	\$44,976,181	\$41,066,373	\$50,843,222	\$46,672,700	\$45,877,548
Stockholders' equity.....	\$43,423,058	\$40,132,545	\$49,071,072	\$45,451,475	\$44,654,428

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

OVERVIEW

Since its inception in November 1981, Advanced Magnetics, Inc., (the "Company") has focused its efforts on developing its core superparamagnetic iron oxide particle technology to develop magnetic resonance imaging ("MRI") contrast agents and its core polysaccharide technology for targeted delivery of therapeutics. The Company has funded its operations with cash from license fees from corporate partners, royalties, sales of its products, fees from contract research performed for third parties, the proceeds of financings and income earned on invested cash. The Company's success in the market for diagnostic and therapeutic products will depend, in part, on the Company's ability to successfully develop, test, produce and market its products; obtain necessary governmental approvals in a timely manner; attract and retain key employees; and successfully respond to technological and other changes in the marketplace.

The Company's operating results may continue to vary significantly from quarter to quarter or from year to year depending on a number of factors, including: the timing of payments from corporate partners and research grants; the introduction of new products by the Company; the timing and size of orders from the Company's customers; and the acceptance of the Company's products. The Company's current planned expense levels are based in part upon expectations as to future revenue. Consequently, profits may vary significantly from quarter to quarter or year to year based on the timing of revenue. Revenue or profits in any period will not necessarily be indicative of results in subsequent periods and there can be no assurance that the Company will maintain profitability or that revenue growth can be sustained in the future.

A substantial portion of the Company's expenses consists of research and development expenses. The Company expects its research and development expenses to remain the same as it completes Combidex clinical trials and associated toxicology and pharmacology studies and devotes resources to developing additional contrast agents and its targeted drug delivery programs.

SALE OF IN VITRO PRODUCT LINE

On October 15, 1993 the Company sold its in vitro product line to PerSeptive Biosystems, Inc. ("PerSeptive") for 151,759 shares of PerSeptive common stock which was worth \$4,156,674 as of that date, plus an additional earn-out amount based on PerSeptive's fiscal 1995 revenues. The amount of the earn-out at September 30, 1995 was \$3,404,527 which PerSeptive satisfied by issuing 373,080 shares of PerSeptive common stock. The Company recognized pre-tax gains on this sale of \$3,404,527 and \$2,649,580 in fiscal 1995 and 1994, respectively. As of the end of fiscal 1996, the Company had sold all of its holdings of PerSeptive common stock.

RESULTS OF OPERATIONS

FISCAL 1997 COMPARED TO FISCAL 1996

Revenues

Total revenues for the fiscal year ended September 30, 1997 were \$11,001,771 compared to \$1,831,022 for the fiscal year ended September 30, 1996.

There were license fee revenues for the fiscal year ended September 30, 1997 of \$5,500,000 and none for the fiscal year ended September 30, 1996. The Company received a non-refundable milestone payment of \$5,000,000 in October 1996 from Berlex Laboratories, Inc. ("Berlex"), as a result of Berlex's market launch of Feridex I.V. in the United States, under an agreement (the "Berlex Agreement") granting Berlex a product license and exclusive marketing rights to the Company's Feridex I.V. MRI contrast agent in the United States. The Company received a non-refundable milestone payment of \$500,000 in December 1996 from Mallinckrodt Inc. ("Mallinckrodt") as a result of the FDA's marketing approval of GastroMARK under an agreement (the "Mallinckrodt Agreement") granting Mallinckrodt a product license and co-marketing rights to the Company's GastroMARK MRI contrast agent in North America.

Royalties for the fiscal year ended September 30, 1997 were \$363,445 as compared to \$50,000 in fiscal 1996. Royalties in fiscal 1997 reflect product sales in the United States of the Company's Feridex I.V. liver MRI contrast agent by Berlex and product sales in North America of GastroMARK oral MRI contrast agent by Mallinckrodt as well as increased product sales in Europe by Guerbet S.A. ("Guerbet") of Feridex I.V. (under the trade name Endorem) and GastroMARK (under the trade name Lumirem) as compared to fiscal 1996.

Product sales for the fiscal year ended September 30, 1997 were \$1,580,357 compared to \$12,762 for the fiscal year ended September 30, 1996 which resulted primarily from the initial product launch by Berlex in the United States of Feridex I.V. and by Mallinckrodt in North America of GastroMARK in the 1997 fiscal year.

Interest, dividends and net gains and losses on sales of securities resulted in revenues of \$3,495,049 for the fiscal year ended September 30, 1997 compared to \$1,761,450 for the fiscal year ended September 30, 1996.

Interest income for the fiscal year ended September 30, 1997 was \$1,385,670 compared to \$1,400,597 for the fiscal year ended September 30, 1996. Dividend income of \$242,029 for the year ended September 30, 1997 was \$112,471 less than the \$354,500 for the fiscal year ended September 30, 1996. There was a net gain on sales of securities of \$1,867,350 for the fiscal year ended September 30, 1997 compared to a net gain of \$6,353 for the fiscal year ended September 30, 1996. The increase was primarily attributable to gains realized on the sale of a certain security.

#### Costs and Expenses

The cost of product sales for the fiscal year ended September 30, 1997 was \$311,678 compared to \$2,550 for the fiscal year ended September 30, 1996. The cost of product sales for the fiscal year ended September 30, 1997 related primarily to the introduction in the United States of Feridex I.V. and GastroMARK. The cost of product sales for both fiscal years was 20% of product sales.

Research and development expenses for the fiscal year ended September 30, 1997 were \$9,304,327, a decrease of 4% compared to \$9,671,897 for the fiscal year ended September 30, 1996. The decrease was primarily attributable to reduced staffing. The Company expects that expenditures for research and development for fiscal 1998 will continue at present levels. In addition, the Company made payments of \$800,000 in accordance with its agreements to license technology from a third party based on the achievement of certain milestones.

Selling, general and administrative expenses for the fiscal year ended September 30, 1997 were \$1,437,599, a decrease of 23% from \$1,871,568 for the fiscal year ended September 30, 1996. The decrease was primarily attributable to expenses associated with a proposed, but later terminated, public offering of the Company's common stock during fiscal 1996.

#### Other

Other income of \$264,800 was recognized during the fiscal year ended September 30, 1997 as the result of an insurance settlement for flood damages in the research and development laboratory in October 1996.

#### Income Taxes

The income tax benefit resulted from payments from the Internal Revenue Service for contingent refunds. There was no income tax provision for the fiscal year ended September 30, 1997 due to the applicable net operating loss carry-forwards. There was no income tax provision for the fiscal year ended September 30, 1996 due to a net operating loss.

#### Earnings

In the fiscal year ended September 30, 1997, the Company recorded a net profit of \$583,174 or \$0.09 per share. In the fiscal year ended September 30, 1996, the Company recorded a net loss of (\$9,714,993) or (\$1.44) per share.

## RESULTS OF OPERATIONS

### FISCAL 1996 COMPARED TO FISCAL 1995

#### Revenues

Total revenues for the fiscal year ended September 30, 1996 were \$1,831,022 compared to \$9,597,261 for the fiscal year ended September 30, 1995.

There were no license fee revenues for the fiscal year ended September 30, 1996 compared to \$5,000,000 for the fiscal year ended September 30, 1995. The Company received a non-refundable \$5,000,000 license fee on February 1, 1995 from Berlex under the Berlex Agreement granting Berlex a product license and exclusive marketing rights to the Company's Feridex I.V. MRI contrast agent in the United States.

Royalties for the fiscal year ended September 30, 1996 were \$50,000 relating to product sales in Europe by Guerbet of the Company's Feridex I.V. (marketed in Europe under the trade name Endorem) and GastroMARK (marketed in Europe under the trade name Lumirem) MRI contrast agents. Royalties of \$50,000 in the fiscal year ended September 30, 1996 as compared with \$189,493 in fiscal 1995 reflect lower sales in Europe of Feridex I.V. in fiscal 1996.

Product sales for the fiscal year ended September 30, 1996 were \$12,762 compared to \$2,120,457 for the fiscal year ended September 30, 1995 which resulted primarily from the initial product launch by Guerbet in Europe of Feridex I.V. in fiscal 1995. Although Guerbet marketed and sold the Company's product during fiscal 1996, a sufficient level of inventory from 1995 existed to satisfy 1996 customer needs.

Interest, dividends and net gains and losses on sales of securities resulted in revenues of \$1,761,450 for the fiscal year ended September 30, 1996 compared to \$2,287,311 for the fiscal year ended September 30, 1995.

Interest income for the fiscal year ended September 30, 1996 was \$1,400,597 compared to \$1,644,328 for the fiscal year ended September 30, 1995. The decrease was primarily due to the maturity of United States Treasury Notes and lower interest rates earned on money market accounts in fiscal 1996. Dividend income of \$354,500 for the year ended September 30, 1996 was \$233,516 less than the \$588,016 for the fiscal year ended September 30, 1995. The decrease was primarily due to a reduction in funds invested in dividend paying preferred stock. There was a net gain on sales of securities of \$6,353 for the fiscal year ended September 30, 1996 compared to a net gain of \$54,967 for the fiscal year ended September 30, 1995.

#### Costs and Expenses

The cost of product sales for the fiscal year ended September 30, 1996 was \$2,550 compared to \$425,187 for the fiscal year ended September 30, 1995. The cost of product sales for the fiscal year ended September 30, 1995 related primarily to the introduction in Europe of Feridex I.V. The cost of product sales for both fiscal years was 20% of product sales.

Research and development expenses for the fiscal year ended September 30, 1996 were \$9,671,897, an increase of 12% compared to \$8,601,791 for the fiscal year ended September 30, 1995. The increase was primarily a result of costs associated with Phase III human clinical trials for the Company's Combindex contrast agent used in imaging lymph nodes, liver, spleen and blood perfusion and preclinical developments of the Company's targeted drug delivery programs. In addition, the Company made payments of \$725,000 in accordance with its agreements to license technology from third parties, of which \$400,000 was based on the achievement of certain milestones.

Selling, general and administrative expenses for the fiscal year ended September 30, 1996 were \$1,871,568, an increase of 6% from \$1,759,348 for the fiscal year ended September 30, 1995. The increase was primarily attributable to expenses associated with a proposed, but later terminated, public offering of the Company's common stock.

The Company adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," in the fiscal year ended September 30, 1995. As a result, the Company recorded a cumulative effect of accounting change of \$117,540 during the year ended September 30, 1995.

#### Income Taxes

There was no income tax provision for the fiscal year ended September 30, 1996 due to an operating loss. The income tax provision for the fiscal year ended September 30, 1995 was \$400,000. The tax rate was lower than the 34% statutory rate as a result of the tax benefit of temporary differences and dividend income exclusions.

#### Earnings

In the fiscal year ended September 30, 1996, the Company recorded a net loss of \$9,714,993 or (\$1.44) per share. In the fiscal year ended September 30, 1995, the Company recorded a net profit of \$2,195,462 or \$0.32 per share before the cumulative effect of accounting change. Including the cumulative effect of accounting change of \$117,540 or \$0.02 per share, net income was \$2,313,002 or \$0.34 per share for the fiscal year ended September 30, 1995.

#### LIQUIDITY AND CAPITAL RESOURCES

At September 30, 1997, the Company's cash and cash equivalents totaled \$10,724,740, compared with \$10,805,842 at September 30, 1996. In addition, the Company had marketable securities of \$27,365,765 at September 30, 1997 as compared to \$23,271,169 on September 30, 1996. Net cash used in operating activities was \$202,281 in the fiscal year ended September 30, 1997 compared to net cash used in operating activities of \$7,430,470 in the fiscal year ended September 30, 1996, a decrease of \$7,228,189. The decrease in cash used in operating activities was due primarily to a net profit of \$583,174 for the year ended September 30, 1997, compared with a net loss of \$9,714,993 in the fiscal year ended September 30, 1996. Cash provided by investing activities was \$803,333 for the fiscal year ended September 30, 1997 compared to \$17,337,281 provided by investing activities in the fiscal year ended September 30, 1996. Cash provided by investing activities in the fiscal year ended September 30, 1997 included the investment of \$20,380,048 in marketable securities which was mostly offset by \$12,500,000 from maturing United States Treasury notes and \$9,270,016 from the sale of marketable securities. Cash provided by investing activities in the fiscal year ended September 30, 1996 included the purchase of marketable securities of \$2,378,934. Proceeds from United States Treasury notes maturing was \$9,499,911 and proceeds from the sale of marketable securities was \$10,733,541 in the fiscal year ended September 30, 1996. Cash used in financing activities was \$682,154 for the fiscal year ended September 30, 1997 and included proceeds of \$179,445 from the issuances of common stock offset by the purchase of 61,300 shares of the Company's common stock on the open market for \$861,599. In May 1996, the Board of Directors authorized the purchase of up to 250,000 shares of the Company's common stock on the open market at prevailing market prices.

Capital expenditures in the fiscal year ended September 30, 1997 were \$533,590 compared to \$466,452 in the fiscal year ended September 30, 1996. Capital expenditures of \$533,590 in the fiscal year ended September 30, 1997 continued the Company's efforts to upgrade laboratory and production equipment. The Company has no current commitment for any significant expenditures on property, plant and equipment. The Company expects that expenditures for research and development for fiscal 1998 will continue at present levels.

Management believes that funds for future needs can be generated from existing cash balances, cash generated from investing activities and cash generated from operations. In addition, the Company will consider from time to time various financing alternatives and may seek to raise additional capital through equity or debt financing or to enter into corporate partnering arrangements. There can be no assurance, however, that funding will be available on terms acceptable to the Company, if at all.

The FASB issued Statement No. 128 ("SFAS 128"), "Earnings per Share." This statement modifies the way in which earnings per share ("EPS") is calculated and disclosed. Currently, the Company discloses primary EPS. Upon adoption of this standard for the fiscal period ending December 31, 1997, the Company will disclose basic and diluted EPS. Basic EPS excludes common stock equivalents and is computed by dividing income available to common shareholders by the weighted average number of Common Shares outstanding for the period. The Company believes the implementation of SFAS 128 will not have a material impact on the earnings per share calculation.

The FASB recently issued Statement No. 130 ("SFAS 130"), "Reporting Comprehensive Income." This statement requires changes in comprehensive income to be shown in a financial statement that is displayed with the same prominence as other financial statements. While not mandating a specific financial statement format, the statement requires that an amount representing total comprehensive income be reported. The statement will become effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods is required for comparative purposes. The Company believes the implementation of SFAS 130 may have a material impact on results of operations.

The FASB also issued Statement No. 131 ("SFAS 131"), "Disclosures about Segments of an Enterprise and Related Information." This statement, which supersedes Statement No. 14, "Financial Reporting for Segments of a Business Enterprise," changes the way public companies report information about segments. The statement, which is based on the management approach to segment reporting, includes requirements to report segment information quarterly and entity-wide disclosures about products and services, major customers, and the material countries in which the entity holds assets and reports revenues. The statement is effective for periods beginning after December 15, 1997. Restatement for earlier years is required for comparative purposes unless impracticable. In addition, SFAS 131 need not be applied to interim periods in the initial year; however, in subsequent years, interim period information must be presented on a comparative basis. The Company is currently evaluating this statement and its effect on financial statement disclosures.

#### CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

The Company does not provide forecasts of its future financial performance. However, from time to time, information provided by the Company or statements made by its employees may contain "forward looking" information that involves risks and uncertainties. In particular, statements contained in this Form 10-K that are not historical facts (including, but not limited to statements contained in this Item 7 relating to liquidity and capital resources) constitute forward looking statements and are made under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company's actual results of operations and financial condition have varied and may in the future vary significantly from those stated in any forward looking statements. Factors that may cause such differences include, without limitation, the risks, uncertainties and other information discussed below and within this Form 10-K, as well as the accuracy of the Company's internal estimates of revenue and operating expense levels. The following discussion of the Company's risk factors should be read in conjunction with the financial statements and related notes thereto. Such factors, among others, may have a material adverse effect upon the Company's business, results of operations and financial condition.

Early Stage of Product Commercialization; Uncertainty of Product Development. The Company has not generated significant revenues from the sale of its products. Feridex I.V. and GastroMARK have only recently been approved for sale in the United States, Feridex I.V. has only recently been approved for sale in Japan, and the sale of Feridex I.V. and GastroMARK has only recently begun in certain European countries. While the Company is conducting human clinical testing of Combidex, this product and the Company's other product candidates, in particular its targeted therapeutic products, may require significant additional research and development efforts, including extensive human clinical testing, prior to submission of any regulatory application for commercial sale of such products. Such products are not expected to be commercially available for several years, if at all. The development of new pharmaceutical products is highly uncertain and no assurance can be given that any of the Company's development programs will be completed successfully, that

required regulatory approvals will be obtained on a timely basis, if at all, or that any product, including Feridex I.V., will be commercially successful.

The Company's long term viability and growth will depend on the successful commercialization of products resulting from its research activities. If any of the Company's development programs are not completed successfully, required regulatory approvals are not obtained or products for which approvals are obtained are not commercially successful, the Company's business, financial condition and results of operations could be materially adversely affected.

**Need for Future Funding; Uncertainty of Access to Capital.** The Company has expended and will continue to expend substantial funds to complete the research, development, clinical trials, regulatory approvals and other activities through final commercialization of its products. It is possible that the Company may need additional financing to satisfy its capital and operating requirements relating to the development, manufacturing and marketing of its products. The Company may seek such financing through arrangements with collaborative partners and through public or private sales of the Company's securities, including equity securities. No assurance can be given that such financing will be available to the Company on acceptable terms, if at all. Any additional equity financings could be dilutive to the Company's stockholders. If adequate additional funds are not available, the Company may be required to curtail significantly one or more of its research and development programs or obtain funds through arrangements with collaborative partners or others that may require the Company to relinquish rights to certain of its products and product candidates on terms that it might otherwise find unacceptable.

**Government Regulation; No Assurance of Regulatory Approval.** Prior to marketing, every product candidate must undergo an extensive regulatory approval process in the United States and in every country in which the Company intends to test and market its product candidates and products. This regulatory process includes testing and clinical trials of such product candidate to demonstrate safety and efficacy and can require many years and the expenditure of substantial resources in the United States and in foreign countries in which approval is sought. Data obtained from preclinical testing and clinical trials are subject to varying interpretations, which can delay, limit or prevent FDA approval. In addition, changes in FDA approval policies or requirements may occur or new regulations may be promulgated which may result in delay or failure to receive FDA approval. Similar delays or failures may be encountered in foreign countries. Delays and related costs in obtaining regulatory approvals could have a material adverse effect on the Company's business, financial condition and results of operation. Although the Company has received approval in the United States and in certain foreign countries to market Feridex I.V. and GastroMARK, there can be no assurance that further regulatory approvals will be obtained for any products developed by the Company. Failure to obtain requisite governmental approvals or failure to obtain approvals of the scope requested could delay and may preclude the Company or its licensees or other collaborators from marketing the Company's products or limit the commercial use of the products and could have a material adverse effect on the Company's business, financial condition and results of operations.

Regulatory approvals may entail limitations on the indicated uses of such products and impose labeling requirements which may adversely impact the Company's ability to market its products. Even if regulatory approval is obtained, a marketed product and its manufacturer are subject to continuing regulatory review. Noncompliance with regulatory requirements at any stage of the approval process may result in various adverse consequences, including the FDA's delay in approving or its refusal to approve a product, withdrawal of an approved product from the market or, under certain circumstances, the imposition of criminal penalties. Any such adverse consequences could have a material adverse effect on the Company's business, financial condition and results of operations.

**Uncertainties Relating to Clinical Trials; Technological Uncertainty.** Before obtaining regulatory approvals for the commercial sale of any of its contrast agents or other product candidates, the Company must demonstrate through extensive preclinical testing and human clinical trials that the product is safe and efficacious. The results from preclinical testing and early clinical trials of products under development by the Company may not be predictive of results obtained in subsequent clinical trials. Clinical trials are often conducted with patients in the most advanced stages of disease. During the course of treatment, these patients

can die or suffer adverse medical effects for reasons that may not be related to the product being tested, but which can nevertheless adversely affect clinical trial results or approvals by the FDA. Clinical testing of pharmaceutical product is itself subject to approvals by various governmental regulatory authorities. There can be no assurance that Advanced Magnetics will be permitted by regulatory authorities to commence or continue clinical trials. Any delays in or termination of the Company's clinical trial efforts could have a material adverse effect on the Company's business, financial condition and results of operations.

Many of the Company's products are subject to technological uncertainty. Only two of the Company's products, Feridex I.V. and GastroMARK, have been approved for sale in the United States. Obtaining regulatory approval for products consisting of arabinogalactan connected to any other therapeutic compound may be more difficult than obtaining approval for a single compound because it could be more difficult to determine the safety and efficacy of the two compounds together. The Company's MRI contrast agents may cause adverse reactions, including death, in certain persons under certain conditions. There can be no assurances that these factors will not adversely affect the development or commercialization of the Company's products.

Dependence on Collaborative Relationships. The Company's strategy for the development and commercialization of its contrast agent product candidates has been to enter into strategic alliances with various corporate partners, licensees, and other collaborators. In some cases, the Company is dependent upon these collaborators to conduct preclinical and clinical testing, to obtain regulatory approvals and to manufacture and market products. There can be no assurance that any revenues or profits will continue or that the Company will be able to enter into future collaborative relationships even if it desires to do so. If any of the Company's collaborators breaches its agreement with the Company or otherwise fails to perform, such event could have a material adverse effect on the Company's business, financial condition and results of operations.

Competition and Risk of Technological Obsolescence. The pharmaceutical and biopharmaceutical industries are subject to intense competition and rapid technological change. The Company has many competitors, many of which have substantially greater capital and other resources than the Company and represent significant competition for Advanced Magnetics. Such companies may succeed in developing technologies and products that are more effective or less costly than any that may be developed by the Company, and such companies may be more successful than the Company in developing, manufacturing and marketing products. In addition, the Company's MRI contrast agents represent a new approach to imaging certain organs, and market acceptance of both MRI as an appropriate imaging technique for such organs and the Company's products is critical to the Company's ability to compete successfully. There can be no assurance that the Company will be able to compete successfully in the future or that developments by others will not render the Company's products or product candidates or technologies obsolete or noncompetitive or that the Company's collaborators or customers will not choose to use competing technologies or products.

Uncertainty Regarding Patents and Proprietary Rights. The patent positions of pharmaceutical and biopharmaceutical companies, including Advanced Magnetics, are generally uncertain and involve complex legal and factual questions. Because of the substantial length of time and expense associated with bringing new products through development and regulatory approval to the marketplace, the pharmaceutical and biopharmaceutical industries place considerable importance on obtaining patent and trade secret protection for new technologies, products and processes. There can be no assurance as to the success or timeliness in obtaining any such patents, that the breadth of the claims obtained will provide any significant protection of the Company's technology, or that the degree of protection afforded by patents for licensed technologies or for future discoveries will be adequate to protect the Company's proprietary technology. Moreover, no assurance can be given that patents issued to Advanced Magnetics will not be contested, invalidated or circumvented. There can be no assurance that future patent interferences involving patents of either the Company or its licensors will not have a material adverse effect on the Company's business. Moreover, there can be no assurance that claims of infringement or violation of the proprietary rights of others will not be asserted against the Company. If Advanced Magnetics is required to defend against such claims or to protect its own proprietary rights against others, the Company may incur substantial costs which could have a material adverse effect on the Company's business, financial condition and results of operations.

In the future, Advanced Magnetics may be required to obtain additional licenses to patents or other proprietary rights of others. There can be no assurance that any such licenses will be available on acceptable terms, if at all. The failure to obtain such licenses could result in delays in marketing the Company's products or the inability to proceed with the development, manufacturing or sale of product candidates requiring such licenses. In addition, the termination of any of the Company's existing licensing arrangements could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company also relies upon unpatented trade secrets and improvements, unpatented know-how and continuing technological innovation to develop and maintain its competitive position, which it seeks to protect, in part, by confidentiality agreements with its corporate partners, collaborators, employees and consultants. There can be no assurance that these agreements will not be breached, that the Company will have adequate remedies for any such breach or that the Company's trade secrets will not otherwise become known or be independently discovered by its competitors. In addition, the Company cannot be certain that others will not independently develop substantially equivalent or superseding proprietary technology, or that an equivalent product will not be marketed in competition with the Company's products, thereby substantially reducing the value of the Company's proprietary rights.

**Uncertainty of Third-Party Reimbursement.** In both the United States and foreign markets, the Company's ability to commercialize its products may depend in part on the extent to which reimbursement for the costs of such products and related treatments will be available from government health administration authorities, private health insurers and other third-party payors. In the United States, there has been, and the Company expects that there will continue to be, a number of federal and state proposals to reform the health care system. Significant uncertainty exists as to the reimbursement status of both newly-approved health care products and products used for indications not approved by the FDA. If adequate reimbursement levels are not maintained by government and other third-party payors for the Company's products and related treatments, the Company's business, financial condition and results of operations may be materially adversely affected.

**Limited Manufacturing Experience and Capacity.** Advanced Magnetics has no experience in manufacturing targeted therapeutic products and limited experience in manufacturing contrast agents in commercial quantities. Currently, the Company manufactures bulk Feridex I.V. product for sale by Guerbet, Feridex I.V. finished product and GastroMARK bulk product in its Massachusetts facilities. These facilities are subject to current Good Manufacturing Practices ("GMP") regulations prescribed by the FDA. There can be no assurance that the Company will be able to continue to operate at commercial scale in compliance with the GMP regulations. Failure to operate in compliance with such GMP regulations and other applicable manufacturing requirements of various regulatory agencies could have a material adverse effect on the Company's business, financial condition and results of operations. In addition, the Company is dependent on contract manufacturers for the production of certain of its product candidates. In the event that the Company is unable to obtain or retain manufacturing for its product candidates, it will not be able to develop and commercialize its products as planned. There can be no assurance that the Company will be able to enter into agreements for the manufacture of future products with manufacturers whose facilities and procedures comply with GMP and other regulatory requirements or that such manufacturer will be able to deliver required quantities of product that conform to specifications in a timely manner.

**Lack of Marketing and Sales History.** Advanced Magnetics has limited experience in marketing and selling its current products and product candidates and relies on its corporate partners to market and sell currently approved and commercially available products. In order to achieve commercial success for any product candidate approved by the FDA for which the Company does not have a marketing partner, Advanced Magnetics may have to establish a marketing and sales force or enter into arrangements with others to market and sell its products. There can be no assurance that Advanced Magnetics will be successful in attracting and retaining qualified marketing and sales personnel or that it will be able to enter into marketing and sales agreements with others on acceptable terms, if at all. Furthermore, there can be no assurance that Advanced Magnetics or its corporate partners will be successful in marketing and selling the Company's products.

Potential Product Liability; Uncertainties Related to Insurance. The use of any of the Company's product candidates in clinical trials and the sale of any approved products may expose the Company to liability claims resulting from the use of products or product candidates. At this time, the Company is a defendant in a lawsuit arising from the death of a clinical trial subject who was administered Combidex and suffered an allergic reaction. The Company maintains product liability insurance coverage for claims arising from the use of its products in clinical trials. However, coverage is becoming increasingly expensive and no assurance can be given that the Company will be able to maintain insurance at a reasonable cost. Furthermore, there can be no assurance that the Company's insurance will provide sufficient coverage amounts to protect the Company against losses due to liability that could have a material adverse effect on the Company's business, financial condition and results of operations. The Company presently maintains product liability insurance covering the sale of Feridex I.V., but there can be no assurance that the Company will be able to obtain commercially reasonable product liability insurance for any product presently being marketed or for any product approved for marketing in the future or that insurance coverage and the resources of the Company would be sufficient to satisfy any liability resulting from product liability claims. A product liability claim or series of claims brought against the Company could have a material adverse effect on its business, financial condition and results of operations, whether or not the plaintiffs in such claims ultimately prevail.

Attraction and Retention of Key Employees. Because of the specialized nature of its business, Advanced Magnetics is highly dependent on its ability to attract and retain qualified scientific and technical personnel for the research and development activities conducted or sponsored by the Company. In addition, the Company is substantially dependent upon Jerome Goldstein, its Chairman of the Board and Chief Executive Officer, and upon Leonard Baum, President and Chief Operating Officer. The loss of Mr. Goldstein, Mr. Baum or other certain key executive officers could be detrimental to the Company. Furthermore, the Company's anticipated growth and expansion into areas and activities requiring additional expertise, such as clinical testing, regulatory compliance, manufacturing and marketing, may require the addition of new management personnel and the development of additional expertise by existing management personnel. There is intense competition for qualified personnel in the areas of the Company's activities, and there can be no assurance that the Company will be able to continue to attract and retain the qualified personnel necessary for the development of its business. The failure to attract and retain such personnel or to develop such expertise could adversely affect the Company's business, financial condition and results of operations.

Volatility of Common Stock Price. The market prices for securities of biopharmaceutical and pharmaceutical companies, including the Company, have historically been highly volatile. Such fluctuations in operating results may cause the market price of the Company's Common Stock to be volatile. In addition, the market prices for securities of biopharmaceutical and pharmaceutical companies have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of such companies. Various factors and events, including announcements by the Company or its competitors concerning technological innovations, new products, clinical trial results, agreements with collaborators, governmental regulations, developments in patent or other proprietary rights, public concern regarding the safety of drugs developed by the Company or others, may have a significant impact on the market price of the Company's Common Stock and dividend policy.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA:

The Company's Financial Statements and related Report of Independent Accountants are presented in the following pages. The financial statements filed in this Item 8 are as follows:

Report of Independent Accountants

Financial Statements:

Balance Sheets -- September 30, 1997 and 1996

Statements of Operations -- for the years ended September 30, 1997, 1996 and 1995

Statements of Stockholders' Equity -- for the years ended September 30, 1997, 1996 and 1995

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Statements of Cash Flow -- for the years ended September 30, 1997, 1996 and 1995

Reconciliation of Net Income (Loss) to Net Cash Used in Operating Activities -- for the years ended September 30, 1997, 1996 and 1995

Notes to Financial Statements

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

Not applicable.

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ADVANCED MAGNETICS, INC.

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Directors and Stockholders of Advanced Magnetcs, Inc.:

We have audited the accompanying balance sheets of Advanced Magnetcs, Inc. as of September 30, 1997 and 1996 and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended September 30, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the 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 Advanced Magnetcs, Inc. as of September 30, 1997 and 1996, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 1997, in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Boston, Massachusetts

## ADVANCED MAGNETICS, INC.

## BALANCE SHEETS

	SEPTEMBER 30,	
	1997	1996
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$10,724,740	\$10,805,842
Marketable securities.....	27,365,765	23,271,169
Accounts receivable.....	546,807	149,235
Inventories.....	113,178	182,166
Prepaid expenses.....	224,868	131,234
Total current assets.....	38,975,358	34,539,646
Property, plant and equipment:		
Land.....	360,000	360,000
Buildings.....	4,356,295	4,320,766
Laboratory equipment.....	7,722,445	7,316,534
Furniture and fixtures.....	645,299	553,149
	13,084,039	12,550,449
Less -- accumulated depreciation and amortization.....	(7,332,118)	(6,219,579)
Net property, plant and equipment.....	5,751,921	6,330,870
Other assets.....	248,902	195,857
Total assets.....	\$44,976,181	\$41,066,373
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable.....	\$ 443,925	\$ 383,335
Accrued expenses.....	1,059,070	500,365
Income taxes payable.....	50,128	50,128
Total current liabilities.....	1,553,123	933,828
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value \$.01 per share, authorized 2,000,000 shares; none issued.....	--	--
Common stock, par value \$.01 per share, authorized 15,000,000 shares; issued and outstanding 6,740,626 shares as of September 30, 1997 and 6,761,612 shares as of September 30, 1996.....	67,406	67,616
Additional paid-in capital.....	44,244,558	44,926,502
Retained earnings (deficit).....	(6,095,302)	(6,678,476)
Net unrealized gains on marketable securities.....	5,206,396	1,816,903
Total stockholders' equity.....	43,423,058	40,132,545
Total liabilities and stockholders' equity.....	\$44,976,181	\$41,066,373
	=====	=====

The accompanying notes are an integral part of the financial statements.

## ADVANCED MAGNETICS, INC.

## STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED SEPTEMBER 30,

	1997	1996	1995
<b>Revenues:</b>			
License fees.....	\$ 5,500,000	\$ --	\$ 5,000,000
Royalties.....	363,445	50,000	189,493
Product sales.....	1,580,357	12,762	2,120,457
Contract research and development.....	62,920	6,810	--
Interest, dividends and net gains and losses on sales of securities.....	3,495,049	1,761,450	2,287,311
<b>Total revenues.....</b>	<b>11,001,771</b>	<b>1,831,022</b>	<b>9,597,261</b>
<b>Costs and expenses:</b>			
Cost of product sales.....	311,678	2,550	425,187
Contract research and development expenses.....	8,815	--	--
Company-sponsored research and development expenses.....	9,304,327	9,671,897	8,601,791
Credit for purchase of in-process research and development.....	--	--	(380,000)
Selling, general and administrative expenses.....	1,437,599	1,871,568	1,759,348
<b>Total cost and expenses.....</b>	<b>11,062,419</b>	<b>11,546,015</b>	<b>10,406,326</b>
<b>Other income:</b>			
Other income.....	264,800	--	--
Gain on sale of in vitro product line.....	--	--	3,404,527
<b>Income (loss) before provision for income taxes and cumulative effect of accounting change.....</b>	<b>204,152</b>	<b>(9,714,993)</b>	<b>2,595,462</b>
Income tax (benefit) provision.....	(379,022)	--	400,000
<b>Income (loss) before cumulative effect of accounting change.....</b>	<b>583,174</b>	<b>(9,714,993)</b>	<b>2,195,462</b>
Cumulative effect of accounting change.....	--	--	117,540
<b>Net income (loss).....</b>	<b>\$ 583,174</b>	<b>\$ (9,714,993)</b>	<b>\$ 2,313,002</b>
<b>Net income (loss) per share before cumulative effect of accounting change.....</b>			
	\$ 0.09	\$ (1.44)	\$ 0.32
Cumulative effect of accounting change.....	--	--	0.02
<b>Net income (loss) per share.....</b>	<b>\$ 0.09</b>	<b>\$ (1.44)</b>	<b>\$ 0.34</b>
<b>Weighted average number of common and common equivalent shares.....</b>			
	6,805,232	6,762,748	6,870,839

The accompanying notes are an integral part of the financial statements.

ADVANCED MAGNETICS, INC.

STATEMENTS OF STOCKHOLDERS' EQUITY  
For the years ended September 30, 1995, 1996, 1997

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	NET UNREALIZED GAINS ON MARKETABLE SECURITIES	TOTAL STOCKHOLDERS' EQUITY
	SHARES	AMOUNT				
Balance at September 30, 1994.....	6,712,572	\$67,126	\$44,660,834	\$ 723,515	--	\$45,451,475
Shares issued in connection with the exercise of stock options.....	29,494	295	207,060	--	--	207,355
Shares surrendered in connection with the exercise of stock options.....	(1,476)	(15)	(24,588)	--	--	(24,603)
Shares issued in connection with employee stock purchase plan.....	12,823	128	130,666	--	--	130,794
Repurchase of warrants.....	--	--	120,000	--	--	120,000
Net change in unrealized gains on marketable securities.....						

securities.....	--	--	--	--	\$ 873,049	873,049
Net income.....	--	--	--	2,313,002	--	2,313,002
Balance at September 30, 1995.....	6,753,413	67,534	45,093,972	3,036,517	873,049	49,071,072
Shares issued in connection with the exercise of stock options.....	26,445	264	185,697	--	--	185,961
Shares surrendered in connection with the exercise of stock options.....	(921)	(9)	(18,463)	--	--	(18,472)
Shares issued in connection with employee stock purchase plan.....	8,875	89	141,379	--	--	141,468
Common shares repurchased.....	(26,200)	(262)	(476,083)	--	--	(476,345)
Net change in unrealized gains on marketable securities.....	--	--	--	--	943,854	943,854
Net loss.....	--	--	--	(9,714,993)	--	(9,714,993)
Balance at September 30, 1996.....	6,761,612	67,616	44,926,502	(6,678,476)	1,816,903	40,132,545
Shares issued in connection with the exercise of stock options.....	42,450	425	271,148	--	--	271,573
Shares surrendered in connection with the exercise of stock options.....	(13,757)	(138)	(209,289)	--	--	(209,427)
Shares issued in connection with employee stock purchase plan.....	11,621	116	117,183	--	--	117,299
Common shares repurchased.....	(61,300)	(613)	(860,986)	--	--	(861,599)
Net change in unrealized gains on marketable securities.....	--	--	--	--	3,389,493	3,389,493
Net income.....	--	--	--	583,174	--	583,174
Balance at September 30, 1997.....	6,740,626	\$67,406	\$44,244,558	\$(6,095,302)	\$5,206,396	\$43,423,058

The accompanying notes are an integral part of the financial statements.

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ADVANCED MAGNETICS, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED SEPTEMBER 30,

	1997	1996	1995
Cash flows from operating activities:			
Cash received from customers.....	\$ 7,043,429	\$ 1,330,567	\$ 5,380,513
Cash paid to suppliers and employees.....	(9,330,973)	(10,850,727)	(8,920,459)
Dividends and interest received.....	1,441,441	2,099,445	1,876,214
Net proceeds from insurance settlement.....	264,800	--	--
Income taxes paid.....	--	(20,000)	(250,000)
Income tax refund.....	379,022	10,245	--
Net cash used in operating activities.....	(202,281)	(7,430,470)	(1,913,732)
Cash flows from investing activities:			
Proceeds from sales of marketable securities.....	9,270,016	10,733,541	1,440,796
Proceeds from notes and bonds maturing.....	12,500,000	9,499,911	3,000,000
Purchase of marketable securities.....	(20,380,048)	(2,378,934)	(6,703,475)
Capital expenditures.....	(533,590)	(466,452)	(1,484,382)
(Increase) decrease in other assets.....	(53,045)	(50,785)	(48,526)
Net cash provided by (used in) investing activities.....	803,333	17,337,281	(3,795,587)
Cash flows from financing activities:			
Proceeds from issuances of common stock, net.....	179,445	308,957	313,545
Purchase of treasury stock.....	(861,599)	(476,345)	--
Net cash (used in) provided by financing activities.....	(682,154)	(167,388)	313,545
Net (decrease) increase in cash and cash equivalents.....	(81,102)	9,739,423	(5,395,774)
Cash and cash equivalents at beginning of year....	10,805,842	1,066,419	6,462,193
Cash and cash equivalents at end of year.....	\$10,724,740	\$10,805,842	\$ 1,066,419

The accompanying notes are an integral part of the financial statements.

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## ADVANCED MAGNETICS, INC.

Reconciliation of Net Income (Loss)  
to Net Cash Provided by (Used in) Operating Activities

	FOR THE YEARS ENDED SEPTEMBER 30,		
	1997	1996	1995
Net income (loss).....	\$ 583,174	\$ (9,714,993)	\$ 2,313,002
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization.....	1,112,539	1,076,482	1,007,005
Cumulative effect of accounting change.....	--	--	(117,540)
Accretion of U.S. Treasury Notes discount.....	(227,721)	(32,217)	(53,943)
(Increase) decrease in accounts receivable.....	(397,572)	1,637,558	(2,231,625)
(Increase) decrease in inventories.....	68,988	(126,599)	(55,567)
(Increase) decrease in prepaid expenses.....	(93,634)	(31,892)	13,504
(Increase) decrease in recoverable income taxes...	--	90,117	--
Increase (decrease) in accounts payable and accrued expenses.....	619,295	(222,701)	900,925
Increase (decrease) in income taxes payable.....	--	(99,872)	150,000
Net realized (gains) on sales of marketable securities.....	(1,867,350)	(6,353)	(54,966)
Gain on sale of in vitro product line.....	--	--	(3,404,527)
(Credit) for the purchase of in-process research and development.....	--	--	(380,000)
Total adjustments.....	(785,455)	2,284,523	(4,226,734)
Net cash (used in) operating activities.....	\$ (202,281)	\$ (7,430,470)	\$ (1,913,732)

The accompanying notes are an integral part of the financial statements.

## NOTES TO FINANCIAL STATEMENTS

## A. SUMMARY OF ACCOUNTING POLICIES:

## Business

Founded in November 1981, Advanced Magnetics, Inc., a Delaware Corporation (the "Company") is a biopharmaceutical company engaged in the development and manufacture of compounds utilizing the Company's core proprietary colloidal superparamagnetic particle technology and core polysaccharide technology for magnetic resonance imaging ("MRI") and for polysaccharide directed, receptor-mediated drug delivery systems. The initial products developed by the Company are diagnostic imaging agents for use in conjunction with MRI to aid in the diagnosis of cancer and other diseases. In therapeutics, the Company is developing targeted drug delivery platforms for the treatment of organ specific diseases.

The Company is subject to risks common to companies in the industry including, but not limited to, development by the Company or its competitors of new technological innovations, uncertainty of product development and commercialization, lack of marketing and sales history, dependence on key personnel, market acceptance of products, product liability, protection of proprietary technology, and compliance with FDA government regulations.

## Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported

period. Actual results could differ from those estimates.

#### Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, money market funds and marketable securities having a maturity of less than three months at the date acquired. Substantially all of the cash and cash equivalents at September 30, 1997 and 1996 were held in a money market account.

#### Marketable Securities

The Company's current portfolio consists of securities classified as available-for-sale which are recorded at fair market value. The fair values of marketable securities are based on quoted market prices. Net unrealized gains and losses on marketable securities are recorded as a separate component of stockholders' equity. Interest income is accrued as earned. Dividend income is accrued on the ex-dividend date, and net realized gains and losses are computed on the basis of average cost and are recognized when realized.

#### Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

#### Property, Plant and Equipment

Property, plant and equipment are stated at cost. The cost of additions and improvements is charged to the property accounts while maintenance and repairs are expensed as incurred. Upon sale or other disposition of property and equipment, the cost and related depreciation are removed from the accounts and any resulting gain or loss is reflected in income.

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#### Depreciation and Amortization

Depreciation and amortization are recorded on the straight line method based on rates sufficient to provide for retirement over estimated useful lives as follows: buildings -- 40 years; laboratory equipment and furniture and fixtures -- 5 years; and leasehold improvements -- over the life of the lease.

#### Revenue Recognition

Revenue is recognized when products are shipped, when contract objectives are achieved or when research activities are performed. License and royalty revenues are accrued as earned.

#### Other Income

Other income of \$264,800 was recognized during the fiscal year ended September 30, 1997 as the result of an insurance settlement for flood damages in the research and development laboratory in October 1996.

#### Income Taxes

The provision (benefit) for income taxes includes federal and state income taxes currently payable and deferred income taxes arising from the recognition of certain income and expenses in different periods for financial and tax reporting purposes.

#### Income (Loss) per Share

Income per share is computed on the basis of the weighted average number of common and common share equivalents outstanding during each period. Loss per share is computed on the weighted average number of shares outstanding during the period.

#### Reclassifications

Certain amounts from the prior year have been reclassified to conform to the current year's presentation.

B. SALE OF IN VITRO PRODUCT LINE:

On October 15, 1993, the Company sold its in vitro product line to PerSeptive Biosystems, Inc. ("PerSeptive") for 151,759 shares of PerSeptive common stock worth \$4,156,674 as of that date, plus an additional earn-out amount based on PerSeptive's fiscal 1995 revenues. The amount of the earn-out at September 30, 1995 was \$3,404,527, which PerSeptive satisfied by issuing 373,080 shares of PerSeptive common stock. The Company recognized pre-tax gains on this sale of \$3,404,527 in fiscal 1995. All shares owned of PerSeptive common stock were sold by the end of fiscal 1996.

C. MARKETABLE SECURITIES:

The cost and fair value of the marketable securities portfolio at September 30 are as follows:

	1997	1997	1996	1996
	----- COST -----	----- FAIR VALUE -----	----- COST -----	----- FAIR VALUE -----
U.S. government securities				
Due in one year or less.....	\$ 5,000,000	\$ 4,998,900	\$ 7,510,203	\$ 7,481,250
Due after one through five years.....	7,438,569	7,429,650	7,392,785	7,312,500
Preferred stock.....	2,604,711	3,092,335	3,062,404	3,145,029
Common stock.....	7,116,089	11,844,880	3,488,874	5,332,390
	-----	-----	-----	-----
	\$22,159,369	\$27,365,765	\$21,454,266	\$23,271,169
	=====	=====	=====	=====

At September 30, 1997, gross unrealized holding gains and gross unrealized holding losses were \$5,344,117 and \$137,721 respectively, resulting in a net unrealized holding gain of \$5,206,396. At September 30, 1996, gross unrealized holding gains and gross unrealized holding losses were \$2,020,876 and \$203,973 respectively, resulting in a net unrealized holding gain of \$1,816,903. For the fiscal years ended September 30, 1997 and 1996, the net unrealized holding gains have been recorded as a separate component of stockholders' equity.

At September 30, 1994, the Company recorded a \$117,540 unrealized net loss on the fair value of securities. In the first fiscal quarter ended December 31, 1994, the Company recorded a cumulative effect of the accounting change of \$117,540 including the reversal of a reserve for the carrying value of the marketable securities.

During the year ended September 30, 1997, gross realized gains and gross realized losses on the sale of marketable securities were \$1,932,504 and \$65,154, respectively, resulting in a net realized gain of \$1,867,350. During the year ended September 30, 1996, gross realized gains and gross realized losses on the sale of marketable securities were \$660,126 and \$653,773, respectively, resulting in a net realized gain of \$6,353. During the year ended September 30, 1995, gross realized gains and gross realized losses on the sale of marketable securities were \$57,394 and \$2,428, respectively, resulting in a net realized gain of \$54,966. Proceeds from U.S. treasury notes maturing were \$12,500,000 and \$9,499,911 and \$3,000,000 in 1997, 1996 and 1995 respectively.

Interest, dividends and net gains (losses) on sales of securities consist of the following:

	FOR THE YEARS ENDED SEPTEMBER 30		
	----- 1997 -----	----- 1996 -----	----- 1995 -----
Interest income.....	\$1,385,670	\$1,400,597	\$1,644,329
Dividend income.....	242,029	354,500	588,016
Net gains on sales of securities.....	1,867,350	6,353	54,966

Totals.....	----- \$3,495,049 =====	----- \$1,761,450 =====	----- \$2,287,311 =====
-------------	-------------------------------	-------------------------------	-------------------------------

D. INVENTORIES:

As of September 30, 1997, the Company's inventory balance consisted of \$113,178 in raw materials. As of September 30, 1996, the Company's inventory balance consisted of \$125,144 in raw materials and \$57,022 in finished goods.

E. COMMITMENTS:

The Company leases laboratory, office and warehouse space under various agreements. Rental expense for the years ended September 30, 1997, 1996 and 1995 amounted to \$339,311, \$340,848, and \$320,920, respectively. Future minimum lease payments for fiscal 1998, 1999, 2000, 2001 and 2002 amount to \$469,751, \$417,661, \$417,661, \$148,800 and \$153,600, respectively.

F. ACCRUED EXPENSES:

Accrued expenses consist of the following at September 30:

	1997	1996
	-----	-----
Salaries and other compensation.....	\$ 183,000	\$ 195,889
License and royalty fees.....	497,307	--
Clinical trials.....	188,288	--
Professional fees.....	56,500	75,638
Other.....	133,975	228,838
Totals.....	----- \$1,059,070 =====	----- \$ 500,365 =====

G. INCOME TAXES:

Deferred tax assets and deferred tax liabilities are recognized based on temporary differences between the financial reporting and tax basis of assets and liabilities using statutory rates. A valuation allowance is recorded against deferred tax assets if it is more likely than not that some or all of the deferred tax assets will not be realized.

The income tax (benefit) provision consisted of the following:

	FOR THE YEARS ENDED SEPTEMBER 30,		
	1997	1996	1995
	-----	-----	-----
Currently payable:			
Federal.....	\$ (379,022)	\$ --	\$ 385,000
State.....	--	--	15,000
	-----	-----	-----
	(379,022)	--	400,000
	=====	=====	=====
Deferred:			
Federal.....	--	--	--
	-----	-----	-----
State.....	\$ (379,022)	\$ --	\$ 400,000
	=====	=====	=====

The provisions for income taxes were at different rates than the U.S. statutory rates for the following reasons:

FOR THE YEARS ENDED  
SEPTEMBER 30,

	1997	1996	1995
U.S. federal statutory tax (benefit) rate.....	34.0%	(34.0%)	34.0%
Dividends received deductions.....	(31.0)	(0.9)	(5.2)
Prior years income tax refund.....	(186.1)	--	--
Other, including a prior year tax adjustment.....	(2.6)	0.1	1.0
Losses without tax benefit.....	--	38.2	--
Tax benefit of temporary differences.....	(--)	(3.4)	(14.4)
	-----	-----	-----
	(185.7%)	--	15.4%
	-----	-----	-----

The \$379,022 tax benefit recorded in fiscal 1997 is due to refunds of alternative minimum taxes paid in prior years.

The components of the deferred tax assets and liabilities at September 30, were as follows:

	1997	1996
Assets		
Net operating loss carryforwards.....	\$ 5,133,259	\$ 4,834,262
Research and experimentation tax credit carryforward.....	2,146,627	1,779,972
Deductible intangibles.....	121,571	481,360
Other.....	226,013	539,140
Liabilities		
Property, plant and equipment depreciation.....	(329,162)	(380,212)
Other.....	(55,206)	(34,283)
	-----	-----
Valuation allowance.....	7,243,102	7,220,239
	(7,243,102)	(7,220,239)
	-----	-----
Net deferred taxes.....	\$ --	\$ --
	=====	=====

Due to the uncertainty surrounding the realization of the favorable tax attributes in future tax returns, the Company has placed a valuation allowance against its otherwise recognizable net deferred tax assets. Realization of favorable tax attributes is, therefore, reflected as a tax benefit in the provision for income taxes.

At September 30, 1997, the Company had unused net operating loss (NOL) carryforwards for federal income tax purposes of approximately \$12,560,000 which expire in fiscal 2012. The Company also has federal research and experimentation credits of approximately \$1,880,000 which expire in fiscal 2012.

H. STOCK PLANS:

The Company's 1993 Stock Option Plan (the "1993 Stock Plan") provides for the grant of options to the Company's directors, officers, employees and consultants to purchase up to an aggregate of 500,000 shares of common stock at a price equal to the fair market value of the stock at the date of the grant. The maximum term of the options under the 1993 Stock Plan is ten years. The number of shares available for future grants at September 30, 1997 was 76,925.

The Company's 1983 Stock Option Plan (the "Plan") does not allow for option grants after June 1993. The Plan provided for the grant of options to purchase up to 900,000 shares of common stock at a price equal to the fair market value of the stock at the date of grant to the Company's employees and mandatory grants to outside directors upon initial election to the Board of Directors. The

maximum terms of incentive stock options and non-statutory options under the Plan are ten years and ten years plus thirty days, respectively.

The Company has also granted to certain scientific advisors non-statutory options to purchase a total of 32,625 shares of common stock at a price equal to fair market value at the date of grant. As of September 30, 1997, 29,625 options have been exercised.

On November 5, 1991, the Company's Board of Directors adopted the 1992 Non-Employee Director Stock Option Plan (the "1992 Plan") which the shareholders approved. This plan provides for the grant to each non-employee director on November 5, 1991, and each fifth anniversary thereafter, of an option to purchase 5,000 shares of common stock up to an aggregate of 100,000 shares at a price equal to the fair market value of the stock at the date of the grant, vesting over a five year period. Under this plan, options to purchase 30,000 shares of common stock at a price of \$21.00 per share and an additional 30,000 shares of common stock at a price of \$15.25 per share were granted on November 5, 1991 and 1996, respectively. The 1992 Plan also provided for the grant of options for 5,000 shares to new members of the Board of Directors. A total of 10,000 stock options were granted to new directors during fiscal year 1997 under the 1992 Plan. No grants may be made under this plan after November 4, 2001.

On November 10, 1992, the Company's Board of Directors adopted the 1993 Non-Employee Director Stock Option Plan (the "1993 Plan") which the shareholders approved. This plan provides for the grant to each non-employee director on November 10, 1992, and each sixth anniversary thereafter an option to purchase 5,000 shares of common stock up to an aggregate of 100,000 shares at a price equal to the fair market value of the stock at the date of the grant, vesting over a five year period. Under this plan, options to purchase 30,000 shares of common stock at a price of \$14.50 per share were granted on November 10, 1992. The 1993 Plan also provided for the grant of options for 5,000 shares to new members of the Board of Directors. A total of 10,000 stock options were granted to new directors during fiscal year 1997 under the 1993 Plan. No grants may be made under this plan after November 10, 2002.

During the fiscal year ended September 30, 1997, the Company's Board of Directors approved the exchange of stock options by the Company's employees and directors at the fair market value of the stock at the effective date of the exchange. This provided for the cancellation of any unexercised stock options and the reissuance of an equal number of stock options at the new price, with 50% of any previously vested options vesting immediately. The stock options cancelled were originally issued under the 1983 and 1993 Stock Option Plans and the 1992 and 1993 Non-Employee Director Stock Option Plans and were reissued under the 1993 Stock Option Plan. 236,825 options under the 1983 and 1993 Stock Option Plans were exchanged effective on July 3, 1997 at an exercise price of \$11.50. 110,000 options under the 1992 and 1993 Non-Employee Director Stock Option Plans were exchanged effective on August 5, 1997 at an exercise price of \$11.125.

Stock option activity for the years ended September 30, 1997, 1996 and 1995 is as follows:

	1997		1996		1995	
	WEIGHTED AVERAGE EXERCISE SHARES	PRICE	WEIGHTED AVERAGE EXERCISE SHARES	PRICE	WEIGHTED AVERAGE EXERCISE SHARES	PRICE
Outstanding at beginning of year.....	407,645	\$13.86	426,315	\$13.29	374,384	\$11.46
Granted.....	475,825	\$12.17	14,500	\$21.37	86,200	\$19.12
Exercised.....	(42,450)	\$ 6.40	(26,445)	\$ 7.03	(29,494)	\$ 7.03
Canceled.....	(380,825)	\$16.45	(6,725)	\$20.56	(4,775)	\$13.28
Outstanding at end of year.....	460,195	\$10.66	407,645	\$13.86	426,315	\$13.29
Options exercisable at year-end...	98,070	\$ 8.01	252,626	\$11.82	201,434	\$ 9.40

Weighted average fair value of  
options granted during the  
year..... \$ 5.63 \$ 9.84  
=====

The fair value of each option granted during 1997 and 1996 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: (1) expected life of 6.0 years (2) expected volatility of 36% (3) risk-free interest rate of 6.2% and (4) no dividend yield.

The following table summarizes information about stock options outstanding and exercisable at September 30, 1997:

RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE
\$ 3.33 -- \$ 5.00.....	34,675	0.4	\$ 3.56	34,675	\$ 3.56
\$ 5.01 -- \$ 7.49.....	3,906	3.1	\$ 6.50	3,906	\$ 6.50
\$ 7.50 -- \$11.24.....	198,414	8.8	\$10.81	28,414	\$ 8.93
\$11.25 -- \$16.86.....	221,650	9.1	\$11.63	30,300	\$12.06
\$16.87 -- \$22.00.....	1,550	9.2	\$22.00	775	\$22.00
\$ 3.33 -- \$22.00.....	460,195	8.3	\$10.66	98,070	\$ 8.01

Employee Stock Purchase Plan:

The Company's 1992 Employee Stock Purchase Plan (the "Purchase Plan") provides for the issuance of up to 150,000 shares of common stock to employees of the Company. Under the terms of the Purchase Plan, eligible employees may purchase shares in five annual offerings ending in 1997, through payroll deductions of up to a maximum of 10% of the employee's earnings, at a price equal to the lower of 85% of the fair market value of the stock on the applicable annual offering commencement date of June 1 or termination date of May 31. The fifth offering under the Purchase Plan ended on May 31, 1997 and 11,621 shares of common stock were purchased by eligible employees at a price of approximately \$10.10 per share. As of September 30, 1997, 56,972 shares have been issued under this plan.

Had the Company adopted SFAS 123, the weighted average for each purchase right granted during fiscal 1997 and 1996 would have been \$3.68 and \$5.72, respectively.

On December 13, 1996 the Board of Directors adopted the 1997 Employee Stock Purchase Plan (the "Plan"). The Plan is essentially the same as the Company's 1992 Employee Stock Purchase Plan, and provides for the issuance of 150,000 shares. The Plan was approved by the shareholders of the Company at the annual meeting of February 4, 1997.

Pro Forma Disclosures

Had compensation cost for the Company's 1997 and 1996 grants for stock-based compensation plans been determined consistent with SFAS 123, the Company's net income (loss) and net income (loss) per share for 1997 and 1996 would approximate the pro forma amounts below:

		1997	1996
		-----	-----
Net income (loss).....	As reported	\$583,174	\$(9,714,993)
	Pro forma	\$276,163	\$(9,748,848)
Net income (loss) per share.....	As reported	\$0.09	\$(1.44)
	Pro forma	\$0.04	\$(1.44)

The effects of applying SFAS 123 in this pro-forma disclosure are not indicative of future amounts. SFAS 123 does not apply to awards prior to fiscal 1996, and additional awards in future years are anticipated.

I. EMPLOYEE'S SAVING PLAN:

The Company provides a 401(k) Plan to employees of the Company by which they may defer compensation for income tax purposes under Section 401(k) of the Internal Revenue Code. Each employee may elect to defer a percentage of his or her salary on a pre-tax basis up to a specified maximum percentage. The Company matches every dollar each employee contributes to the 401(k) Plan up to six percent of each employee's salary to a maximum of \$2,000 annually per employee. Salary deferred by employees and contributions by the Company to the 401(k) Plan are not taxable to employees until withdrawn from the 401 k) Plan and contributions are deductible by the Company when made. The amount of the Company's matching contribution for the 401 (k) Plan was \$104,943, \$110,542, and \$99,751 for 1997, 1996, and 1995, respectively.

J. COMMON STOCK TRANSACTIONS:

On February 11, 1991, Squibb Diagnostics, a division of Bristol-Myers Squibb Co. purchased a warrant for \$950,000 to purchase 600,000 shares of common stock at \$10.92 per share. On August 30, 1994, the Company signed an agreement to reacquire the development and marketing rights to the MRI contrast agent, (the Bristol-Myers Agreement) Combidex (AMI-227). As part of the transaction, Bristol-Myers Squibb, Inc. returned the warrant which was valued at \$240,000 to the Company. In the first quarter of fiscal 1995, the Company and Bristol-Myers Squibb Co. agreed to modify the agreement. As a result, payments to be made under the agreement were modified (See Note O). Accordingly, the Company adjusted the value of the warrant to purchase 600,000 shares of the Company's common stock by \$120,000 in the first quarter of fiscal 1995.

In May 1996, the Board of Directors authorized the purchase of 250,000 shares of the Company's common stock on the open market. Through September 30, 1997, the Company purchased 87,500 shares for \$1,337,944 and the shares have been retired. The Board had previously authorized the purchase of 350,000 shares of which 24,700 shares were retired through fiscal 1995.

K. PREFERRED STOCK:

The preferred stock may be issued from time to time in one or more series. The rights, preferences, restrictions, qualifications and limitations of such stock shall be determined by the Board of Directors.

L. BUSINESS SEGMENTS AND CUSTOMERS:

The Company's operations are located solely within the United States. The Company is focused principally on developing and manufacturing MRI contrast agents and drug delivery systems. Accordingly, its revenues are attributable to one principal business segment. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. One customer accounted for 54% of the

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Company's revenues in fiscal 1997, while no customer accounted for more than 10% of the Company's revenues in fiscal 1996. Two customers accounted for 52% and 23% respectively, of the Company's revenues in fiscal 1995.

Revenues from customers and licensees outside the United States were not significant in fiscal 1997 and 1996. Revenues in fiscal 1995, from customers and licensees outside of the United States, principally in Europe and Japan, amounted to 23% of the Company's total revenues.

M. LEGAL PROCEEDINGS:

The Company and certain of its officers were sued in an action in the United States District Court for the District of Massachusetts on September 3, 1992. The plaintiff, a former consultant to the Company, claims that he was incorrectly omitted as an inventor or joint inventor on six of the Company's patents and on pending applications, and seeks injunctive relief and unspecified monetary damages. In October 1995, the plaintiff appealed an interlocutory order

of the United States District Court to the United States Court of Appeals for the Federal Circuit. The plaintiff's appeal is pending and the United States District Court has administratively closed the case. The plaintiff filed a related case in the Superior Court of the Commonwealth of Massachusetts. The Superior Court has dismissed most of the related tort claims on summary judgment. While the final outcome of these actions cannot be determined, the Company believes that the plaintiff's claims are without merit and intends to defend the actions vigorously.

#### N. AGREEMENTS:

To facilitate the marketing and distribution of its contrast agents, the Company has entered into strategic relationships with certain established pharmaceutical companies. These relationships, both in the United States and abroad, include: (i) Guerbet S.A. ("Guerbet"), a leading European producer of contrast agents, in Western Europe and Brazil; (ii) Eiken Chemical Co., Ltd. ("Eiken"), one of Japan's leading medical diagnostics manufacturers, in Japan; (iii) Berlex Laboratories, Inc. ("Berlex"), the leading marketer of MRI contrast agents, in the United States; and (iv) Mallinckrodt Inc. ("Mallinckrodt") a leading manufacturer of contrast agents, in the United States, Canada and Mexico.

On February 1, 1995, the Company entered into an agreement with Berlex granting Berlex a product license and exclusive marketing rights to Feridex I.V. in the United States and Canada. Under the terms of the agreement, Berlex paid a \$5,000,000 non-refundable license fee in fiscal 1995. An additional \$5,000,000 license fee was received in October 1996 as a result of the FDA's marketing approval and Berlex's market launch of Feridex I.V. in the United States. In addition, the company receives payments for manufacturing the product and royalties on sales.

In fiscal 1991, the Company entered into agreements with Squibb Diagnostics, granting exclusive world-wide rights (except for Japan, Western Europe and Brazil) to manufacture and sell two MRI products, AMI-HS and Combix. In addition, Squibb Diagnostics received the right to use the Company's core technology in its own development of other MRI contrast agents. In fiscal 1994, the Company and Squibb Diagnostics terminated their agreement with respect to the AMI-HS product. The Company signed an agreement to reacquire the development and marketing rights to Combix previously licensed to Squibb Diagnostics. The Company agreed to pay Bristol-Myers Squibb, Co. \$1,000,000 in two cash payments, of which \$500,000 was paid on August 30, 1994 and \$500,000 was to be paid upon acceptance of the 1,200 vials of the Combix product suitable for worldwide preclinical and clinical studies. Furthermore, the Company is required to pay up to \$2,750,000 in future royalties based on the Company's sale of Combix. As part of the transaction, Bristol-Myers Squibb, Co. returned to the Company a warrant to purchase 600,000 shares of the Company's common stock, valued at \$240,000. The Company recorded a \$760,000 expense which represented the value of in-process research and development reacquired in fiscal 1994. In the first quarter of fiscal 1995, the Company and Bristol-Myers Squibb Co. agreed that the 1,200 vials of Combix delivered to the Company were not acceptable. In addition, they agreed that any future delivery of Combix under the agreement will not be required and that the Company will not be required to make the \$500,000 payment.

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Accordingly, the Company recorded a credit for \$380,000 to the purchase of in-process research and development and adjusted the value of the warrant by \$120,000 in the first quarter of fiscal 1995.

In 1990, the Company entered into a manufacturing and distribution agreement with Mallinckrodt granting Mallinckrodt a product license and co-marketing rights to GastroMARK(R) in the United States, Canada and Mexico. Under the terms of the agreement, Mallinckrodt paid a \$500,000 non-refundable license fee in fiscal 1997 as a result of the FDA's marketing approval of Feridex I.V. in the United States. In addition, the company received payments for manufacturing the product and royalties on sales.

The Company is the licensee of certain technologies under agreements with third parties which require the Company to make payments in accordance with these license agreements and upon the attainment of particular milestones. The Company is also required to pay royalties on a percentage of certain product sales, if any. During fiscal year 1997, 1996 and 1995, the Company made

milestone payments of \$800,000, \$725,000, and \$350,000 in relation to these agreements. Future milestone payments are not to exceed \$400,000.

O. RELATED PARTY TRANSACTIONS:

During the fiscal years ended September 30, 1997, 1996 and 1995, the Company paid approximately \$58,910, \$26,573 and \$7,050, respectively, to Fahnstock & Co. Inc. as commissions on transactions involving its investments in securities. Mr. Leslie Goldstein, a shareholder and member of the Company's Board of Directors and the brother of Jerome Goldstein, Chairman of the Board and CEO of the Company, is employed by SRG Associates, a division of Fahnstock & Co. Inc., as an investment analyst and advisor.

P. QUARTERLY FINANCIAL DATA -- UNAUDITED:

The following table provides quarterly data for the fiscal years ended September 30, 1997, and 1996.

	FISCAL 1997 QUARTERS ENDED			
	SEPTEMBER 30	JUNE 30	MARCH 31	DEC. 31, 1996
License fees.....	\$ --	\$ --	\$ --	\$ 5,500,000
Royalties.....	57,541	85,000	95,904	125,000
Product sales.....	372,366	394,656	209,793	603,542
Research and development services.....	--	--	--	62,920
Interest, dividends and net gains and losses on sales of securities.....	984,385	705,323	1,058,895	746,446
Total revenues.....	1,414,292	1,184,979	1,364,592	7,037,908
Cost of product sales.....	60,722	83,436	33,139	143,196
Operating expenses.....	3,386,242	2,312,148	2,425,778	2,617,758
Other (income).....	--	(264,749)	(51)	--
Income tax benefit.....	--	(379,022)	--	--
Net income (loss).....	\$ (2,032,672)	\$ (566,834)	\$ (1,094,274)	\$ 4,276,954
Net income (loss) per share.....	\$ (0.30)	\$ (0.08)	\$ (0.16)	\$ 0.63

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	FISCAL 1996 QUARTERS ENDED			
	SEPTEMBER 30	JUNE 30	MARCH 31	DEC. 31, 1995
License fees.....	\$ --	\$ --	\$ --	\$ --
Royalties.....	(75,000)	(25,000)	75,000	75,000
Product sales.....	--	--	12,762	--
Research and development services.....	6,810	--	--	--
Interest, dividends and net gains and losses on sales of securities.....	450,911	470,373	388,307	451,859
Total revenues.....	382,721	445,373	476,069	526,859
Cost of product sales.....	--	--	2,550	--
Operating expenses.....	2,871,713	3,308,476	2,911,732	2,451,544
Net income (loss).....	\$ (2,488,992)	\$ (2,863,103)	\$ (2,438,213)	\$ (1,924,685)
Net income (loss) per share.....	\$ (0.37)	\$ (0.42)	\$ (0.36)	\$ (0.28)

Q. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS:

The FASB issued Statement No. 128 ("SFAS 128"), "Earnings per Share", which modifies the way in which earnings per share ("EPS") is calculated and disclosed. Currently, the Company discloses primary EPS. Upon adoption of this

standard for the first fiscal period ending December 31, 1997, the Company will disclose basic and diluted EPS. Basic EPS excludes dilution and common stock equivalents and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. The Company believes the implementation of SFAS 128 will not have a material impact on the earnings per share calculation.

The FASB recently issued Statement No 130 ("SFAS 130"), "Reporting Comprehensive Income". This statement requires changes in comprehensive income to be shown in a financial statement that is displayed with the same prominence as other financial statements. While not mandating a specific financial statement format, the Statement requires that an amount representing total comprehensive income be reported. The Statement is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods is required for comparative purposes. The Company believes the implementation of SFAS 130 may have a material impact on results of operations.

The FASB also issued Statement No. 131 ("SFAS 131"), "Disclosures about Segments of an Enterprise and Related Information". This Statement, which supersedes Statement No. 14, "Financial Reporting for Segments of a Business Enterprise," changes the way public companies report information about segments. The Statement, which is based on the management approach to segment reporting, includes requirements to report segment information quarterly and entity-wide disclosures about products and services, major customers, and the material countries in which the entity holds assets and reports revenues. The Statement is effective for periods beginning after December 15, 1997. Restatement for earlier years is required for comparative purposes unless impracticable. In addition, SFAS 131 need not be applied to interim periods in the initial year, however, in subsequent years, interim period information must be presented on a comparative basis. The Company is currently evaluating this Statement and its effect on financial statement disclosures.

R. SUBSEQUENT EVENT:

On October 24, 1997, the Company acquired an 80.7% interest in Kalisto Biologicals, Inc. ("Kalisto"), an early-stage company that intends to develop, manufacture and market veterinary and food testing systems and products. Kalisto has formed a technology and support relationship with Precise Animal Diagnostics, Inc. of Madison, Wisconsin ("PAD") to manufacture and market PAD's veterinary testing systems worldwide.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT:

The information required by this item, with respect to the directors of the registrant, is incorporated by reference from the Company's definitive proxy statement in connection with its Annual Meeting of Stockholders to be held on February 3, 1998, filed with the Commission on December 19, 1997, in the table under the caption "Election of Directors."

THE EXECUTIVE OFFICERS OF THE REGISTRANT ARE AS FOLLOWS:

Jerome Goldstein, 58, is a founder of the Company and has been Chief Executive Officer, Chairman of the Board of Directors and Treasurer since the Company's organization in November 1981. Mr. Goldstein was President of the Company from the Company's organization until May 1997. Mr. Goldstein was a cofounder of Clinical Assays, Inc., serving from 1972 to 1980 as Vice President and then as President. Mr. Goldstein is the brother of Leslie Goldstein, a director of the Company, and husband of Marlene Kaplan Goldstein, Secretary of the Company.

Leonard M. Baum, 44, joined the Company in October 1994 as Senior Vice President and has been President and Chief Operating Officer since May 1997. From 1986 to 1994, Mr. Baum was employed as Senior Director, Worldwide Regulatory Affairs/Drug Safety by Squibb Diagnostics. Mr. Baum is also a member of the Board of Directors.

Ernest Groman, 52, is a co-founder of the Company and has been Senior Vice President -- Research since June 1997. From 1994 to 1997, he was Director of Exploratory Research and from 1981 to 1994 he was a Senior Scientist of the

Company.

Dennis Lawler, 43, joined the Company in February 1989 as Director of Quality Control and has been Vice President -- Quality Control since January 1997. Prior to February 1989, Mr. Lawler was employed at CIS-US, first as Senior Quality Control Analyst, then as a Production Manager and then as a Plant Manager.

Jerome M. Lewis, 48, joined the Company in April 1986 as a Senior Scientist and has been Vice President -- Scientific Operations since February 1991. Prior to April 1986, Dr. Lewis was employed as a senior scientist by Petroferm Ltd., a biotechnology company.

James A. Matheson, 53, joined the Company in May 1996 as Vice President -- Finance. Prior to May 1996, Mr. Matheson was Controller of Diatech Diagnostics, Inc.

Paula M. Jacobs, 53, joined the Company in January 1986 as Vice President -- Development. From 1981 to 1986, Dr. Jacobs was employed at Seragen, Inc., first as Production Manager and later as General Manager of the Research Products Division.

Mark C. Roessel, 47, joined the Company in January 1982 as Director of Regulatory Affairs and has been Vice President -- Regulatory Affairs since January 1995. Prior to January 1982, Mr. Roessel was Compliance Manager of the Clinical Assay Division of Baxter International, Inc.

Marlene Kaplan Goldstein is a founder of the Company and has been Secretary of the Company since the Company's organization in November 1981.

ITEM 11. EXECUTIVE COMPENSATION:

The information required by this item is incorporated by reference from the Company's definitive proxy statement in connection with its Annual Meeting of Stockholders to be held on February 3, 1998, filed with the Commission on December 19, 1997, under the captions "Compensation of Directors" and "Compensation and Other Information Concerning Directors and Officers."

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ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT:

The information required by this item is incorporated by reference from the Company's definitive proxy statement in connection with its Annual Meeting of Stockholders to be held on February 3, 1998, filed with the Commission on December 19, 1997, in the table under the caption "Principal Stockholders".

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS:

Not applicable.

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PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K:

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. Financial Statements. The following financial statements of the Company and Independent Auditors' Report are incorporated in Item 8 of this report.

Report of Independent Accountants  
Balance Sheets at September 30, 1997 and 1996  
Statements of Operations for the Years Ended September 30, 1997, 1996 and

1995  
 Statements of Stockholders' Equity for the Years Ended September 30, 1997,  
 1996 and 1995>  
 Statements of Cash Flow for the Years Ended September 30, 1997, 1996 and 1995  
 Reconciliation of Net Income (Loss) to Net Cash Used in Operating Activities  
 for the Years Ended September 30, 1997, 1996 and 1995

Notes to Financial Statements

2. Financial Statement Schedules. Financial statement schedules have been omitted because the required information is not present or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the financial statements or the notes thereto.
3. The exhibits listed in the Exhibit Index immediately preceding the Exhibits are filed as a part of this Annual Report on Form 10-K.

(b) Reports on Form 8-K:

No reports on Form 8-K were filed by the Company during the fiscal quarter ended September 30, 1997.

SIGNATURES

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

ADVANCED MAGNETICS, INC.

By: /s/ JERMONE GOLDSTEIN

-----  
 Jerome Goldstein, Chief Executive  
 Officer,  
 Chairman of the Board of Directors  
 and Treasurer

December 22, 1997

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

NAME	TITLE	
----- /s/ JEROME GOLDSTEIN ----- Jerome Goldstein	Chief Executive Officer, Chairman of the Board of Directors and Treasurer (principal executive and financial officer)	December 22, 1997
----- /s/ JAMES MATHESON ----- James Matheson	Vice President-Finance (principal accounting officer)	December 22, 1997
----- /s/ LEONARD M. BAUM ----- Leonard M. Baum	Director	December 22, 1997
----- /s/ THOMAS COOR ----- Thomas Coor	Director	December 22, 1997
----- /s/ LESLIE GOLDSTEIN ----- Leslie Goldstein	Director	December 22, 1997
----- /s/ JOSEPH LASSITER -----	Director	December 22, 1997

Joseph Lassiter

/s/ MICHAEL LOBERG

Director

December 22, 1997

-----  
Michael Loberg

/s/ RICHARD L. MCINTIRE

Director

December 22, 1997

-----  
Richard L. McIntire

/s/ EDWARD B. ROBERTS

Director

December 22, 1997

-----  
Edward B. Roberts

/s/ ROGER E. TRAVIS

Director

December 22, 1997

-----  
Roger E. Travis

/s/ GEORGE M. WHITESIDES

Director

December 22, 1997

-----  
George M. Whitesides

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EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION
3.1(1)	Certificate of Incorporation of the Company, as amended.
3.2(2)	By-Laws of the Company, as amended.
10.1(6)	1983 Stock Option Plan of the Company, as amended on November 13, 1990.
10.2(7)	1987 Employee Stock Purchase Plan.
10.3(7)	1992 Employee Stock Purchase Plan.
10.4(7)	1992 Non-Employee Director Stock Option Plan.
10.5(9)	1993 Stock Plan.
10.6(9)	1993 Non-Employee Director Stock Option Plan.
10.7(13)	1997 Employee Stock Purchase Plan.
10.8(3)	Technology Agreement dated January 21, 1983 between the Company and Corning Glass Works (now Ciba Corning Diagnostics Corp.) (confidential treatment previously granted).
10.9(2)	Agreements between the Company and ML Technology Ventures, L.P. dated as of March 23, 1987 (confidential treatment previously granted).
10.10(2)	Clinical Testing, Supply and Marketing Agreement between the Company and Guerbet, S.A. dated May 22, 1987 (confidential treatment previously granted).
10.11(4)	Clinical Testing, Supply and Marketing Agreement between the Company and Eiken Chemical Co., Ltd., dated August 30, 1988 (confidential treatment previously granted).
10.12(5)	Contrast Agent Agreement dated between the Company and Guerbet, S.A. dated September 29, 1989 (confidential treatment previously granted).
10.13(6)	Contrast Agent Agreement between the Company and Eiken Chemical Co., Ltd. dated March 27, 1990 (confidential treatment previously granted).
10.14(6)	Amendment to Clinical Testing, Supply and Marketing Agreement between the Company and Eiken Chemical Co., Ltd., dated September 29, 1990 (confidential treatment previously granted).
10.15(6)	License, Supply and Marketing Agreement between the Company and Mallinckrodt Medical, Inc., dated June 28, 1990 (confidential treatment previously granted).
10.16(6)	Agreement of Amendment between the Company and ML Technology Ventures, L.P. dated as of June 28, 1990.
10.17(7)	Technology License Agreement between the Company and Squibb Diagnostics, dated February 5, 1991 (confidential treatment previously granted).
10.18(7)	AMI-227 License Agreement between the Company and Squibb Diagnostics, dated February 5, 1991 (confidential treatment previously granted).
10.19(7)	AMI-HS License Agreement between the Company and Squibb Diagnostics, dated February 5, 1991 (confidential treatment previously granted).
10.20(7)	Warrant Purchase Agreement between the Company and Squibb Diagnostics, dated February 11, 1991.
10.21(7)	Purchase Agreement between the Company and ML Technology.

- 10.22(7) Agreement of Amendment to Clinical Testing, Supply and Marketing Agreement between the Company and Guerbet, S.A., dated August 13, 1990.
- 10.23(8) Asset Purchase Agreement dated as of October 15, 1993 by and between the Company and PerSeptive Biosystems, Inc.
- 10.24(10) License, Supply and Marketing Agreement dated September 27, 1993 between the Company and Sterling (confidential treatment previously granted).
- 10.25(10) Termination Agreement dated November 8, 1993 between the Company and Squibb Diagnostics (confidential treatment previously granted).
- 10.26(10) Amendment to License Agreement dated November 8, 1993 between the Company and Squibb Diagnostics (confidential treatment previously granted).

EXHIBIT NUMBER	DESCRIPTION
10.27(11)	Termination Agreement dated August 30, 1994 between the Company and Bristol-Myers Squibb Co.
10.28(12)	License and marketing agreement between the Company and Berlex Laboratories, Inc. dated as of February 1, 1995.
10.29(12)	Supply Agreement between the Company and Berlex Laboratories, Inc. dated as of February 1, 1995.
10.30	Lease and Lease Agreement between the Company and Carnegie Center Associates dated September 6, 1994.
10.31	Lease between Silver Lake Realty Trust and Kalisto Biologicals, Inc. dated October 24, 1997.
11.1	Computation of earnings per share.
23.1	Consent of Coopers & Lybrand L.L.P., independent accountants.
27	Financial Data Schedule.

- (1) Incorporated herein by reference to the exhibits to the Company's Registration Statement on Form S-8 (File No. 33-13953).
- (2) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1987.
- (3) Incorporated herein by reference to the exhibits to the Company's Registration Statement on Form S-1 (File No. 33-5312).
- (4) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1988.
- (5) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1989.
- (6) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1990.
- (7) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1991.
- (8) Incorporated herein by reference to the exhibits to the Company's Current Report on Form 8-K dated October 15, 1993.
- (9) Incorporated herein by reference to the exhibits to the Company's definitive proxy statement for the fiscal year ended September 30, 1992.
- (10) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K, as amended, for the fiscal year ended September 30, 1993.
- (11) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K, for the fiscal year ended September 30, 1994.
- (12) Incorporated herein by reference to the exhibits to the Company's Quarterly Report on Form 10-Q, for the fiscal quarter ended December 31, 1994.

(13) Incorporated herein by reference to the exhibits to the Company's definitive Proxy Statement for the fiscal year ended September 30, 1996.

LEASE AND LEASE AGREEMENT

Between

CARNEGIE CENTER ASSOCIATES

The Landlord

And

ADVANCED MAGNETICS, INC.

The Tenant

For Leased Premises In

104 Carnegie Center  
Princeton, New Jersey

September 6, 1994

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LEASE AND LEASE AGREEMENT, dated as of September 6, 1994, between CARNEGIE CENTER ASSOCIATES, a New Jersey general partnership, with offices at Suite 100, 210 Carnegie Center, Princeton, New Jersey 08540 (the "Landlord"), and ADVANCED MAGNETICS, INC., a Delaware corporation, with its principal office at 61 Mooney Street, Cambridge, Massachusetts 02138 (the "Tenant").

Subject to all the terms and conditions set forth below, the Landlord and the Tenant hereby agree as follows:

1 DEFINITIONS. Certain terms and phrases used in this Agreement (generally those whose first letters are capitalized) are defined in Exhibit E attached hereto and, as used in this Agreement, they shall have the respective meanings assigned or referred to in that exhibit.

2 LEASE OF THE LEASED PREMISES.

2.1 The Landlord shall, and hereby does, lease to the Tenant, and the Tenant shall, and hereby does, accept and lease from the Landlord, the Leased Premises during the Term. The Leased Premises consist of 5,174 square feet of gross rentable floor space on the second floor of 104 Carnegie Center, as more fully described in the definition of Leased Premises set forth in Exhibit E attached hereto.

2.2 The Landlord shall, and hereby does, grant to the Tenant, and the Tenant shall, and hereby does, accept from the Landlord, the non-exclusive right to use the Common Facilities during the Term for itself, its employees, other agents and Guests in common with the Landlord, any tenants of Other Leased Premises, any of their respective employees, other agents and guests and such

other persons as the Landlord may, in the Landlord's sole discretion, determine from time to time.

3 RENT.

3.1 The Tenant shall punctually pay the Rent for the Leased Premises for the Term to the Landlord in the amounts and at the times set forth below, without bill or other demand and without any offset, deduction or, except as may be otherwise specifically set forth in this Agreement, abatement whatsoever.

3.2 The Basic Rent for the Leased Premises during the Initial Term shall be at the rate per year set forth below:

Period -----	Annual Basic Rental Rate -----
Commencement Date through the end of Lease Year 1	\$117,449.80
Lease Year 2	\$120,036.80

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The annual rate of Basic Rent for the Leased Premises during any Renewal Term shall be as set forth in subsection 6.3 of this Agreement for the respective Renewal Term.

3.3 The Tenant shall punctually pay the applicable Basic Rent in equal monthly installments in advance on the first day of each month during the Term, with the exception of Basic Rent for the first full calendar month of the Initial Term and for any period of less than a full calendar month at the beginning of the Term. The Tenant shall pay the Basic Rent for the first full calendar month of the Initial Term upon execution and delivery of this Agreement. The Tenant shall punctually pay the Basic Rent for a period of less than a full calendar month at the beginning of the Term on the Commencement Date.

3.4 The Basic Rent and the Additional Rent for any period of less than a full calendar month shall be prorated on a per diem basis within the partial month. In the event that any installment of Basic Rent cannot be calculated by the time payment is due, such portion as is then known or calculable shall be then due and payable; and the balance shall be due upon the Landlord's giving notice to the Tenant of the amount of the balance due.

3.5 The Additional Rent for the Leased Premises during the Term shall be promptly paid by the Tenant in the respective amounts and at the respective times set forth in this Agreement.

3.6 That portion of any amount of Rent or other amount due under this Agreement which is not paid on the day it is first due shall incur a late charge equal to the sum of: (i) five percent of that portion of any amount of Rent or other amount due under this Agreement which is not paid on the day it is first due and (ii) interest on that portion of any amount of Rent or other amount due under this Agreement which is not paid on the day it is first due at the Base Rate(s) in effect from time to time plus two additional percentage points from the day such portion is first due through the day of receipt thereof by the Landlord. Any such late charge due from the Tenant shall be due immediately.

4 TERM.

4.1 The Initial Term shall commence on the Commencement Date and shall continue for two years from the beginning of the Initial Year, unless sooner terminated in accordance with section 24 of this Agreement. The Term shall commence on the Commencement Date and shall continue until the later of the conclusion of the Initial Term or the conclusion of any Renewal Term, unless sooner terminated in accordance with section 24 of this Agreement.

4.2 Unless one or more of the conditions contemplated by subsection 4.3 of this Agreement occurs, the Commencement Date shall be the later of:

4.2.1 the Target Date; or

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4.2.2 the date that the last of each of the following conditions set forth in this subsection 4.2.2 of the Agreement that is specifically applicable shall have occurred:

4.2.2.1 if the Leased Premises is being prepared exclusively by contractors selected and retained by the Landlord, the date the Leased Premises can first be legally occupied for its intended use;

4.2.2.2 preparation of the Leased Premises in accordance with the Tenant Plan as it pertains to repainting and recarpeting is substantially completed ;

4.2.2.3 the Landlord can deliver actual and exclusive possession of the Leased Premises, free of rubbish and debris, to the Tenant (except for any contractors not selected and retained by the Landlord and their rubbish and debris).

4.3 In the event one or more of the conditions contemplated by this subsection 4.3 of the Agreement occurs, notwithstanding anything to the contrary set forth in subsection 4.2 of this Agreement, the Commencement Date shall be the earliest applicable date specified below:

4.3.1 the earliest date the Tenant takes any of the following actions shall be the Commencement Date in the event the Tenant takes possession of, occupies or moves any furniture, furnishings equipment (with the exception of equipment required for telecommunications hook-ups), supplies or other possessions into, the Leased Premises or any portion thereof earlier than the date otherwise determined in accordance with subsection 4.2 of this Agreement;

4.3.2 the date that the last of the conditions set forth in subsection 4.2.2 of this Agreement that is specifically applicable shall have occurred if (i) the Tenant shall have requested the Landlord or any contractors selected and retained by the Landlord to complete their work as it pertains to repainting and recarpeting before the Target Date and (ii) they shall have done so.

4.4 Once it is ascertained in accordance with subsections 4.2 and 4.3 of this Agreement, the Landlord shall give prompt notice of the Commencement Date to the Tenant; and if the Tenant does not object thereto by notice given to the Landlord within 10 days of the Landlord's notice, the date set forth in the Landlord's notice shall thereafter be conclusively presumed to be the Commencement Date.

5 PREPARATION OF THE LEASED PREMISES.

5.1 [This subsection intentionally left blank.]

5.2 [This subsection intentionally left blank.]

5.3 If, at or prior to the execution and delivery of this Agreement, the Tenant shall not have requested the Landlord in writing to provide the Tenant Plan, the Tenant shall deliver the complete Tenant Plan as it pertains to repainting and recarpeting to the Landlord not

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later than the Tenant Plan Due Date and the complete Tenant Plan as it pertains to other work to the Landlord at the Tenant's convenience. The Tenant Plan shall

be the Tenant's expense.

5.4 Within three days after receipt of each of the Tenant Plans contemplated by subsection 5.3 of this Agreement, the Landlord shall give notice\* to the Tenant of the Landlord's price to the Tenant to supply or perform, or both, the work contemplated by the respective Tenant Plan being provided by the Landlord or the Landlord's contractors. Such price shall include 15% of the Landlord's contractors' aggregate price as the Landlord's general contracting fee and shall be net of any credit for work being provided by the Landlord without charge to the Tenant in accordance with subsection 44.1 of this Agreement. If acceptable to the Tenant, the Tenant shall sign a copy of the notice and return it to the Landlord, together with payment of 33-1/3% of such net price, within three days after it was given authorizing the Landlord and the Landlord's contractors to supply or perform the work contemplated by both the respective Tenant Plan and the notice at the net price set forth in the respective notice. The Tenant shall pay the balance of such net price to the Landlord in proportion to the progress of such work, as and when billed by the Landlord at convenient intervals, with payment of any remaining final balance due from the Tenant upon completion of such respective work which, to the extent the Tenant Plan pertains to repainting and recarpeting, the Landlord shall use its best efforts to complete by the Target Date and which, in the case of other work, shall be completed as soon as reasonably practicable after receipt of the related Tenant Plan and notice contemplated above.

6 OPTIONS.

6.1 If, prior to the respective date of exercise thereof, (a) (i) no Event of Default shall have occurred or (ii) if an Event of Default shall have occurred, the Tenant shall have previously cured it in full or the Landlord shall have waived it and (b) there shall not have been a History of Recurring Events of Default, the Tenant shall have two options, exercisable exclusively at the times and in the manner set forth below in subsection 6.2 of this Agreement, to extend the Term for one additional period of one year's duration per option. The respective options and the respective periods to which each option relates shall be consecutive and, if the respective option is properly exercised, the respective period to which it relates shall commence upon the end of the Expiring Term. Each such option is an "Option to Renew."

6.2 In the event the Tenant desires to exercise the next available Option to Renew, the Tenant shall do so exclusively by giving timely notice thereof to the Landlord no earlier than nine, and no later than six, months prior to the end of the Expiring Term. In the event the Tenant fails timely to exercise any Option to Renew, that option to Renew and any subsequent Options to Renew shall thereupon expire.

6.3 The Basic Rent for the Leased Premises during any Renewal Term shall be at the rate per year set forth below:

- -----  
\* in the form attached hereto as Exhibit F, entitled "Acknowledgment & Amendment."

Period -----	Annual Basic Rental Rate -----
Lease Year 3 (Renewal Term Appurtenant to first Option to Renew)	\$123,917.30
Lease Year 4 (Renewal Term Appurtenant to second option to Renew)	\$127,797.80

6.4 In the event the Tenant assigns this Agreement or sublets, or licenses the use or occupancy of, the Leased Premises or any portions thereof other than in accordance with subsection 17.6 of this Agreement, or attempts to do so:

6.4.1 any Option to Renew which the Tenant has theretofore properly exercised with respect to a Renewal Term that has not yet actually commenced shall be rescinded, if the Landlord so elects by notice to the Tenant, to the same extent as if it had not been exercised at all; and

6.4.2 any Option to Renew or any other type of option or optional right exercisable by the Tenant not theretofore timely and otherwise properly exercised by the Tenant shall thereupon expire.

7 USE AND OCCUPANCY.

7.1 The Tenant shall continuously occupy and use the Leased Premises during the Term exclusively as a general business, sales and administrative office for its business of manufacturing pharmaceutical products.

7.2 In connection with the Tenant's use and occupancy of the Leased Premises and use of the Common Facilities, the Tenant shall observe, and the Tenant shall cause the Tenant's employees, other agents and Guests to observe, each of the following:

7.2.1 the Tenant shall not do, or permit or suffer the doing of, anything which might have the effect of creating not insignificantly increased risk of, or damage from, fire, explosion or other casualty;

7.2.2 the Tenant shall not do, or permit or suffer the doing of, anything which would have the effect of (a) increasing any premium for any liability, property, casualty or excess coverage insurance policy otherwise payable by the Landlord or any tenant of Other Leased Premises or (b) making any such types or amounts of insurance coverage unavailable or less available to the Landlord or any tenant of Other Leased Premises;

7.2.3 to the extent they are not inconsistent with this Agreement, the Tenant and the Tenant's employees, other agents and Guests shall comply with the Building Rules and Regulations attached hereto as Exhibit D, and with any changes made therein by the Landlord if, with respect to any such changes, the Landlord shall have given notice of the

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particular changes to the Tenant and such changes shall not materially adversely affect the conduct of the Tenant's business in the Leased Premises and shall apply to all tenants of Other Leased Premises generally;

7.2.4 the Tenant and the Tenant's employees, other agents and Guests shall not create, permit or continue any Nuisance in or around the Carnegie Center Complex, the Leased Premises, the Other Leased Premises, the Building, the common Facilities and the Property;

7.2.5 The Tenant and the Tenant's employees, other agents and Guests shall not permit the Leased Premises to be regularly occupied by more than one individual per 200 square feet of usable floor space of the Leased Premises;

7.2.6 the Tenant and the Tenant's employees, other agents and Guests shall comply with all Federal, state and local statutes, ordinances, rules, regulations and orders as they pertain to the Tenant's use and occupancy of the Leased Premises, to the conduct of the Tenant's business and to the use of the common Facilities, except that this subsection shall not require the Tenant to make any structural changes that may be required thereby that are generally applicable to the Building as a whole;

7.2.7 the Tenant and the Tenant's employees, other agents and Guests shall comply with the requirements of the Board of Fire underwriters

(or successor organization) and of any insurance carriers providing liability, property, casualty or excess insurance coverage regarding the Property, the Building, the Common Facilities or any portions thereof, any other improvements on the Property and the Carnegie Center Complex, except that this subsection shall not require the Tenant to make any structural changes that may be required thereby that are generally applicable to the Building as a whole;

7.2.8 the Tenant and the Tenant's employees, other agents and Guests shall not bring or discharge any substance (solid liquid or gaseous), or conduct any activity, in or on the Carnegie Center Complex, the Property, the Building, the Common Facilities or the Leased Premises that shall have been identified by any Federal, state or local statute (including, without limiting the generality of the foregoing, the Spill Compensation and Control Act (58 N.J.S.A. ss.23.11 ET SEQ.) and the Environmental Cleanup Responsibility Act (13 N.J.S.A. ss.1 K-6 ET SEQ.), as they may be amended), ordinance, rule, regulation or order as toxic or hazardous to health or to the environment;

7.2.9 the Tenant and the Tenant's employees, other agents and Guests shall not draw electricity in the Leased Premises in excess of the rated capacity of the electrical conductors and safety devices including, without limiting the generality of the foregoing, circuit breakers and fuses, by which electricity is distributed to and throughout the Leased Premises and, without the prior written consent of the Landlord in each instance, shall not connect any fixtures, appliances or equipment to the electrical distribution system serving the Building and the Leased Premises other than typical professional office equipment such as minicomputers, microcomputers, typewriters, copiers, telephone systems, coffee machines and table top

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microwave ovens, none of which, considered individually and in the aggregate, overall and per fused or circuit breaker protected circuit, shall exceed the above limits;

7.2.10 on a timely basis the Tenant shall pay directly and promptly to the respective taxing authorities any taxes (other than Taxes) charged, assessed or levied exclusively on the Leased Premises or arising exclusively from the Tenant's use and occupancy of the Leased Premises; and

7.2.11 the Tenant shall not initiate any appeal or contest of any assessment or collection of Taxes for any period without, in each instance, the prior written consent of the Landlord which, without being deemed unreasonable, the Landlord may withhold if the Building was not 90% occupied by paying tenants throughout that period or if the Tenant is not joined by tenants of Other Leased Premises that leased throughout that period, and that are then leasing, at least 80% of all Other Leased Premises, determined by their gross rentable floor space.

## 8 UTILITIES, SERVICES, MAINTENANCE AND REPAIRS.

### 8.1 The Landlord shall provide or arrange for the provision of:

8.1.1 such maintenance and repair of the Building (except the Leased Premises and Other Leased Premises); the common Facilities; and the heating, ventilation and air conditioning systems, any plumbing systems and the electrical systems in the Building, the common Facilities, the Leased Premises and other Leased Premises as is necessary to keep the same in good order and operational condition;

8.1.2 such garbage removal from the Building and the Common Facilities; and such janitorial services for the Building, the Leased Premises and Other Leased Premises as is customarily provided for first class office buildings in the immediate area;

8.1.3 water to the Building and, if the appropriate plumbing has been installed therein, the Leased Premises and Other Leased Premises;

8.1.4 sewage disposal for the Building;

8.1.5 passenger elevator service for the Building;

8.1.6 snow clearance from, and sweeping of, Parking Facilities, sidewalks and private access roads which are part of the Property or the Common Facilities; and

8.1.7 the maintenance of landscaping which is part of the Property or the Common Facilities.

8.2 The Landlord shall provide or arrange for the provision of:

8.2.1 such maintenance and repair of the Leased Premises, except for refinishing walls and wall treatments, base, ceilings, floor treatments and doors in general from

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time to time or for gouges, spots, marks, damage or defacement caused by anyone other than the Landlord, its employees and other agents, and except for the Tenant's furniture, furnishings, equipment and other property;

8.2.2 such maintenance and repair of the Other Leased Premises, except for refinishing walls and wall treatments, base, ceilings, floor treatments and doors in general from time to time or for gouges, spots, marks, damage or defacement caused by anyone other than the Landlord, its employees and other agents, and except for the respective tenants' furniture, furnishings, equipment and other property;

8.2.3 the electricity required for the operation of the Building, the Property and the Common Facilities during Regular Business Hours and, on a reduced service basis, during other than Regular Business Hours; and, at all times, the electricity required for the Leased Premises and Other Leased Premises;

8.2.4 such heat, ventilation and air conditioning for the Building, the Leased Premises and Other Leased Premises as is customarily provided for first class office buildings in the immediate area for the comfortable use of the Building during Regular Business Hours; and

8.2.5 heated water to the Building (except the Leased Premises and other Leased Premises, unless the appropriate plumbing, fixtures and hot water heating units have been installed therein).

8.3 Except as specifically set forth in subsections 8.1 and 8.2.1 of this Agreement, the Tenant shall maintain and repair the Leased Premises and keep the Leased Premises in as good condition and repair, reasonable wear and use excepted, as the Leased Premises are upon the completion of any improvements contemplated by section 5 of this Agreement.

9 ALLOCATION OF THE EXPENSES OF UTILITIES, SERVICES, MAINTENANCE, REPAIRS AND TAXES.

9.1 Tenant Electric Charges for periods other than Regular Business Hours shall be borne by the Tenant.

9.2 The Tenant shall not bear any portion of the operational Expenses and Taxes incurred during the Term.

10 COMPUTATION AND PAYMENT OF ALLOCATED EXPENSES OF UTILITIES AND CAPITAL EXPENDITURES.

10.1 The Tenant shall promptly pay the following additional amounts to the Landlord at the respective times set forth below:

10.1.1 commencing with the first day of the first month after the Landlord gives any notice contemplated by subsection 10.9 of this Agreement to the Tenant and

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continuing on the first day of each month thereafter until the earlier of (a) the end of the Term or (b) the last month of the useful life set forth in the respective notice, one-twelfth of the Tenant's Share of any Annual Amortized Capital Expenditure, computed in accordance with subsection 10.9 of this Agreement;

10.1.2 promptly as and when billed therefor by the Landlord, Tenant Electric Charges for periods other than Regular Business Hours; and

10.1.3 promptly as and when billed therefor by the Landlord, the amount of any expense which would otherwise fall within the definition of Operational Expenses, but which is specifically paid or incurred by the Landlord for operation and maintenance of the Building, the Common Facilities or the Property outside Regular Business Hours at the specific request and for the sole benefit of the Tenant or the amount of any expenditure incurred for maintenance or repair of damage to the Building, the Common Facilities, the Property, the Leased Premises or the Other Leased Premises caused directly or indirectly, in whole or in part, by the active or passive negligence or intentional act of the Tenant or any of its employees, other agents or Guests.

10.2 "Operational Expenses" means all expenses paid or incurred by the Landlord in connection with the operation and maintenance of the Property, the Building, the Common Facilities and any other improvements on the Property (other than Taxes, Capital Expenditures (which are separately allocated to the Tenant in accordance with subsection 10.1.1 of this Agreement) and those expenses contemplated by subsections 10.1.2 and 10.1.3 of this Agreement) including, without limiting the generality of the foregoing:

10.2.1 Utilities Expenses;

10.2.2 the expense of providing the services, maintenance and repairs contemplated by subsections 8.1, 8.2.1 and 8.2.2 of this Agreement, whether furnished by the Landlord's employees or by independent contractors or other agents;

10.2.3 wages, salaries, fees and other compensation and payments and payroll taxes and contributions to any social security, unemployment insurance, welfare, pension or similar fund and payments for other fringe benefits required by law or union agreement (or, if the employees or any of them are not represented by a union, then payments for benefits comparable to those generally required by union agreement in first class office buildings in the immediate area which are unionized) made to or on behalf of any employees of Landlord performing services rendered in connection with the operation and maintenance of the Building, the Common Facilities and the Property, including, without limiting the generality of the foregoing, elevator operators, elevator starters, window cleaners, porters, janitors, maids, miscellaneous handymen, watchmen, persons engaged in patrolling and protecting the Building, the Common Facilities and the Property, carpenters, engineers, firemen, mechanics, electricians, plumbers, other tradesmen, other persons engaged in the operation and maintenance of the Building, Common Facilities and Property, Building superintendent and assistants; building manager, and clerical and administrative personnel;

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10.2.4 the uniforms of all employees and the cleaning, pressing and repair thereof;

10.2.5 premiums and other charges incurred by Landlord with respect to all insurance relating to the Building, the Common Facilities and the

Property and the operation and maintenance thereof, including, without limitation: property and casualty, fire and extended coverage insurance, including windstorm, flood, hail, explosion, other casualty, riot, rioting attending a strike, civil commotion, aircraft, vehicle and smoke insurance; public liability insurance; elevator, boiler and machinery insurance; excess liability coverage insurance; use and occupancy insurance; worker's compensation and health, accident, disability and group life insurance for all employees; and casualty rent insurance;

10.2.6 sales and excise taxes and the like upon any Operational Expenses and Capital Expenditures;

10.2.7 management fees of any independent managing agent for the Property, the Building or the Common Facilities; and if there shall be no independent managing agent, or if the managing agent shall be a person affiliated with the Landlord, the management fees that would customarily be charged for the management of the Property, the Building and the Common Facilities by an independent, first class managing agent in the immediate area;

10.2.8 the cost of replacements for tools, supplies and equipment used in the operation, service, maintenance, improvement, inspection, repair and alteration of the Building, the Common Facilities and the Property;

10.2.9 the cost of repainting or otherwise redecorating any part of the Building or the Common Facilities;

10.2.10 decorations for the lobbies and other Common Facilities in the Building;

10.2.11 the cost of licenses, permits and similar fees and charges related to operation, repair and maintenance of the Building, the Property and the Common Facilities;

10.2.12 an allocable share of service, replacement, repair, maintenance and other charges assessed from time to time by the Carnegie Center Owner's Association to the Building; and

10.2.13 any and all other expenditures of the Landlord in connection with the operation, alteration, repair or maintenance of the Property, the Common Facilities or the Building as a first-class office building and facilities in the immediate area which are properly treated as an expense fully deductible as incurred in accordance with generally applied real estate accounting practice.

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10.3 "Capital Expenditures" means the following expenditures incurred or paid by the Landlord in connection with the Property, the Building, the Common Facilities and any other improvements on the Property:

10.3.1 all costs and expenses incurred by the Landlord in connection with retrofitting the entire Building or the common Facilities, or any portion thereof, to comply with any change in Federal, state or local statute, rule, regulation, order or requirement which change takes effect after the original completion of the Building;

10.3.2 all costs and expenses incurred by the Landlord to replace and improve the Property, the Building or the Common Facilities or portions thereof for the purpose of continued operation of the Property, the Building and the Common Facilities as a first class office complex in the immediate area; and

10.3.3 all costs and expenses incurred by the Landlord in connection with the installation of any energy, labor or other cost saving device or system on the Property or in the Building or the Common Facilities.

10.4 "Capital Expenditures" shall not include any of the following:

10.4.1 principal or interest on any mortgage indebtedness on the Property, the Building or any portion thereof;

10.4.2 any capital expenditure, or amortized portion thereof, other than those included in the definition of Capital Expenditures set forth in subsection 10.3 above;

10.4.3 expenditures for any leasehold improvement which is made in connection with the preparation of any portion of the Building for occupancy by a new tenant or which is not made generally to or for the benefit of the Leased Premises and all Other Leased Premises or generally to the Building or the Common Facilities;

10.4.4 to the extent the Landlord actually receives proceeds of property and casualty insurance policies on the Building, other improvements on the Property or the Common Facilities, expenditures for repairs or replacements occasioned by fire or other casualty to the Building or the Common Facilities;

10.4.5 expenditures for repairs, replacements or rebuilding occasioned by any of the events contemplated by section 16 of this Agreement;

10.4.6 expenditures for costs, including advertising and leasing commissions, incurred in connection with efforts to lease portions of the Building and to procure new tenants for the Building;

10.4.7 expenditures for the salaries and benefits of the executive officers, if any, of the Landlord;

10.4.8 Operational Expenses and Taxes; and

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10.4.9 depreciation (as that term is used in the accounting sense in the context of generally applied real estate accounting practice) of the Building, the Common Facilities and any other improvement on the Property.

10.5 As soon as practicable after incurring any Capital Expenditure, the Landlord shall furnish the Tenant with a notice setting forth:

10.5.1 a description of the Capital Expenditure and the subject thereof;

10.5.2 the date the subject of the respective Capital Expenditure was first placed into service and the period of useful life selected by the Landlord in connection with the determination of the Annual Amortized Capital Expenditure;

10.5.3 the amount of the Annual Amortized Capital Expenditure; and

10.5.4 the Tenant's Share of item 10.5.3 above.

10.6 Within 30 days after the Landlord gives any notice enumerated in subsection 10.5 of this Agreement, the Tenant or the Tenant's authorized agent, upon one week's prior notice to the Landlord, may inspect the Landlord's books and records, as they pertain to the particular expense in question, at the Landlord's office regarding the subject of any such notice to verify the amount(s) and calculation(s) thereof.

10.7 The mere enumeration of an item within the definitions of Operational Expenses and Capital Expenditures in subsections 10.2 and 10.3 of this Agreement, respectively, shall not be deemed to create an obligation on the part of the Landlord to provide such item unless the Landlord is affirmatively required to provide such item elsewhere in this Agreement.

11 LEASEHOLD IMPROVEMENTS, FIXTURES AND TRADE FIXTURES. All leasehold improvements to the Leased Premises, fixtures installed in the Leased Premises and the blinds and floor treatments or coverings shall be the property of the

Landlord, regardless of when, by which party or at which party's cost the item is installed. Movable furniture, furnishings, trade fixtures and equipment of the Tenant which are in the Leased Premises shall be the property of the Tenant, except as may otherwise be set forth in section 23 of this Agreement.

12 ALTERATIONS, IMPROVEMENTS AND OTHER MODIFICATIONS BY THE TENANT.

12.1 Except as may be otherwise contemplated by section 5 of this Agreement, the Tenant shall not make any alterations, improvements or other modifications to the Leased Premises which effect structural changes in the Building or any portion thereof, change the functional utility or rental value of the Leased Premises or affect the mechanical, electrical, plumbing or other systems installed in the Building or the Leased Premises.

12.2 The Tenant shall not make any other alterations, improvements or modifications to the Leased Premises, the Building or the Property or make any boring in the ceiling, walls or floor of the Leased Premises or the Building unless the Tenant shall have first:

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12.2.1 furnished to the Landlord detailed, New Jersey architect-certified construction drawings, construction specifications and, if they pertain in any way to the heating, ventilation and air conditioning or other systems of the Building, related engineering design work and specifications regarding, the proposed alterations, improvements or other modifications;

12.2.2 not received a notice from the Landlord objecting thereto in any respect within 30 days of the furnishing thereof (which objection shall not be unreasonably made by the Landlord or which lack of timely notice of objection shall not be deemed the Landlord's affirmative consent for any purpose);

12.2.3 obtained any necessary or appropriate building permits or other approvals from the Municipality and, if such permits or other approvals are conditional, satisfied all conditions to the satisfaction of the Municipality; and

12.2.4 met, and continued to meet, all the following conditions with regard to any contractors selected by the Tenant and any subcontractors, including materialmen, in turn selected by any of them:

12.2.4.1 the Tenant shall have sole responsibility for payment of, and shall pay, such contractors;

12.2.4.2 the Tenant shall have sole responsibility for coordinating, and shall coordinate, the work to be supplied or performed by such contractors, both among themselves and with any contractors selected by the Landlord;

12.2.4.3 the Tenant shall not permit or suffer the filing of any mechanic's notice of intention or other lien or prospective lien by any such contractor or subcontractor with respect to the Property, the Common Facilities, the Building or any other improvements on the Property; and if any of the foregoing should be filed by any such contractor or subcontractor, the Tenant shall forthwith obtain and file the complete discharge and release thereof or provide such payment bond(s) from a reputable, financially sound institutional surety as will, in the opinions of the Landlord, the holders of any mortgage indebtedness on, or other interest in, the Property, the Building, the Common Facilities or any other improvements on the Property, or any portions thereof, and their respective title insurers, be adequate to assure the complete discharge and release thereof;

12.2.4.4 prior to any such contractor's entering upon the Property, the Building or the Leased Premises or commencing work the Tenant shall have delivered to the Landlord (a) all the Tenant's certificates of insurance set forth in section 14 of this Agreement, conforming in all respects

to the requirements of section 14 of this Agreement, except that the effective dates of all such insurance policies shall be prior to any such contractor's entering upon the Property, the Building or the Leased Premises or commencing work (if any work is scheduled to begin before the Commencement Date) and (b) similar certificates of insurance from each of the Tenant's contractors providing for coverage in equivalent amounts, together with their respective certificates of workers' compensation insurance, employer's liability insurance and

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products completed operations insurance, the latter providing coverage in at least the amount required for the Tenant's comprehensive general public liability and excess insurance;

12.2.4.5 each such contractor shall be a party to collective bargaining agreements with those unions that are certified as the collective bargaining agents of all bargaining units of such contractor, of which all such contractor's workpersons shall be members in good standing;

12.2.4.6 each such contractor shall perform its work in a good and workpersonlike manner and shall not interfere with or hinder the Landlord or any other contractor in any manner;

12.2.4.7 there shall be no labor dispute of any nature whatsoever involving any such contractor or any workpersons of such contractor or the unions of which they are members with anyone; and if such a labor dispute exists or comes into existence the Tenant shall forthwith, at the Tenant's sole cost and expense, remove all such contractors and their workpersons from the Building, the Common Facilities and the Property; and

12.2.4.8 the Tenant shall have the sole responsibility for the security of the Leased Premises and all contractors' materials, equipment and work, regardless of whether their work is in progress or completed.

12.3 After the Commencement Date, the Tenant may apply any wall covering or other treatment to the walls of the Leased Premises (so long as such wall covering or treatment is not unconventional in first class office buildings and hang any decorative wall hangings), all without the prior written consent of the Landlord.

13 LANDLORD'S RIGHTS OF ENTRY AND ACCESS. The Landlord and its authorized agents shall have the following rights of entry and access to the Leased Premises:

13.1 In case of any emergency or threatened emergency, at any time for any purpose which the Landlord reasonably believes under such circumstances will serve to prevent, eliminate or reduce the emergency, or the threat thereof, or damage or threatened damage to persons and property.

13.2 Upon at least two days' prior verbal advice to the Tenant, at any time for the purpose of erecting or constructing improvements, modifications, alterations and other changes to the Building or any portion thereof, including, without limiting the generality of the foregoing, the Leased Premises, the Common Facilities or the Property or for the purpose of repairing, maintaining or cleaning them, whether for the benefit of the Landlord, the Building, all tenants of Other Leased Premises in the Building, or one or more tenants of Other Leased Premises, the Carnegie Center Complex or others. In connection with any such improvements, modifications, alterations, other changes, repairs, maintenance or cleaning, the Landlord may close off such portions of the Property, the Building and the Common Facilities and interrupt such services as may be necessary to accomplish such work, without liability to the Tenant therefor and without such closing or interruption being deemed an eviction or constructive

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eviction or requiring an abatement of Rent. However, in accomplishing any such work, the Landlord shall endeavor not to materially interfere with the Tenant's use and enjoyment of the Leased Premises or the conduct of the Tenant's business and to minimize interference, inconvenience and annoyance to the Tenant.

13.3 At all reasonable hours for the purpose of performing janitorial services in the Leased Premises and, during Regular Business Hours or, by prior arrangement with the Tenant, at all reasonable hours for the purpose of operating, inspecting or examining the Building, including the Leased Premises, or the Property.

13.4 At any time after the Tenant has vacated the Leased Premises, for the purpose of preparing the Leased Premises for another tenant or prospective tenant.

13.5 If practicable by appointment with the Tenant, at all reasonable hours for the purpose of showing the Building to prospective purchasers, mortgagees and prospective mortgagees and prospective ground lessees and lessors.

13.6 If practicable by appointment with the Tenant, at all reasonable hours during the last six months of the Term for the purpose of showing the Leased Premises to prospective tenants thereof.

13.7 The mere enumeration of any right of the Landlord within this section 13 of the Agreement shall not be deemed to create an obligation on the part of the Landlord to exercise any such right unless the Landlord is affirmatively required to exercise such right elsewhere in this Agreement.

#### 14 LIABILITIES AND INSURANCE OBLIGATIONS.

14.1 The Tenant shall, at the Tenant's own expense, purchase before the Commencement Date, and maintain in full force and effect throughout the Term and any other period during which the Tenant may have possession of the Leased Premises, the following types of insurance coverage from financially sound and reputable insurers, licensed by the State of New Jersey to provide such insurance and acceptable to the Landlord, in the minimum amounts set forth below, each of which insurance policies shall be for the benefit of, and shall name the Landlord, the Landlord's managing agent and mortgagees and ground lessors known to the Tenant, if any, of the Building, the Common Facilities, the Property or any interest therein, their successors and assigns as additional persons insured, and none of which insurance policies shall contain a "co-insurance" clause:

14.1.1 comprehensive general public liability insurance (including a "broad form" coverage endorsement) and excess ("umbrella") insurance which, without limiting the generality of the foregoing, considered together shall insure against such risks as bodily injury, death and property damage, with a combined single limit of not less than \$3,000,000.00 for each occurrence with respect to each type of risk;

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14.1.2 contractual liability insurance which shall insure the risk of the Tenant's failure to perform all the Tenant's obligations under this Agreement by which the Tenant indemnifies the Landlord, in an amount not less than \$3,000,000.00; and

14.1.3 property, casualty and "all risks" insurance which, without limiting the generality of the foregoing, shall insure against the risk of damage and loss by reason of fire, explosion and all other casualties, of the Leased Premises and leasehold improvements thereto.

14.2 With respect to risks:

14.2.1 as to which this Agreement requires either party to maintain insurance, or

14.2.2 as to which either party is effectively insured and for which risks the other party may be liable, the party required to maintain such insurance and the party effectively insured shall use its best efforts to obtain a clause, if available from the respective insurer, in each such insurance policy expressly waiving any right of recovery, by reason of subrogation to such party's rights or otherwise, the respective insurer might otherwise have or obtain against the other party, so long as such a clause can be obtained in the respective insurance policy without additional premium cost. If such a clause can be obtained in the respective insurance policy, but only at additional premium cost, such party shall, by notice to the other party, promptly advise the other party of such fact and the amount of the additional premium cost. If the other party desires the inclusion of such a clause in the notifying party's respective insurance policy, the other party shall, within 10 days of receipt of the notifying party's notice, by notice advise the notifying party of its desire and enclose therewith its check in the full amount of the additional premium cost; otherwise the notifying party need not obtain such a clause in the respective insurance.

14.3 Each party hereby waives any right of recovery against the other party for any and all damages for property losses and property damages which are actually insured by either party, but only to the extent:

14.3.1 that the waiver set forth in this subsection 14.3 does not cause or result in any cancellation of, or diminution in, the insurance coverage otherwise available under any applicable insurance policy;

14.3.2 of the proceeds of any applicable insurance policy (without adjustment for any deductible amount set forth therein) actually received by such party for such respective loss or damages; and

14.3.3 the substance of the clause contemplated by subsection 14.2 of this Agreement is actually and effectively set forth in the respective insurance policy.

The waiver set forth in this subsection 14.3 of the Agreement shall not apply with respect to liability insurance policies (as opposed to property and casualty insurance policies).

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14.4 The Tenant hereby waives any right of recovery it might otherwise have against the Landlord for losses and damages caused actively or passively, in whole or in part, by any of the risks the Tenant is required to insure against in accordance with subsections 14.1.1 or 14.1.3 of this Agreement, unless such waiver would cause or result in a cancellation of, or diminution in, the coverage of the Tenant's policies of insurance against such risks.

14.5 The Landlord shall have no liability whatsoever to the Tenant or the Tenant's employees, other agents or Guests or anyone else for any death, bodily injury, property loss or other damages suffered by any of them or any of their property which is not proximately caused by the negligence or intentional misconduct of the Landlord, its agents or employees.

14.6 Each policy of insurance required under subsection 14.1 of this Agreement shall include provisions to the effect that:

14.6.1 no act or omission of the Tenant, its employees, other agents or Guests shall result in a loss of insurance coverage otherwise available under such policy to any person required to be named as an additional insured in accordance with subsection 14.1 of this Agreement; and

14.6.2 the insurance coverage afforded by such policy shall not be diminished, cancelled, permitted to expire or otherwise terminated for any reason except upon 30 days' prior written notice from the insurer to every

person required to be named as an additional insured in accordance with subsection 14.1 of this Agreement.

14.7 With respect to each type of insurance coverage referred to in subsection 14.1 of this Agreement, prior to the Commencement Date the Tenant shall cause its insurer(s) to deliver to the Landlord the certificate(s) of the insurer(s) setting forth the name and address of the insurer, the name and address of each additional insured, the type of coverage provided, the limits of the coverage, any deductible amounts, the effective dates of coverage and that each policy under which coverage is provided affirmatively includes provisions to the effect set forth in subsection 14.6 of this Agreement. In the event any of such certificates indicates a coverage termination date earlier than the end of the Term or the end of any other period during which the Tenant may have possession of the Leased Premises, no later than 10 days before any such coverage termination date, the Tenant shall deliver to the Landlord respective, equivalent, new certificate(s) of the insurer(s).

14.8 The Landlord represents that it maintains property insurance coverage for the Building and other improvements on the Property and liability insurance coverage in the form of a blanket insurance policy for several projects of the Landlord and its Affiliates. The basic property insurance blanket policy limit is well in excess of \$100,000,000 with a \$10,000 deductible.

14.9 The Landlord hereby waives any right of recovery it might otherwise have against the Tenant for losses and damages caused actively or passively, in whole or in part, by any of the risks the Landlord is required to insure against in accordance with subsection 14.8 of

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this Agreement, unless such waiver would cause or result in a cancellation of, or diminution in, the coverage of the Landlord's policies of insurance against such risks.

#### 15 CASUALTY DAMAGE TO BUILDING OR LEASED PREMISES.

15.1 In the event of any damage to the Building or any portion thereof by fire or other casualty:

15.1.1 with the result that the Leased Premises are rendered untenable in whole or in part due either (i) to casualty damage to the Leased Premises itself or (ii) to casualty damage to necessary Common Facilities such that the Tenant is unable to access and use any portion of the Leased Premises for the purpose contemplated by subsection 7.1 of this Agreement;

15.1.2 regarding which, within 60 days after the occurrence of the casualty, the Landlord gives notice to the Tenant that the Landlord can restore the Leased Premises within 180 days after the occurrence of the casualty to the same condition they were in immediately prior to the occurrence of the casualty and can restore the Common Facilities within the same period so that there is no material interference in the Tenant's ability to access and use and enjoy the Leased Premises, and

15.1.3 regarding which the Landlord does restore the Leased Premises within such period of 180 days, then this Agreement shall remain in full force and effect, but Rent shall abate from the date of the casualty until such time as such restoration has been completed and be reduced during such period by the amount which bears the same proportion to the Rent otherwise payable during such period as the gross rentable floor space of the Leased Premises which are rendered untenable bears to the gross rentable floor space of the Leased Premises.

15.2 In the event of casualty damages in the circumstances set forth in subsection 15.1 of this Agreement which do not result in a termination of the Term, the Landlord shall cause restoration to proceed diligently and expediently to the extent the Landlord has received proceeds of any property, casualty or liability insurance on the damaged portions.

15.3 The Tenant shall promptly advise the Landlord by the quickest means of communication of the occurrence or threatened occurrence of any casualty damage to the Building or the Leased Premises of which the Tenant becomes aware.

16 CONDEMNATION. If the Leased Premises, or any portion thereof, or the Building or the Common Facilities, or any substantial portion of any of the foregoing, shall be acquired for any public or quasi-public use or purpose by statute, right of eminent domain or private sale in lieu thereof, with the result the Tenant can not use and occupy the Leased Premises for the purpose set forth in subsection 7.1 of this Agreement, the Tenant hereby waives any claim against the Landlord, the condemning authority or other person acquiring same for any thing of value, tangible or intangible, including, without limiting the generality of the foregoing, the putative value of any leasehold interest or loss of the use of same, except for any right the Tenant

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might have to make a claim, independent of, and without reference to or having any effect on, any award or claim of the Landlord, against the condemning authority or other acquiring party regarding the value of the Tenant's installed trade fixtures and other installed equipment which are not removable from the Leased Premises or for ordinary and necessary moving and relocation expenses occasioned thereby.

17 ASSIGNMENT OR SUBLETTING BY TENANT.

17.1 Except as may be specifically set forth in this section 17 of the Agreement, the Tenant shall not:

17.1.1 assign, or purport to assign, this Agreement or any of the Tenant's rights hereunder;

17.1.2 sublet, or purport to sublet, the Leased Premises or any portion thereof;

17.1.3 license, or purport to license, the use or occupancy of the Leased Premises or any portion thereof;

17.1.4 otherwise transfer, or attempt to transfer any interest including, without limiting the generality of the foregoing, a mortgage, pledge or security interest, in this Agreement, the Leased Premises or the right to the use and occupancy of the Leased Premises; or

17.1.5 indirectly accomplish, or permit or suffer the accomplishment of, any of the foregoing by merger or consolidation with another entity, by acquisition or disposition of assets or liabilities outside the ordinary course of the Tenant's business or by acquisition or disposition, by the Tenant's equity owners or subordinated creditors, of any of their respective interests in the Tenant.

17.2 The Tenant shall not assign this Agreement or any of the Tenant's rights hereunder or sublet the Leased Premises or any portion thereof without first giving 30 days' prior notice to the Landlord of its desire to assign or sublet and requesting the Landlord's consent and without first receiving the Landlord's prior written consent. The Tenant's notice to the Landlord shall include:

17.2.1 the full name, address and telephone number of the proposed assignee or sublessee;

17.2.2 a description of the type(s) of business in which the proposed assignee or sublessee is engaged and proposes to engage;

17.2.3 a description of the precise use to which the proposed assignee or sublessee intends to put the Leased Premises or portion thereof;

17.2.4 the proposed assignee's or subtenant's most recent

quarterly and annual financial statements prepared in accordance with generally accepted accounting principles

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and any other evidence of financial position and responsibility that the Tenant or proposed assignee or sublessee may desire to submit;

17.2.5 by diagram and measurement of the actual square feet of floor space, the precise portion of the Leased Premises proposed to be subject to the assignment of this Agreement or to be sublet;

17.2.6 a complete, accurate and detailed description of the terms of the proposed assignment or sublease including, without limiting the generality of the foregoing, all consideration paid or given, or proposed to be paid or to be given, by the proposed assignee, sublessee or other person to the Tenant and the respective times of payment or delivery; and

17.2.7 any other information reasonably requested by the Landlord.

17.3 By the expiration of the notice period contemplated by subsection 17.2 of this Agreement, the Landlord, in its sole discretion, shall take one of the following actions by notice to the Tenant:

17.3.1 grant consent on the terms and conditions set forth in subsection 17.4 of this Agreement and such other reasonable terms and conditions set forth in the Landlord's notice;

17.3.2 refuse to grant consent for any of the reasons set forth in subsection 17.5 of this Agreement; or

17.3.3 elect to terminate the Term as of (a) the end of the third full month after the Tenant has given notice of the Tenant's desire to assign or sublet or (b) the proposed effective date of the proposed assignment or sublease.

17.4 The Landlord's consent to the Tenant's proposed assignment or sublease, if granted under subsection 17.3.1 of this Agreement, shall be subject to all the following terms and conditions (and to any other terms and conditions permitted by that subsection):

17.4.1 any proposed assignee or sublessee shall, by document executed and delivered forthwith to the Landlord, agree to be bound by all the obligations of the Tenant set forth in this Agreement;

17.4.2 the Tenant shall remain liable under this Agreement, jointly and severally with any proposed assignee or sublessee, for the timely performance of all obligations of the Tenant set forth in this Agreement;

17.4.3 the Tenant shall forthwith deliver to the Landlord manually executed copies of all documents regarding the proposed assignment or sublease and a written, accurate and complete description, manually executed both by the Tenant and the proposed assignee or sublessee, of any other agreement, arrangement or understanding between them regarding the same;

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17.4.4 with respect to any consideration or other thing of value received or to be received by the Tenant in connection with any such assignment or sublease (other than those payable in equal monthly installments each month during the proposed term of any such assignment or sublease), the

Tenant shall pay to the Landlord one-half of any such amount and one-half of the fair market value of any other thing of value within 10 days of receipt of same; and

17.4.5 with respect to any amount payable to the Tenant in equal monthly installments each month during the proposed term of any such assignment or sublease in connection with such assignment or sublease, which amount is in excess of the amount which bears the same ratio to the monthly installment of Rent due from the Tenant as the usable floor space of the Leased Premises subject to the assignment or sublease bears to the usable floor space of the entire Leased Premises, the Tenant shall pay one-half of such excess to the Landlord together with the Tenant's monthly installment of Rent.

17.5 The Landlord's refusal to grant consent under subsection 17.3.2 of this Agreement shall not be deemed an unreasonable withholding of consent if based upon any of the following reasons (or any other reason permitted by that subsection):

17.5.1 the Landlord desires to take the action enumerated in subsection 17.3.3 of this Agreement:

17.5.2 there is already another assignee, sublessee or licensee of all or a portion of the Leased Premises;

17.5.3 the proposed sublease is for a term of less than one year;

17.5.4 the proposed sublease is for a term which would expire after the Term;

17.5.5 less than one year remains in the Term as of the proposed effective date of the proposed assignment or sublease;

17.5.6 the general reputation, financial position or ability or type of business of, or the anticipated use of the Leased Premises by the proposed assignee or proposed sublessee is reasonably unsatisfactory to the Landlord or is inconsistent with those of tenants of Other Leased Premises or of the Carnegie Center Complex or inconsistent with any commitment made by the Landlord to any such other tenant;

17.5.7 the proposed consideration to be paid to the Tenant during any period of 12 months is less than the amount of the Market Rental Rate divided by the gross rentable floor space of the Leased Premises and multiplied by that portion of the gross rentable floor space of the Leased Premise proposed to be subject to the proposed assignment or sublease and the Tenant or any of its agents shall have publicized such lower rate in any media or broad based mailing;

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17.5.8 the gross rentable floor space of the portion of the Leased Premises proposed to be sublet is less than one-third of the gross rentable floor space of the Leased Premises; or

17.5.9 the proposed assignee or sublessee is a tenant of other Leased Premises or other premises in the Carnegie Center Complex.

17.6 Notwithstanding anything to the contrary set forth in section 17 of this Agreement, the Landlord hereby consents to the Tenant's subletting the Leased Premises or portion thereof specified below if:

17.6.1 at or prior to the respective dates of exercise and effectiveness thereof (a) (i) no Event of Default shall have occurred or (ii) if an Event of Default shall have occurred, the Tenant shall have previously cured it in full and the Landlord shall have waived it and (b) there shall not have been a History of Recurring Events of Default; and

17.6.2 the Tenant and the proposed sublessee comply with all the conditions set forth in subsections 17.4.1 through 17.4.3 of this

Agreement; and

17.6.3 at the date of effectiveness of the proposed sublet there is not already more than one other assignee, sublessee or licensee of the Leased Premises or any portions thereof; and

17.6.4 one of the following is applicable:

17.6.4.1 the proposed sublessee is, and continues to be, an Affiliate of the Tenant, and if the proposed sublessee is also a person controlling the Tenant the proposed sublessee shall also have and shall continue to have a net worth at least as great as the greatest of the net worth of the Tenant (i) on the Commencement Date, (ii) before the transaction or event giving rise to such controlling relationship and (iii) immediately after the transaction or event giving rise to such controlling relationship; or

17.6.4.2 the proposed sublessee is a person (a) resulting from the merger or consolidation of the Tenant with or into such person or (b) purchasing substantially all the assets (subject to substantially all the liabilities) of the Tenant, provided either the Tenant or the proposed sublessee shall have and shall continue to have a net worth at least as great as the greatest of the net worth of the Tenant (i) on the Commencement Date, (ii) before the transaction or event giving rise to such controlling relationship and (iii) immediately after the transaction or event giving rise to such controlling relationship.

## 18 SIGNS, DISPLAYS AND ADVERTISING.

18.1 The Tenant shall have one sign identifying the Landlord's assigned number for the Leased Premises at the principal entrance to the Leased Premises. The Tenant may identify itself in or on each of: the sign at the principal entrance to the Leased Premises, the Building directory and the directory, if any, on the floor of the Building on which the Leased

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Premises is located. All such signs, and the method and materials used in mounting and dismounting them, shall be in accordance with the Landlord's specifications. All such signs shall be provided and mounted by the Landlord at the Landlord's expense, except that the Tenant shall bear any expense of identifying itself on the sign at the principal entrance to the Leased Premises.

18.2 No other sign, advertisement, fixture or display shall be used by the Tenant on the Property or in the Building or the Common Facilities. Any signs other than those specifically permitted under subsection 18.1 of this Agreement shall be removed promptly by the Tenant or by the Landlord at the Tenant's expense.

19 QUIET ENJOYMENT. The Landlord is the owner of the Building, the Property and those Common Facilities located on the Property. The Landlord has the right and authority to enter into and execute and deliver this Agreement with the Tenant. So long as an Event of Default shall not have occurred, the Tenant shall and may peaceably and quietly have, hold and enjoy the Leased Premises during the Term in accordance with this Agreement.

20 RELOCATION. At any time and from time to time during the Term, on at least 60 days' prior notice to the Tenant, the Landlord shall have the right to move the Tenant out of the Leased Premises and into premises having at least equal floor space located in the Building or in any other comparable building located in the Carnegie Center Complex for the duration of the Term. In the event the Landlord exercises this right of relocation, the Landlord shall decorate the new premises similarly to the Leased Premises and remove, relocate and reinstall the Tenant's furniture, trade fixtures, furnishings and equipment, all at the sole cost and expense of the Landlord. When the substitute new premises are ready, the Tenant shall surrender the Leased Premises. Following any such relocation, this Agreement shall continue in full force and effect except for the description of the Leased Premises, the Building and the Property which, upon completion of such relocation, shall be deemed amended to describe the substitute new premises, building and property, respectively, to which the Tenant shall have been relocated in accordance with this section 20 of the

Agreement.

21 SURRENDER. Upon termination of the Term, or at any other time at which the Landlord, by virtue of any provision of this Agreement or otherwise has the right to re-enter and re-take possession of the Leased Premises, the Tenant shall surrender possession of the Leased Premises; remove from the Leased Premises all property owned by the Tenant or anyone else other than the Landlord; remove from the Leased Premises any alterations, improvements or other modifications to the Leased Premises that the Landlord may request by notice; make any repairs required by such removal; clean the Leased Premises; except in the event of casualty damage to the Leased Premises which shall not have been restored, leave the Leased Premises in as good order and condition as it was upon the completion of any improvements contemplated by section 5 of this Agreement, ordinary wear and use excepted; return all copies of all keys and passes to the Leased Premises, the Common Facilities and the Building to the Landlord; and, if termination of the term shall have occurred other than exclusively in connection with expiration of the Term, receive the Landlord's written acceptance of the Tenant's surrender. In those instances where written acceptance of surrender is required, the Landlord shall not be deemed to

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have accepted the Tenant's surrender of the Leased Premises unless and until the Landlord shall have executed and delivered the Landlord's written acceptance of surrender to the Tenant, which shall not be unreasonably withheld or delayed.

22 EVENTS OF DEFAULT. The occurrence of any of the following events shall constitute an Event of Default under this Agreement:

22.1 the Tenant's failure to pay any installment of Basic Rent or any amount of Additional Rent when it is first due, except in the case of the first two instances thereof in any period of 12 consecutive months, in which instances, the Tenant's failure to pay any installment of Basic Rent or any amount of Additional Rent within five days after the Landlord's verbal advice to the Tenant that any such amount was not received by the time it was first due;

22.2 the Tenant's failure to complete performance of any of the Tenant's obligations under this Agreement (other than those contemplated by subsection 22.1 of this Agreement) within 20 days after the Landlord shall have given notice to the Tenant specifying which of the Tenant's obligations has not been performed and in what respects, unless completion of performance within such period of 20 days is not possible using diligence and expedience, then within a reasonable time of the Landlord's notice so long as the Tenant shall have commenced substantial performance within the first five days of such period of 20 days and shall have continued to provide substantial performance, diligently and expeditiously, through to completion of performance;

22.3 the discovery that any representation made by the Tenant in this Agreement shall have been inaccurate or incomplete in any material respect either on the date it was made or the date as of which it was made;

22.4 the sale, transfer or other disposition of any interest of the Tenant in the Leased Premises by way of execution or other legal process;

22.5 with the exception of those of the following events to which section 365 of the Bankruptcy Code shall apply in the context of an office lease (in which case subsection 22.7 of this Agreement shall apply):

22.5.1 the Tenant's voluntarily becoming a "debtor," as that term is defined in section 101 of the Bankruptcy Code;

22.5.2 in connection with the Tenant's involuntarily becoming a "debtor," as that term is defined in section 101 of the Bankruptcy Code, the earlier of: (i) the expiration of 60 days from the date of the filing of the involuntary petition in bankruptcy without the Tenant's obtaining a dismissal of the involuntary petition or (ii) the Bankruptcy Court's granting an order for relief;

22.5.3 in connection with the appointment of a receiver or trustee of the Tenant's property or affairs, the expiration of 60 days from that time without the Tenant's obtaining a dismissal of such appointment; or

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22.5.4 the Tenant's making an assignment for the benefit of, or an arrangement with or among, creditors or filing a petition in insolvency or for reorganization or for the appointment of a receiver;

22.6 in the event of the occurrence of any of the events enumerated in subsection 22.6 of this Agreement to which section 365 of the Bankruptcy Code shall apply in the context of an office lease, the earlier of the bankruptcy trustee's rejection or deemed rejection (as those terms are used in section 365 of the Bankruptcy Code) of this Agreement; or

22.7 the Tenant's abandoning the Leased Premises before expiration of the Term without the prior written consent of the Landlord.

23 RIGHTS AND REMEDIES.

23.1 Upon the occurrence of an Event of Default the Landlord shall have all the following rights and remedies:

23.1.1 to elect to terminate the Term by giving notice of such election, and the effective date thereof, to the Tenant and to receive Termination Damages;

23.1.2 to elect to re-enter and re-take possession of the Leased Premises, without thereby terminating the Term, by giving notice of such election, and the effective date thereof, to the Tenant and to receive Re-Leasing Damages;

23.1.3 if the Tenant remains in possession of the Leased Premises after the Tenant's obligation to surrender the Leased Premises shall have arisen, to remove the Tenant and the Tenant's and any others' possessions from the Leased Premises by any of the following means without any liability to the Tenant therefor, any such liability to the Tenant therefor which might otherwise arise being hereby waived by the Tenant: legal proceedings (summary or otherwise), writ of dispossession and any other means and to receive Holdover Damages and, except in the circumstances contemplated by section 20 of this Agreement, to receive all expenses incurred in removing the Tenant and the Tenant's and any others' possessions from the Leased Premises, and of storing such possessions if the Landlord so elects;

23.1.4 to be awarded specific performance, temporary restraints and preliminary and permanent injunctive relief regarding Events of Default where the Landlord's rights and remedies at law may be inadequate and, in connection with any Event of Default involving the Tenant's failure to perform its obligations under sections or subsections 7.2, 12, 13, 17.1, 17.2, 18, 20, 21, 26.3, 26.4 and 32, without the necessity of proving actual damages or the inadequacy of the rights and remedies at law;

23.1.5 to receive all expenses incurred in securing, preserving, maintaining and operating the Leased Premises during any period of vacancy, in making repairs to the Leased Premises,, in preparing the Leased Premises for re-leasing and in re-leasing the Leased Premises including, without limiting the generality of the foregoing, any brokerage commissions;

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23.1.6 to receive all legal expenses, including without limiting the generality of the foregoing, attorneys' fees incurred in connection with pursuing any of the Landlord's rights and remedies, including indemnification rights and remedies;

23.1.7 if the Landlord, in its sole discretion, elects to perform any obligation of the Tenant under this Agreement (other than the obligation to pay Rent) which the Tenant has not timely performed, to receive all expenses incurred in so doing;

23.1.8 to elect to pursue any legal or equitable right and remedy available to the Landlord under this Agreement or otherwise; and

23.1.9 to elect any combination, or any sequential combination of any of the rights and remedies set forth in subsection 23.1 of this Agreement.

23.2 In the event the Landlord elects the right and remedy set forth in subsection 23.1.1 of this Agreement, Termination Damages shall be equal to the amount which, at the time of actual payment thereof to the Landlord, is the sum of:

23.2.1 all accrued but unpaid Rent;

23.2.2 the present value (calculated using the most recently available (at the time of calculation) published weekly average yield on United States Treasury securities having maturities comparable to the balance of the then remaining Term) of the sum of all payments of Rent remaining due (at the time of calculation) until the date the Term would have expired (had there been no election to terminate it earlier) less the present value (similarly calculated) of all payments of rent to be received through the end of the Term (had there been no election to terminate it earlier) from a lessee, if any, of the Leased Premises at the time of calculation; and

23.2.3 the Landlord's reasonably estimated cost of demolishing any leasehold improvements to the Leased Premises.

23.3 In the event the Landlord elects the right and remedy set forth in subsection 23.1.2 of this Agreement, Re-Leasing Damages shall be equal to the Rent less any rent actually and timely received by the Landlord from any lessee of the Leased Premises or any portion thereof, payable at the respective times that Rent is payable under the Agreement.

23.4 In the event the Landlord elects the right and remedy set forth in subsection 23.1.3 of this Agreement, Holdover Damages shall mean damages at the rate per month or part thereof equal to the greater of: (a) one and one-half times one-twelfth of the then Market Rental Rate plus all Additional Rent as set forth in this Agreement or (b) double the average amount of all payments of Rent due under this Agreement during each of the last 12 full calendar months prior to the Landlord's so electing or, in the event the Term shall have terminated by expiration under subsection 24.1.1 of this Agreement, the last full 12 calendar months of the Term, in either case payable in full on the first day of each holdover month or part thereof.

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23.5 In connection with any summary proceeding to dispossess and remove the Tenant from the Leased Premises under subsection 23.1.3 of this Agreement, the Tenant hereby waives:

23.5.1 any notices for delivery of possession thereof, of termination, of demand for removal therefrom, of the cause therefor, to cease, to quit and all other notices that might otherwise be required pursuant to 2 A N.J.S.A. 18-53 ET SEQ.;

23.5.2 any right the Tenant might otherwise have to transfer or remove such proceeding from the court (or the particular division or part of the court) or other forum in which it shall have been instituted by the Landlord to another court, division or part; and

23.5.3 any right the Tenant might otherwise have to appeal any judgment awarding possession of the Leased Premises to the Landlord (but this subsection shall not be deemed a waiver of any right the Tenant might

otherwise have to appeal any judgment other than a judgment awarding possession of the Leased Premises to the Landlord).

23.6 The enumeration of rights and remedies in this section 23 of the Agreement is not intended to be exhaustive or exclusive of any rights and remedies which might otherwise be available to the Landlord, or to force an election of one or more rights and remedies to the exclusion of others, concurrently, consecutively or sequentially. On the contrary, each right and remedy enumerated in this section 23 of the Agreement is intended to be cumulative with each other right and remedy enumerated in this section 23 of the Agreement and with each other right and remedy that might otherwise be available to the Landlord; and the selection of one or more of such rights and remedies at any time shall not be deemed to prevent resort to one or more others of such rights and remedies at the same time or a subsequent time, even with regard to the same occurrence sought to be remedied. Nothing in this section 23 of the Agreement shall be deemed to sanction recovery by the Landlord of damages for unpaid Rent in arrears with respect to any given period under more than one of the following subsections: 23.2, 23.3 and 23.4.

#### 24 TERMINATION OF THE TERM.

24.1 The Term shall terminate upon the earliest of the following events to occur:

24.1.1 expiration of the Term;

24.1.2 in connection with a transaction contemplated by section 16 of this Agreement, the later of (a) the vesting of the acquiring party's right to possession or (b) the Tenant's vacating the Leased Premises;

24.1.3 under the circumstances contemplated by subsection 15.1 of this Agreement, upon the Tenant's giving notice of the failure of the Landlord to give, on a timely basis, the notice contemplated by subsection 15.1.2 of this Agreement (within 30 days of the last date that the Landlord might timely have given timely notice under subsection 15.1.2 of this

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Agreement) and that the Tenant desires termination of the Term (which termination shall be effective as of the date of the subject casualty with respect to those portions of the Leased Premises rendered untenable and as of the date of the Tenant's giving notice with respect to those portions of the Leased Premises which were not rendered untenable);

24.1.4 under the circumstances contemplated by subsection 15.1 of this Agreement, upon the expiration of 30 additional days (without the Landlord's completion of restoration in the interim) after the Tenant's notice that the Landlord has not restored the Leased Premises on a timely basis and that the Tenant desires termination of the Term (which termination shall be effective as of the date of the subject casualty with respect to those portions of the Leased Premises rendered untenable and as of the date of the Tenant's giving notice with respect to those portions of the Leased Premises which were not rendered untenable);

24.1.5 the effective date of any election by the Landlord under subsection 17.3.3 of this Agreement in response to the Tenant's notice of the Tenant's desire to assign this Agreement or to sublet all or a portion of the Leased Premises; or

24.1.6 the effective date of any election by the Landlord to terminate the Term under subsection 23.1.1 of this Agreement.

24.2 No termination of the Term shall have the effect of releasing the Tenant from any obligation or liability theretofore or thereby incurred and, until the Tenant shall have surrendered the Leased Premises in accordance with section 21 of this Agreement, from any obligation or liability thereafter incurred.

#### 25 MORTGAGE AND UNDERLYING LEASE PRIORITY. This Agreement and the

estate, interest and rights hereby created for the benefit of the Tenant are, and shall always be, subordinate to any mortgage (other than a mortgage created by the Tenant or a sale, transfer or other disposition by the Tenant in the nature of a security interest in violation of subsections 17.1.4 and 22.5, respectively, of this Agreement) already or afterwards placed on the Carnegie Center Complex, the Property, the Common Facilities, the Building or any estate or interest therein including, without limiting the generality of the foregoing, any new mortgage or any mortgage extension, renewal, modification, consolidation, replacement, supplement or substitution. This Agreement and the estate, interest and rights hereby created for the benefit of the Tenant are, and shall always be, subordinate to any ground lease already or afterwards made with regard to the Carnegie Center Complex, the Property, the Common Facilities, the Building or any estate or interest therein including, without limiting the generality of the foregoing, any new ground lease or any ground lease extension, renewal, modification, consolidation, replacement, supplement or substitution. The provisions of this section 25 of the Agreement shall be self-effecting; and no further instrument shall be necessary to effect any such subordination. Nevertheless, the Tenant hereby consents that any mortgagee or mortgagee's successor in interest may, at any time and from time to time, by notice to the Tenant, subordinate its mortgage to the estate and interest created by this Agreement; and upon the giving of such notice, the subject mortgage shall be deemed subordinate to the estate and interest created by this Agreement regardless of the respective times of execution or delivery of either or of recording the subject mortgage.

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26        TRANSFER BY LANDLORD.

26.1     The Landlord shall have the right at any time and from time to time to sell, transfer, lease or otherwise dispose of the Carnegie Center Complex, the Property, the common Facilities or the Building or any of the Landlord's interests therein, or to assign this Agreement or any of the Landlord's rights thereunder.

26.2     upon giving notice of the occurrence of any transaction contemplated by subsection 26.1 of this Agreement, the Landlord shall thereby be relieved of any obligation that might otherwise exist under this Agreement with respect to periods subsequent to the effective date of any such transaction. If, in connection with any transaction contemplated by subsection 26.1 of this Agreement the Landlord transfers, or makes allowance for, any Security Deposit of the Tenant and gives notice of that fact to the Tenant, the Landlord shall thereby be relieved of any further obligation to the Tenant with regard to any such Security Deposit; and the Tenant shall look solely to the transferee with respect to any such Security Deposit.

26.3     In the event of the occurrence of any transaction contemplated by subsection 26.1 of this Agreement the Tenant, upon written request therefor from the transferee, shall attorn to and become the tenant of such transferee upon the terms and conditions set forth in this Agreement.

26.4     Notwithstanding anything to the contrary that may be set forth in subsections 26.1, 26.2 and 26.3 of this Agreement, in the event any mortgage contemplated by section 25 of this Agreement is enforced by the respective mortgagee pursuant to remedies provided in the mortgage or otherwise provided by law or equity and any person succeeds to the interest of the Landlord as a result of, or in connection with, any such enforcement, the Tenant shall, upon the request of such successor in interest, automatically attorn to and become the Tenant of such successor in interest without any change in the terms or provisions of this Agreement, except that such successor in interest shall not be bound by: (a) any payment of Basic Rent or Additional Rent (exclusive of prepayments in the nature of a Security Deposit) -for more than one month in advance or (b) any amendment or other modification of this Agreement which was made without the consent of such mortgagee or such successor in interest; and, upon the request of such successor in interest, the Tenant shall execute, acknowledge and deliver any instruments) confirming such attornment.

26.5 If this Agreement and the estate, interest and rights hereby created for the benefit of the Tenant are ever subject and subordinate to any ground lease contemplated by section 25 of this Agreement:

26.5.1 upon the expiration or earlier termination of the term of any such ground lease before the termination of the Term under this Agreement, the Tenant shall attorn to, and become the Tenant of, the lessor under any such ground lease and recognize such lessor as the Landlord under this Agreement for the balance of the Term; and

26.5.2 such expiration or earlier termination of the term of any such ground lease shall have no effect on the Term under this Agreement.

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26.6 Notwithstanding anything to the contrary that may be set forth in section 25 of this Agreement, with respect to any mortgages or ground leases contemplated by section 25 of this Agreement, the Landlord shall use its best efforts to obtain from each such mortgagee and ground lessor its respective standard form of non-disturbance, attornment and subordination agreement including a provision to the effect that, in the event of enforcement of any remedies provided in the respective mortgage or ground lease, respectively, or otherwise, so long as an Event of Default shall not have occurred, the Tenant shall not be disturbed in its possession of the Leased Premises in accordance with this Agreement. Any processing or other fee that the mortgagee or ground lessor may charge and any reasonable legal expense that the Landlord may incur in connection with performing its obligations under this subsection shall be paid by the Tenant and, with respect to any processing or other fee charged by the mortgagee or ground lessor, in advance.

#### 27 INDEMNIFICATION.

27.1 The Tenant shall, and hereby does, indemnify the Landlord against any and all liabilities, obligations, damages, penalties, claims, costs, charges and expenses including, without limiting the generality of the foregoing, expenses of investigation, defense and enforcement thereof or of the obligation set forth in this section 27 of the Agreement including, without limiting the generality of the foregoing, attorneys' fees, imposed on or incurred by the Landlord in connection with any of the following matters which occurs during the Term:

27.1.1 any matter, cause or thing arising out of the use, occupancy, control or management of the Leased Premises or any portion thereof which is not proximately caused by the Landlord's negligence or intentional misconduct;

27.1.2 any negligence or intentional act on the part of the Tenant or any of its employees, other agents or Guests;

27.1.3 any accident, injury or damage to any person or property occurring in the Leased Premises which is not proximately caused by the Landlord's negligence intentional misconduct ;

27.1.4 any representation made by the Tenant in this Agreement shall have been inaccurate or incomplete in any material respect either on the date it was made or the date as of which it was made;

27.1.5 the imposition of any mechanic's, materialman's or other lien on the Property, the Common Facilities, the Building, the Leased-Premises or any-portion-of any of the foregoing, or the filing of any notice of intention to obtain any such lien, in connection with any alteration, improvement or other modification of the Leased Premises made or authorized by the Tenant (which indemnification obligation shall be deemed to include the Tenant's obligations set forth in subsection 12.2.4.3 of this Agreement); or

27.1.6 any failure on the part of the Tenant to perform or comply with any obligation of the Tenant set forth in this Agreement.

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27.2 Payment of indemnification claims by the Tenant to the Landlord shall be due upon the Landlord's giving notice thereof to the Tenant.

27.3 The Landlord shall promptly give notice of any claim asserted, or action or proceeding commenced, against it as to which it intends to claim indemnification from the Tenant and, upon notice from the Tenant so requesting, shall forward to the Tenant copies of all claim or litigation documents received by it. Upon receipt of such notice the Tenant may, by notice to the Landlord, participate therein and, to the extent it may desire, assume the defense thereof through independent counsel selected by the Tenant and reasonably satisfactory to the Landlord. The Landlord shall not be bound by any compromise or settlement of any such claim, action or proceeding without its prior written consent.

28 PARTIES' LIABILITY.

28.1 None of the following occurrences shall constitute a breach of this Agreement by the Landlord, a termination of the Term, an active or constructive eviction or an occurrence requiring an abatement of Rent:

28.1.1 the inability of the Landlord to provide any utility or service to be provided by the Landlord, as described in section 8 of this Agreement which is due to causes beyond the Landlord's control, or to necessary or advisable improvements, maintenance, repairs or emergency, so long as the Landlord uses reasonable efforts and diligence under the circumstances to restore the interrupted service or utility;

28.1.2 any improvement, modification, alteration or other change made to the Carnegie Center Complex, the Property, the Building or the common Facilities by the Landlord consistently with the Landlord's obligations set forth in subsection 13.2 of this Agreement; and

28.1.3 any change in any Federal, state or local law or ordinance.

28.2 Except for the commencement, duration or termination of the Term (other than under the circumstances contemplated by subsection 15.1 of this Agreement), the Tenant's obligation to make timely payments of Rent, the Tenant's obligation to maintain certain insurance coverage in effect and the period within which any option to Renew or any other type of option or optional right exercisable by the Tenant must be exercised, any period of time during which the Landlord or the Tenant is prevented from performing any of its respective obligations under this Agreement because of fire, any other casualty or catastrophe, strikes, lockouts, civil commotion, acts of God or the public enemy, governmental prohibitions or preemptions, embargoes or inability to obtain labor or material due to shortage, governmental regulation or prohibition, shall be added to the time when such performance is otherwise required under this Agreement.

28.3 In the event the Landlord is an individual, partnership, joint venture, association or a participant in a joint tenancy or tenancy in common, the Landlord, the partners, venturers, members and joint owners shall not have any personal liability or obligation under or

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in connection with this Agreement or the Tenant's use and occupancy of the Leased Premises; but recourse shall be limited exclusively to the Landlord's interest in the Building.

28.4 If, at any time during the Term, the payment or collection of any Rent otherwise due under this Agreement shall be limited, frozen or otherwise subjected to a moratorium by applicable law, and such limitation, freeze or other moratorium shall subsequently be lifted, whether before or after

the termination of the Term, such aggregate amount of Rent as shall not have been paid or collected during the Term on account of any such limitation, freeze or other moratorium, shall thereupon be due and payable at once. There shall be added to the maximum period of any otherwise applicable statute of limitation the entire period during which any such limitation, freeze or other moratorium shall have been in effect.

28.5 If this Agreement is executed by more than one person as Tenant, their liability under this Agreement and in connection with the use and occupancy of the Leased Premises shall be joint and several.

28.6 In the event any rate of interest, or other charge in the nature of interest, calculated as set forth in this Agreement would lead to the imposition of a rate of interest in excess of the maximum rate permitted by applicable usury law, only the maximum rate permitted shall be charged and collected.

29 SECURITY DEPOSIT. The Tenant shall pay to the Landlord upon execution and delivery of this Agreement the sum of \$14,228.00 as a security deposit to be held by the Landlord as security for the Tenant's performance of all the Tenant's obligations under this Agreement. The Landlord may commingle the Security Deposit with its general funds. Any interest earned on the Security Deposit shall belong to the Landlord. The Tenant shall not encumber the Security Deposit. The Landlord, in its sole discretion, may apply the Security Deposit to cure any Event of Default under this Agreement. If any such application is made, upon notice by the Landlord to the Tenant, the Tenant shall promptly replace the amount so applied. If there has been no Event of Default, within 30 days after termination of the Term the Landlord shall return the entire balance of the Security Deposit to the Tenant. The Tenant will not look to any foreclosing mortgagee of the Property, the Building, the Common Facilities or any interest therein for such return of the balance of the Security Deposit, unless the mortgagee has expressly assumed the Landlord's obligations under this Agreement or has actually received the balance of the Security Deposit.

30 REPRESENTATIONS. The Tenant hereby represents and warrants that:

30.1 its Standard Industrial Classification (SIC) code is 2834 and it will promptly give notice of any change therein during the Term to the Landlord;

30.2 no broker or other agent has shown the Leased Premises or the Building to the Tenant, or brought either to the Tenant's attention, except Princeton Realty Advisors L. P., whose entire commission therefor is set forth in a separate document and which commission the Tenant understands will be paid by the Landlord directly to the person named;

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30.3 the execution and delivery of, the consummation of the transactions contemplated by and the performance of all its obligations under, this Agreement by the Tenant have been duly and validly authorized by its general partners, to the extent required by their partnership agreement and applicable law, if the Tenant is a partnership or, if the Tenant is a corporation, by its board of directors and, if necessary by its stockholders at meetings duly called and held on proper notice for that purpose at which there were respective quorums present and voting throughout or, alternatively, by effective written consent of its board of directors and, if necessary, its stockholders; and no other approval, partnership, corporate, governmental or otherwise, is required to authorize any of the foregoing or to give effect to the Tenant's execution and delivery of this Agreement; and

30.4 the execution and delivery of, the consummation of the transactions contemplated by and the performance of all its obligations under, this Agreement by the Tenant will not result in a breach or violation of, or constitute a default under, the provisions of any statute, charter, certificate of incorporation or bylaws or partnership agreement-of the Tenant or any affiliate of the Tenant, as presently in effect, or any indenture, mortgage, lease, deed of trust, other agreement, instrument, franchise, permit, license,

decree, order, notice, judgment, rule or order to or of which the Tenant or any affiliate of the Tenant is a party, a subject or a recipient or by which the Tenant, any affiliate of the Tenant or any of their respective properties and other assets is bound.

31 RESERVATION IN FAVOR OF TENANT. Neither the Landlord's forwarding a copy of this document to any prospective tenant nor any other act on the part of the Landlord prior to execution and delivery of this Agreement by the Landlord shall give rise to any implication that any prospective tenant has a reservation, an option to lease or an outstanding offer to lease any premises.

32 TENANT'S CERTIFICATES AND MORTGAGEE NOTICE REQUIREMENTS.

32.1 Upon request of the Landlord at any time or from time to time, but in no event more than 13 days after the Landlord's respective request, the Tenant shall execute, acknowledge and deliver to the Landlord or its designee an estoppel or other certificate, satisfactory in form and substance to the Landlord and any of its mortgagees, ground lessors or lessees or transferees or prospective mortgagees, ground lessors or lessees or transferees, with respect to any of or all the following matters:

32.1.1 whether this Agreement is then in full force and effect;

32.1.2 whether this Agreement has not been amended, modified, superseded, canceled, repudiated or revoked;

32.1.3 whether the Landlord has satisfactorily completed all construction work, if any, required of the Landlord or contractors selected and retained by the Landlord in connection with readying the Leased Premises for occupancy by the Tenant in accordance with section 5 of this Agreement;

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32.1.4 whether the Tenant is then in actual possession of the Leased Premises;

32.1.5 whether, to its knowledge, the Tenant then has no defenses or counterclaims under this Agreement or otherwise against the Landlord or with respect to the Leased Premises;

32.1.6 whether, to the Tenant's knowledge, Landlord is not then in breach of this Agreement in any respect;

32.1.7 whether the Tenant then has no knowledge of any assignment of this Agreement, the pledging or granting of any security interest in this Agreement or in Rent due and to become due under this Agreement;

32.1.8 whether Rent is not then accruing under this Agreement in accordance with its terms;

32.1.9 whether any Rent is not then in arrears;

32.1.10 whether Rent due or to become due under this Agreement has not been prepaid by more than one month;

32.1.11 if the response to any of the foregoing matters is in the negative, a specification of all the precise reasons that necessitated the negative response in each instance; and

32.1.12 any other matter reasonably requested by the Landlord or any of its mortgagees, ground lessors or lessees or transferees or prospective mortgagees, ground lessors or lessees or transferees, including, without limiting the generality of the foregoing, such information as the Landlord may reasonably request for purposes of assuring compliance with the Environmental Cleanup Responsibility Act (13 N.J.S.A. ss.1K-6 ET SEQ.), as it may be amended, and any other applicable Federal, state or local statute, ordinance, rule, regulation or order concerned with environmental matters.

32.2 If, in connection with the Landlord's or a prospective transferee's obtaining financing or refinancing of the Carnegie Center Complex, the Property, the Building, the Common Facilities, any portion thereof or any interest therein, the Landlord or a prospective lender shall so request, the Tenant shall furnish to the requesting party within 15 days of the request:

32.2.1 its written consent to any requested modifications of this Agreement provided that, in each such instance, the requested modification does not increase the Rent otherwise due or, in the reasonable judgment of the Tenant, otherwise materially increase the obligations of the Tenant under this Agreement or materially adversely affect the Tenant's leasehold interest created hereby or the Tenant's use and enjoyment of the Leased Premises (except in the circumstances contemplated by section 16 of this Agreement).

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32.3 If the Landlord or any of its mortgagees gives notice to the Tenant of any of their respective names and addresses from time to time, the Tenant shall give notice to each such mortgagee of any notice of breach or default previously or afterwards given by the Tenant to the Landlord under this Agreement and provide in such notice that if the Landlord has not cured such breach or default within any permissible cure period then such mortgagee shall have the greater of (a) an additional period of 30 days or (b) if such default cannot practically be cured within such period, such additional period as is reasonable under the circumstances, within which to cure such default. Upon request of the Landlord at any time or from time to time, the Tenant shall execute, acknowledge and deliver to the Landlord or its designee an acknowledgment of receipt of any such notice, an acknowledgment of receipt of any notice of assignment of this Agreement or rights hereunder by the Landlord to any of its mortgagees and the Tenant's agreement to the foregoing effect on the respective forms, -if any, furnished by the Landlord or the respective mortgagees.

32.4 Approximately (i) 90 days prior to the termination of the Term and (ii) 30 days prior to any relocation of the Tenant from the Leased Premises (as constituted on the Commencement Date), the Tenant shall obtain from the New Jersey Department of -Environmental Protection, and deliver to the Landlord, the Department's-unconditional certificate of non-applicability or approval of the Tenant's negative declaration or clean-up plan, together with copies of all documents furnished to the Department in connection with obtaining such certificate or approval.

33 WAIVER OF JURY TRIAL AND ARBITRATION. The parties hereby waive any right they might otherwise have to a trial by jury in connection with any dispute arising out of or in connection with this Agreement or the use and occupancy of the Leased Premises; and they hereby consent to arbitration of any such dispute in Princeton, New Jersey, in accordance with the rules for commercial arbitration of the American Arbitration Association or successor organization, except that the Landlord, in its sole discretion, may, with respect to any dispute involving either (i) the Landlord's right to re-enter and re-take possession of the Leased Premises or (ii) the determination of money damages following the occurrence of an Event of Default under this Agreement, elect to pursue any of or all its rights in any court of competent jurisdiction. Judgment upon any arbitration award may be entered in any court of competent jurisdiction.

34 SEVERABILITY. In the event that any provision of this Agreement, or the application of any provision in any instance, shall be conclusively determined by a court of competent jurisdiction to be illegal, invalid or otherwise unenforceable, such determination shall not affect the validity or enforceability of the balance of this Agreement.

35 NOTICES. All notices contemplated, permitted or required by this Agreement shall be in writing. All notices required by this Agreement shall be delivered by messenger, by overnight courier service (such as Fedex and the like) or by facsimile or forwarded by certified mail--return receipt requested, addressed to the intended party at its address first set forth above (adding, in the case of notices to the Landlord after the Commencement Date, "Attention:

Lease Administration") or, in the case of notices to the Tenant during the Term or any other period

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during which the Tenant shall be in possession of the Leased Premises, at the Leased Premises. Either party may from time to time change the address prescribed in this Agreement for notices to it by notice to the other. All mailed notices required under this Agreement shall be deemed given upon their deposit, properly addressed and postage prepaid, in a postal depository or upon delivery by any of the other modes contemplated above, to the intended party, regardless of whether delivery shall be refused.

36 CAPTIONS. Captions have been inserted at the beginning of each section of this Agreement for convenience of reference only and such captions shall not affect the construction or interpretation of any such section of this Agreement.

37 COUNTERPARTS. This Agreement may be executed in more than one counterpart, each of which shall constitute an original of this Agreement but all of which, taken together, shall constitute one and the same Agreement.

38 APPLICABLE LAW. This Agreement and the obligations of the parties hereunder shall be governed by and construed in accordance with the laws of the State of New Jersey.

39 EXCLUSIVE BENEFIT. Except as may be otherwise specifically set forth in this Agreement, this Agreement is made exclusively for the benefit of the parties hereto and their permitted assignees and no one else shall be entitled to any right, remedy or claim by reason of any provision of this Agreement.

40 SUCCESSORS. This Agreement shall be binding upon the parties hereto and their respective successors and assigns.

41 AMENDMENTS. This Agreement contains the entire agreement of the parties hereto, subsumes all prior discussions and negotiations and, except as may otherwise be specifically set forth in this Agreement, this Agreement may not be amended or otherwise modified except by a writing signed by all the parties to this Agreement.

42 WAIVER. Except as may otherwise be specifically set forth in this Agreement, the failure of any party at any time or times to require performance of any provision of this Agreement shall in no manner affect the right at a later time to enforce the same. No waiver by any party of any condition, or of the breach of any term, covenant, representation or warranty set forth in this Agreement, whether by conduct or otherwise, in any one or more instances shall be deemed to be or construed as a further or continuing waiver of any such condition or breach, or as a waiver of any other condition or of the breach of any other term, covenant, representation or warranty set forth in this Agreement. The Landlord's acceptance of, or endorsement on, any partial payment of Rent or any late payment of Rent from the Tenant shall not operate as a waiver of the Landlord's right to the balance of the Rent due on a timely basis regardless of any writing to the contrary on, or accompanying, the Tenant's partial payment or the Landlord's putative acquiescence therein.

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43 COURSE OF PERFORMANCE. No course of dealing or performance by the

parties, or any of them, shall be admissible for the purpose of obtaining an interpretation or construction of this Agreement at variance with the express language of the Agreement itself.

44 LANDLORD'S CONCESSIONS.

44.1 Notwithstanding anything to the contrary that may be set forth in subsection 5.4 of this Agreement, (a) (i) if no Event of Default shall have occurred or (ii) if an Event of Default shall have occurred, the Tenant shall have previously cured it in full and the Landlord shall have waived it and (b) if the preparation of the Leased Premises contemplated by section 5 of this Agreement is being accomplished exclusively through contractors selected by the Landlord and (c) if the scope of the work contemplated by the Tenant Plan is limited to (i) repainting those portions of the interior walls of the Leased Premises in the Tenant's choice of building standard color where the Tenant does not wish to retain existing wall treatments, (ii) recarpeting floors of the Leased Premises with building standard carpet in the Tenant's choice of building standard color (from the Landlord's existing inventory of building standard carpet on hand) and (iii) constructing two offices in the Leased Premises with building standard materials and finishes, the Landlord shall credit against any amount otherwise due from the Tenant in accordance with subsection 5.4 of this Agreement an amount equal to 100% thereof.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first above written.

LANDLORD:

CARNEGIE CENTER ASSOCIATES

By: Princeton Carnegie Associates

By /s/ Alan B. Landes

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Alan B. Landis, General Partner

TENANT:

ADVANCED MAGNETICS, INC.

By /s/ Jerome M. Lewis

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Jerome M. Lewis, Vice President  
Scientific Operations

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EXHIBIT A

LEASED PREMISES FLOOR SPACE DIAGRAM

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EXHIBIT B

PROPERTY DESCRIPTION

DESCRIPTION OF 104 CARNEGIE CENTER  
WEST WINDSOR TOWNSHIP  
MERCER COUNTY, NEW JERSEY

All that certain lot, parcel or tract of land situate and lying in the Township of West Windsor, County of Mercer and State of New Jersey and being more particularly described as lot 70 in block 9, as shown on a map entitled "Final Plat, Carnegie Center, Tax Lot 2, Block 9, situate in West Windsor Township, Mercer County, New Jersey," dated February 11, 1980, and filed in the Mercer County Clerk's Office as Map No. 2426 on May 29, 1980, as the same may be amended.

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EXHIBIT C-

WORK LETTER

The following is the Work Letter referred to in the Agreement of which this exhibit is a part.

The Building's structure is a three-story office building of Construction Type 2C with a steel frame, a metal deck floor system, a brick exterior facade and insulated glass. The floors will sustain a live load of 100 pounds per square foot of usable floor space plus an allowance of 20 pounds per square foot for partitions and will have a typical bay size of 30 feet by 30 feet.

Among other Common Facilities, the Building will contain two men's and two women's bathrooms on each floor, two drinking fountains on each floor and two hydraulic elevators with a capacity of 2,500 pounds each and will have Parking Facilities with approximately 500 lined parking spaces. For purposes of telecommunications hookups, a Building telephone switching room and space between the finished ceilings and the underside of the floor above (or roof) are provided as common Facilities.

"Building standard" shall mean the type and grade of material, equipment or device designated by the Landlord as standard for leased premises in the Building.

The Tenant will include the following information as part of its Tenant Plan:

1. The location and extent of floor loading, if any, in excess of the building standard specified above.
2. Special air conditioning requirements, if any, in excess of the building standard.
3. Plumbing requirements, if any.
4. Estimated total electrical load, including lighting

requirements, lighting switch requirements and electrical outlet requirements, if any, in excess of the building standard, setting forth the amount of the load, locations and types.

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EXHIBIT D-  
BUILDING RULES AND REGULATIONS

The following are the Building Rules and Regulations adopted in accordance with subsection 7.2.3 of the Agreement of which this exhibit is a part; and the Tenant and the Tenant's employees, other agents and Guests shall comply with these Building Rules and Regulations:

1. The sidewalks, driveways, entrances, passages, courts, lobby, esplanade areas, plazas, elevators, vestibules, stairways, corridors, halls and other Common Facilities shall not be obstructed or encumbered or used for any purpose other than ingress and egress to and from the Leased Premises. The Tenant shall not permit or suffer any of its employees, other agents or Guests to congregate in any of the said areas. No door mat of any kind whatsoever shall be placed or left in any public hall or outside any entry door of the Leased Premises.

2. No awnings or other projections shall be attached to the outside walls of the Building. No curtains, drapes, blinds, shades or screens shall be attached to, hung in or used in connection with any window or door of the Leased Premises without the prior written consent of Landlord. If such consent is given, such curtains, drapes, blinds, shades or screens shall be of a quality, type, design and color, and attached in the manner, approved by Landlord.

3. Except as otherwise specifically provided in subsection 18.1 of the Agreement, no sign, insignia, advertisement, object, notice or other lettering shall be exhibited, inscribed, painted or affixed so as to be visible from outside the Leased Premises or the Building. In the event of the violation of the foregoing by the Tenant, the Landlord may remove same without any liability and may charge the expense incurred in such removal to the Tenant.

4. The sashes, doors, skylights, windows, and doors that reflect or admit light and air into the halls, passageways or other public places in the Building shall not be covered or obstructed and no bottles, parcels or other articles shall be placed on the window sills.

5. No showcase or other articles shall be placed in front of or affixed to any part of the Building or the Common Facilities.

6. The lavatories, water and wash closets and other plumbing fixtures shall not be used for any purposes other than those for which they were designed and constructed, and no sweepings, rubbish, rags, acids or other substances shall be thrown or deposited therein. All damages resulting from any misuse thereof shall be repaired at the expense of the Tenant that permitted or suffered the violation hereof by the Tenant, the Tenant's employees, other agents or Guests.

7. The Tenant shall not mark, paint, drill into or in any way deface any part of the Leased Premises, the Building, the Common Facilities or the Property. No boring, cutting or stringing of wires shall be permitted, except with the prior written consent of the Landlord,

and as the Landlord may direct. Linoleum and other resilient floor coverings shall be laid so that the same shall not come in direct contact with the floor of the Leased Premises; and if linoleum or other resilient floor coverings are desired, an interlining of builder's deadening felt shall be first affixed to the floor by a paste or other material that is, and will remain, soluble in water. The use of cement or other adhesive material that either is not, or will not remain, soluble in water is prohibited.

8. No bicycles, vehicles, animals, reptiles, fish or birds of any kind shall be brought into or kept in or about the Leased Premises.

9. No noise including, without limiting the generality of the foregoing, music or the playing of musical instruments, recordings, radio or television which, in the reasonable judgment of Landlord, might disturb tenants of Other Leased Premises shall be made or permitted by the Tenant. Nothing shall be done or permitted in the Leased Premises by the Tenant which would impair or interfere with the use or enjoyment of Other Leased Premises by any tenant thereof. Nothing shall be thrown out of the doors, windows or skylights or down the passageways of the Building.

10. The Tenant shall not manufacture any commodity, or prepare or dispense any foods or beverages, tobacco, flowers or other commodities or articles without the prior written consent of the Landlord.

11. Duplicates of keys and passes distributed to the Tenant by the Landlord shall not be made. The Tenant shall provide appropriate security for keys. Nothing shall be done to render any lock inoperable by the Building Grand Master Key. No lock shall be installed without the Landlord's prior written consent; and any lock so installed shall be operable by the Building Grand Master Key. Upon termination of the Term, all keys, passes and duplicates provided by the Landlord to the Tenant, or otherwise procured by the Tenant, shall be returned to the Landlord. Any failure to comply with the foregoing which requires changes in locks, new or additional keys, passes or duplicates or other services of a locksmith shall be paid by the Tenant.

12. All deliveries and removals, and the carrying in or out of any safes, freight, furniture, packages, boxes, crates or any other object or matter of any description shall take place during such hours, in such manner and in such elevators and passageways as the Landlord may determine from time to time. The Landlord reserves the right to inspect all objects and matter being brought into the Building or the Common Facilities and to exclude from the Building and the Common Facilities all objects and matter that violates any of these Building Rules and Regulations or that are contraband. The Landlord may (but shall not be obligated to) require any person leaving the Building or the common Facilities with any package or object or matter from the Leased Premises to establish his authority from the Tenant to do so. The establishment and enforcement of such a requirement shall not impose any responsibility on the Landlord for the - -protection of the Tenant against the removal of property from the Leased Premises. The Landlord shall not be liable to the Tenant for damages or loss arising from the admission, exclusion or ejection of any person to or from the Leased-Premises or the Building or the Common Facilities under this rule.

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13. The Tenant shall not place any object in any advertising or display of such identifying sign.

14. The Landlord shall have the right to prohibit any advertising or display of any identifying sign by the Tenant which in the Landlord's judgment tends to impair the reputation of the Building or its desirability; and, on written notice from the Landlord, the Tenant shall refrain from or discontinue such advertising or display of such identifying sign.

15. The Landlord reserves the right to exclude from the Building and the Common Facilities during hours other than Regular Business Hours all persons who do not present a pass thereto signed by both the Landlord and the Tenant. All persons entering or leaving the Building or the Common Facilities during hours other than Regular Business may be required to sign a register. The Landlord will furnish passes to persons for whom the Tenant requests same in writing. The establishment and enforcement of such a requirement shall not impose any responsibility on the Landlord for the protection of the Tenant against unauthorized entry of persons.

16. The Tenant, before closing and leaving the Leased Premises at any time shall see that all lights and appliances generating heat (other than the heating system) are turned off. All entrance doors to the Leased Premises shall be left locked by the Tenant when the Leased Premises are not in use. At any time when the Building or the Common Facilities are locked during hours other than Regular Business Hours, the Building and the Common Facilities locks shall not be defeated by any means, such as by leaving a door ajar.

17. No person shall go upon the roof of the Building without the prior written consent of the Landlord.

18. Any requirements of the Tenant may be attended to only upon application at the office of the Building. The Landlord and its agents shall not perform any work or do any work or do anything outside of the Landlord's obligations under the Agreement except upon special instructions from the Landlord on terms acceptable to the Landlord and the Tenant.

19. Canvassing, soliciting and peddling in the Building and the Common Facilities are prohibited and the Tenant shall cooperate to prevent same.

20. There shall not be used in any space, or in the public halls or other Common Facilities of the Building, in connection with the moving or delivery or receipt of safes, freight, furniture, packages, boxes, crates, paper, office material, or any other matter or thing, any hand trucks or dollies except those equipped with rubber tires, side guards and such other safeguards as the Landlord shall require. No hand trucks shall be used in passenger elevators, and no passenger elevators shall be used for the moving, delivery or receipt of the aforementioned articles. In connection with moving in or out any Furniture, furnishings, equipment, heavy articles and heavy packages, the Tenant shall take such precautions as may be

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necessary to prevent excessive wear and tear in the Building's common Facilities and the Leased Premises including, without limiting the generality of the foregoing, floor and wall treatments.

21. The Tenant shall not cause or permit any odors of cooking or other processes or any unusual or objectionable odors to emanate from the Leased Premises which might constitute a Nuisance. No cooking shall be done in the Leased Premises other than as specifically permitted in the Agreement.

22. The Landlord reserves the right not to enforce any Building Rule or Regulation against any tenants of Other Leased Premises. The Landlord reserves the right to rescind, amend or waive any Building Rule and Regulation when, in the Landlord's reasonable judgment, it appears necessary or desirable for the reputation, safety, care or appearance of the Building or the preservation of good order therein or the operation of the Building or the comfort of tenants or others in the Building. No rescission, amendment or waiver of any Building Rule and Regulation in favor of one tenant shall operate as a rescission, amendment or waiver in favor of any other tenant.

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## EXHIBIT E

## DEFINITIONS AND INDEX OF DEFINITIONS

In accordance with section 1 of the Agreement of which this exhibit is a part, throughout the Agreement the following terms and phrases shall have the meanings set forth or referred to below:

- 1 "Additional Rent" means all amounts, other than Basic Rent and any Security Deposit, required to be paid by the Tenant to the Landlord in accordance with this Agreement.
- 2 "Affiliate" of any person means a person controlling, controlled by, or under common control with, that person.
- 3 "Agreement" means this Lease and Lease Agreement (including exhibits), as it may have been amended.
- 4 "Annual Amortized Capital Expenditure" means the payment amount determined as an annuity payable in arrears using the cost incurred by the Landlord for any Capital Expenditure as the present value, the number of years of its useful life (not exceeding 10 years) selected by the Landlord in accordance with generally applied real estate accounting practice as the number of periods and the Base Rate in effect when the respective improvement is first placed into service plus two additional percentage points as the annual rate of interest.
- 5 "Base Rate" means the prime commercial lending rate per year as announced from time to time by The Chase Manhattan Bank (National Association) at its principal office in New York City.
- 6 "Basic Rent" is defined in subsection 3.2 of this Agreement.
- 7 "Building" means the office building erected on the Property which is commonly known as 104 Carnegie Center, Princeton, New Jersey 08540, as it may, in the Landlord's sole discretion, be increased, decreased, modified; altered or otherwise changed from time to time before, during or after the Term. As the Building is presently constructed it consists of 100,338 gross rentable square feet of floor space.
- 8 "Capital Expenditure" is defined in subsection 10.3 of this Agreement.
- 9 "Commencement Date" is defined in section 4 of this Agreement.
- 10 "Common Facilities" means the areas, facilities and improvements provided by the Landlord in the Building. (except the Leased Premises and the Other Leased Premises) and on or about the Property, including, without limiting the generality of the foregoing, the Parking Facilities and access roads thereto, sidewalks providing access to the Building, hallways,

stairways, elevators, lobbies and other public areas for non-exclusive use by the Tenant in accordance with subsection 2.2 of this Agreement, as they may, in the Landlord's sole discretion, be increased, decreased, modified, altered or otherwise changed from time to time before, during or after the Term.

11 "Common Walls" means those walls which separate the Leased Premises from Other Leased Premises.

12 "Electric Charges" means all the supplying utility's charges for, or in connection with, furnishing electricity including charges determined by actual usage, any seasonal adjustments, demand charges, energy charges, energy adjustment charges and any other charges, howsoever denominated, of the supplying utility, including sales and excise taxes and the like.

13 "Event of Default" is defined in section 22 of this Agreement.

14 "Expiring Term" means, when used in the context of any option to Renew, the Term as it is then scheduled to expire (immediately prior to exercise of the next available Option to Renew).

15 The Tenant's "Guests" shall mean the Tenant's licensees, invitees and all others in, on or about the Leased Premises, the Building, the Common Facilities or the Property, either at the Tenant's express or implied request or invitation or for the purpose of soliciting or visiting the Tenant.

16 A "History of Recurring Events of Default" means the occurrence of three or more Events of Default (whether or not cured by the Tenant) in any period of 12 months.

17 "Holdover Damages" is defined in subsection 23.4 of this Agreement.

18 The "Index" means the "all items" index figure for the New York Northeastern New Jersey average of the Consumer Price Index for all urban wage earners and clerical workers which uses a base period of 1982-84=100, published by the United States Department of Labor, so long as it continues to be published. If the Index is not published for a period of three consecutive months, or if its base period is changed, the term "Index" shall mean that index, as nearly equivalent in purpose, function and coverage as practicable to the original Index, which the Landlord shall have designated by notice to the Tenant.

19 "Initial Term" means the period so designated in subsection 4.1 of this Agreement.

20 "Initial Year" means the first 12 full calendar months of the Initial Term.

21 "Landlord" means the person so designated at the beginning of this Agreement and those successors to the Landlord's interest in the Property and/or the Landlord's rights and obligations under this Agreement contemplated by section 26 of this Agreement.

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22 "Leased Premises" means that portion of the interior of the Building (as viewed from the interior of the Leased Premises) bounded by the interior sides of the unfinished floor and the finished ceiling on the second floor (as the floors have been designated by the Landlord) of the Building, the centers of all Common Walls and the exterior sides of all walls other than Common Walls, the outline of which floor space is designated on the diagram set forth in Exhibit A attached hereto, which portion contains 4,445 square feet of usable floor space and 5,174 square feet of gross rentable floor space; and references within this Agreement to the gross rentable floor space and the usable floor space, respectively, of the Leased Premises shall mean the respective quantities herein specified.

23 "Legal Holidays" means New Year's Day, Presidents' Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day and Christmas Day.

24 "Market Rental Rate" means, at the time of reference, the gross rentable

floor space of the Leased Premises multiplied by the greater of: (a) that annual rate of Basic Rent per square foot of gross rentable floor space which is then being quoted by the Landlord for comparable Other Leased Premises (or would then be quoted if comparable Other Leased Premises were then available) or (b) that annual rate of Basic Rent per square foot of gross rentable floor space in effect during the Expiring Term.

25 "Municipality" means the Township of West Windsor in Mercer County, New Jersey, or any successor municipality with jurisdiction over the Property.

26 "Nuisance" means any condition or occurrence which unreasonably or materially interferes with the authorized use and enjoyment of the Other Leased Premises and the Common Facilities by any tenant of Other Leased Premises or by any person authorized to use any other Leased Premises or Common Facilities or with the authorized use of any other areas, buildings or other improvements in the Carnegie Center Complex.

27 "Operational Expenses" is defined in subsection 10.2 of this Agreement.

28 "Option to Renew" is defined in subsection 6.1 of this Agreement.

29 "Other Leased Premises" means all premises within the Building, with the exception of the Leased Premises, that are, or are available to be, leased to tenants or prospective tenants, respectively.

30 "Parking Facilities" means the parking area adjacent to the Building, containing the approximate number of lined parking spaces set forth in the Work Letter, which parking area is provided as Common Facilities and which parking area shall not be reduced in such a manner as to materially interfere with the Tenant's requirements for parking for its employees, other agents and Guests.

31 "Person" includes an individual, a corporation, a partnership, a trust, an estate, an unincorporated group of persons and any group of persons.

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32 "Property" means the parcel of land, as it may, in the Landlord's sole discretion, be increased, decreased, modified, altered or otherwise changed from time to time before, during or after the Term, on which the Building is erected. As the Property is presently constituted it is more particularly described in Exhibit B attached hereto.

33 "Regular Business Hours" means 8:00 A.M. to 6:00 P.M., Monday through Friday, except on Legal Holidays.

34 "Re-Leasing Damages" is defined in subsection 23.3.

35 "Renewal Term" means, at the time of reference, any portion of the Term, other than the Initial Term, as to which the Tenant has properly exercised an Option to Renew which Option to Renew has not, been rescinded in accordance with subsection 6.4.1 of this Agreement.

36 "Rent" means Basic Rent and Additional Rent.

37 "Security Deposit" is designated in section 29 of this Agreement.

38 "Target Date" means September 19, 1994.

39. "Taxes" means, in any calendar year, the aggregate amount of real property taxes, assessments and sewer rents, rates and charges, state and local taxes, transit taxes and every other governmental charge, whether general or special, ordinary or extraordinary (except corporate franchise taxes and taxes imposed on, or computed as a function of, net income or net profits from all sources and except taxes charged, assessed or levied exclusively on the Leased Premises or arising exclusively from the Tenant's occupancy of the Leased Premises) charged, assessed or levied by any taxing authority with respect to the Property, the Building, the Common Facilities and any other improvements on

the Property and an allocable portion of Taxes with respect to other portions of the Carnegie center Complex, less any refunds or rebates (net of expenses incurred in obtaining any such refunds or rebates) of Taxes actually received by the Landlord during such calendar year with respect to any period during the Term for the benefit of the Tenant, tenants of Other Leased Premises and the Landlord. If during the Term there shall be a change in the means or methods of taxing real property generally in effect at the beginning of the Term and another type of tax or method of taxation should be substituted in whole or in part for, or in lieu of, Taxes, the amounts calculated under such other types of tax or by such other methods of taxation shall also be deemed to be Taxes. Until such time as the actual amount of Taxes for any calendar year becomes known, the amount thereof shall be the Landlord's estimate of Taxes for that calendar year.

40 "Tenant" means the person so designated at the beginning of this Agreement.

41 "Tenant Electric Charges" means (a) during Regular Business Hours, none and (b) during other than Regular Business Hours, a charge at the rate of \$75.00 per hour or partial hour of use.

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42 "Tenant Plan" means informal construction drawings and related construction specifications regarding the build-out of the Leased Premises including, without limiting the generality of the foregoing, the information called for by the Work Letter, complying in all respects with applicable building and fire codes and insurance underwriting standards in effect and in sufficient detail to permit skilled contractors to supply and perform the work called for therein.

43 "Tenant Plan Due Date" means September 7, 1994.

44 "Tenant's Share" of any amount means 5.16%.

45 "Term" means the Initial Term plus, at the time of reference, any Renewal Term.

46 "Termination Damages" is defined in subsection 23.2 of this Agreement.

47 "Utilities Expenses" means Electric Charges (other than Tenant Electric Charges) and all charges for any other fuel that may be used in providing electricity and services powered by electricity that the Landlord provides in accordance with section 8 of this Agreement to the Building, the Leased Premises, Other Leased Premises, the Common Facilities and the Property, including sales and excise taxes and the like.

48 "Work Letter" means Exhibit C attached hereto which generally describes the type of construction of the Building.

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EXHIBIT F

ACKNOWLEDGMENT AND AMENDMENT

CARNEGIE CENTER ASSOCIATES, as Landlord, and ADVANCED MAGNETICS, INC., as Tenant, acknowledge and agree as follows:

1. The Tenant Plan, as it pertains to work other than repainting and recarpeting ("TP2"), referred to in the Lease and Lease Agreement dated September 6, 1994 (the "Agreement") between the Landlord and the Tenant for the Leased Premises, was received on 1994 by the Landlord and consists of the following:

[DESCRIPTION TO BE INSERTED]

2. Through contractors selected by it, the Landlord shall perform certain work shown on the TP2 as itemized below, in a good and workmanlike manner, and use its best efforts to achieve completion of that work in a timely manner after receipt of the TP2 at a net price to the Tenant of \$\_\_\_\_\_ (which is net of all credits to the Tenant in accordance with the Lease and which includes the Landlord's general contractor's fee).

[ITEMIZATION TO BE INSERTED]

3. The Tenant hereby authorizes the Landlord to proceed with preparation of the Leased Premises in accordance with this Acknowledgment and Amendment and the work shown on the TP2 as itemized above. Any subsequent changes in the work shown on the TP2, together with related price and schedule adjustments, shall be authorized only by a written change order signed by the Landlord and the Tenant. The price reflecting the change order, if any, shall be paid for within 30 days after completion of the work required by the change order.

4. Defined terms used herein shall have the respective meanings assigned in the Agreement.

5. Except as specifically set forth above, the Agreement will be in full force and effect in accordance with its original terms.

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Date: \_\_\_\_\_, 1994

Landlord:

By: Metric Construction & Development, its Affiliate

By: \_\_\_\_\_  
George Waugh  
Director of Construction

Tenant: ADVANCED MAGNETICS, INC.

Date: \_\_\_\_\_, 1994

By: \_\_\_\_\_  
Jerome M. Lewis  
Vice President  
Scientific Operations







14. SUBORDINATION This lease shall be subject and subordinate to any and all mortgages, deeds of trust and other instruments in the nature of a mortgage, now or at any time hereafter, a lien or liens on the property of which the leased premises are a part and the LESSEE shall, when requested, promptly execute and deliver such written instruments as shall be necessary to show the subordination of this lease to said mortgages, deeds of trust or other such instruments in the nature of a mortgage.
15. LESSOR'S ACCESS The LESSOR or agents of the LESSOR may, at reasonable times, enter to view the leased premises and may remove placards and signs not approved and affixed as herein provided, and make repairs and alterations as LESSOR should elect to do and may show the leased premises to others, and at any time within three (3) months before the expiration of the term, may affix to any suitable part of the leased premises a notice for letting or selling the leased premises or property of which the leased premises are a part and keep the same so affixed without hindrance or molestation.
16. INDEMNIFICATION AND LIABILITY (fill in) The LESSEE shall save the LESSOR harmless from all loss and damage to Lessee's property occasioned by the use or escape of water or by the bursting of pipes, as well as from any claim or damage resulting from neglect in not removing snow and ice from the roof of the building or from the sidewalks bordering upon the premises so leased, or by any nuisance made or suffered on the leased premises, unless such loss is caused by the neglect of the LESSOR. The removal of snow and ice from the sidewalks bordering upon the leased premises shall be Lessee's responsibility. The Lessor shall machine snow-plow the paved parking area.
17. LESSEE'S LIABILITY INSURANCE (fill in) The LESSEE shall maintain with respect to the leased premises and the property, of which the leased premises are a part, comprehensive public liability insurance in the amount of \$1,000,000.  
with property damage insurance in limits of \$300,000.  
in responsible companies qualified to do business in Massachusetts and in good standing therein insuring the LESSOR as well as LESSEE against injury to persons or damage to property as provided. The LESSEE shall deposit with the LESSOR certificates for such insurance at or prior to the commencement of the term, and thereafter within thirty (30) days prior to the expiration of any such policies. All such insurance certificates shall provide that such policies shall not be cancelled without at least ten (10) days prior written notice to each assured named therein.
18. FIRE, CASUALTY-EMINENT DOMAIN Should a substantial portion of the leased premises, or of the property of which they are a part, be substantially damaged by fire or other casualty, or be taken by eminent domain, the LESSOR may elect to terminate this lease. When such fire, casualty, or taking renders the leased premises substantially unsuitable for their intended use, a just and proportionate abatement of rent shall be made, and the LESSEE may elect to terminate this lease if:
- (a) The LESSOR fails to give written notice within thirty (30) days of intention to restore leased premises, or
  - (b) The LESSOR fails to restore the leased premises to a condition substantially suitable for their intended use within ninety (90) days of said fire, casualty, or taking.
- The LESSOR reserves, and the LESSEE grants to the LESSOR, all rights which the LESSEE may have for damages or injury to the leased premises for any taking by eminent domain, except for damage to the LESSEE's fixtures, property, or equipment.

19. DEFAULT  
AND  
BANKRUPTCY

In the event that:

- (a) The LESSEE shall default in the payment of any installment of rent or other sum herein specified and such default shall continue for ten (10) days after written notice thereof; or
- (b) The LESSEE shall default in the observance or performance of any other of the LESSEE's covenants, agreements, or obligations hereunder and such default shall not be corrected within thirty (30) days after written notice thereof; or
- (c) The LESSEE shall be declared bankruptcy or insolvent according to law, or, if any assignment shall be made of LESSEE's property for the benefit of creditors,

then the LESSOR shall have the right thereafter, while such default continues, to re-enter and take complete possession of the leased premises, to declare the term of this lease ended, and remove the LESSEE's effects, without prejudice to any remedies which might be otherwise used for arrears of rent or other default. The LESSEE shall indemnify the LESSOR against all loss of rent and other payments which the LESSOR may incur by reason of such termination during the residue of the term. If the LESSEE shall default, after reasonable notice thereof, in the observance or performance of any conditions or covenants on LESSEE's part to be observed or performed under or by virtue of any of the provisions in any article of this lease, the LESSOR, without being under any obligation to do so and without thereby waiving such default, may remedy such default for the account and at the expense of the LESSEE. If the LESSOR makes any expenditures or incurs any obligations for the payment of money in connection therewith, including but not limited to, reasonable attorney's fees in instituting, prosecuting or defending any action or proceeding, such sums paid or obligations insured, with interest at the rate of six (6) per cent per annum and costs, shall be paid to the LESSOR by the LESSEE as additional rent.

20. NOTICE  
(fill in)

Any notice from the LESSOR to the LESSEE relating to the leased premises or to the occupancy thereof, shall be deemed duly served, if mailed to the leased premises, registered or certified mail, return receipt requested, postage prepaid, addressed to the LESSEE. Any notice from the LESSEE to the LESSOR relating to the leased premises or to the occupancy thereof, shall be deemed duly served, if mailed to the LESSOR by registered or certified mail, return receipt requested, postage prepaid, addressed to the LESSOR at such address as the LESSOR may from time to time advise in writing. All rent and notices shall be paid and sent to the LESSOR at P.O. Box 269, Newton, MA 02160.

21. SURRENDER

The LESSEE shall at the expiration or other termination of this lease remove all LESSEE's goods and effects from the leased premises, (including, without hereby limiting the generality of the foregoing, all signs and lettering affixed or painted by the LESSEE, either inside or outside the leased premises). LESSEE shall deliver to the LESSOR the leased premises and all keys, locks thereto, and other fixtures connected therewith and all alterations and additions made to or upon the leased premises, in the same condition as they were at the commencement of the term, or as they were put in during the term hereof, reasonable wear and tear and damage by fire or other casualty only excepted. In the event of the LESSEE's failure to remove any of

LESSEE's property from the premises, LESSOR is hereby authorized, without liability to LESSEE for loss or damage thereto, and at the sole risk of LESSEE, to remove and store any of the property at LESSEE's expense, or to retain same under LESSOR's control or to sell at public or private sale, without notice any or all of the property not so removed and to apply the net proceeds of such sale to the payment of any sum hereunder, or to destroy such property.

22. OTHER PROVISION

It is also understood and agreed that the attached RIDER, PLAN, and GUARANTY are parts of this lease.

IN WITNESS WHEREOF, the LESSOR and LESSEE have hereunto set their hands and common seals this 24th day of October 1997

/s/ John Sain  
-----  
LESSOR Silver Lake Realty Trust

/s/ Francis E. Capitanio, President  
-----  
LESSEE Kalisto Biologicals, Inc.

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RIDER TO LEASE, DATED OCTOBER 24, 1997, BETWEEN SILVER LAKE REALTY TRUST AND KALISTO BIOLOGICALS, INC., FOR PREMISES AT 1480 SOLDIERS FIELD ROAD, BRIGHTON, MASS.:

22.A. EXTENSION PRIVILEGE

AND RENT: The Lessee shall have the right to extend the lease for one additional term of five years commencing November 1, 2002, exercisable by notice to the Lessor, as provided in Section 20. herein, on or before May 1, 2002.

During the extension term, if exercised, the base rent shall be \$153,600. per year, adjusted annually to reflect the change in the cost of living according to the change in the Consumer Price Index (CPI-U\*) over that for 2001, according to the following formula:

$$\text{Rent for year commencing} = \$153,600.00 \times \frac{\text{CPI-U July 200x}}{\text{CPI-U July 2001}}$$

November 1, 200x

\* where the CPI-U is the Consumer Price Index, All Urban Consumers, All Items, (1982-84 = 100), Boston, Mass. Should this index be unavailable or inapplicable, comparable data shall be used.

Notwithstanding the above, the base rent for the extension term shall not be less than \$153,600. per year, nor be reduced from one year to the next.

22.B. BASE RENT:

The Lessee shall pay to the Lessor Base Rent as per the following schedule:

Nov. 1, 1997- April 30, 1998:	\$10,500. per month;	
May 1, 1998 - Oct. 31, 1998:	\$11,000. per month;	
Nov. 1, 1998 - Oct. 31, 1999:	\$138,000. per year,	\$11,500. per mo.;
Nov. 1, 1999 - Oct. 31, 2000:	\$144,000. per year,	\$12,000. per mo.;
Nov. 1, 2000 - Oct. 31, 2001:	\$148,800. per year,	\$12,400. per mo.;
Nov. 1, 2001 - Oct. 31, 2002:	\$153,600. per year,	\$12,800. per mo.

Base rent shall be payable in advance on the first day of each month. Base Rent for November 1997 shall be paid

upon execution of the lease.

Rents or other sums due hereunder not received by the 10th day of the month shall be subject to interest at the rate of 18% per annum from the first day of the month.

22.C. ADDITIONAL RENT: Lessee shall pay to the Lessor as Additional Rent:

- Reimbursement for 50% of real estate taxes levied against the land and building of which the premises are a part.
- Reimbursement for 50% of premiums for "all-risk" insurance, including loss of rent, on the building and improvements thereto.
- Reimbursement for 100% of common area costs including but not limited to landscaping, snowplowing, and exterior lighting. (If and when other tenant(s) occupy the building, an equitable adjustment will be made.) The Lessor represents that such common area costs shall be typical of similar buildings in the area.

Lessee shall pay this Additional Rent as estimated by Lessor, in 1/12th installments payable in advance on the first day of each month. At reasonable intervals, Lessor shall provide Lessee with updated estimates of these expenses, and over- or under-payments shall be credited or debited to the Lessee. Lessor's initial estimate of the Additional Rent is \$3,000.00 per month.

Lessee shall pay the Additional Rent for November 1997 upon execution of this lease.

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22.D. MAINTENANCE

(Continued):

Any sign to be erected by Lessee shall be installed in accordance with applicable building codes, and in accordance with section 11. herein.

The Lessor shall be responsible for the structural integrity of the building, the roof, and repairs and maintenance of the building common areas and exterior.

The Lessee shall be responsible for interior cleaning, disposal of debris, maintenance, and repairs, including maintenance and repairs to the freight elevator, HVAC, electrical and plumbing systems servicing its premises.

22.E. LEASEHOLD

IMPROVEMENTS:

Upon execution of the lease, the Lessor shall put all building systems, including the freight elevator, in good working order; and segregate the utilities to provide separate metering. Lessor shall also be responsible for putting the associated parking lot and landscaping in good condition. Lessor shall complete such work in a timely manner.

The Lessee shall be responsible for the installation of vinyl tile throughout the lab areas (including removal of existing carpet) as well as any other changes or improvements associated with Lessee's intended use. The Lessee shall also be responsible for the removal of any resulting debris. Lessee will obtain Lessor's permission pursuant to section 12. herein prior to making any alterations to the leased premises. All work

to be done according to applicable building codes and in a good and workmanlike manner.

Upon full execution of this lease, including payment of security deposit and first month's rent, Lessee may have early occupancy of the premises to commence its improvements.

- 22.F. PARKING: The Lessee shall have the use of 35 parking spaces in the associated common parking lot. Lessor reserves the right to establish reasonable rules and regulations governing parking for the property.
- 22.G. LABORATORY USE: The Lessee shall comply with all applicable governmental codes and regulations in its use of the laboratory within the premises, and shall effect, at its sole expense, any modifications to the premises required for such compliance.
- 22.H. ENVIRONMENT: The Lessee shall not permit any hazardous materials or substances to be used, stored, or disposed of improperly or in conflict with any law, ordinance or code, and Lessee shall be solely responsible for any and all contamination or other damage associated with use, control or disposal of same by Lessee.
- 22.I. ELEVATOR: Lessor shall modify the area on the first floor of the building as shown on the attached PLAN in order to provide Lessee access to the freight elevator.

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PLAN  
----

PREMISES LEASE TO KALISTO BIOLOGICALS, INC.  
(2nd Floor)

[SECOND FLOOR PLAN]

[FIRST FLOOR PLAN]  
(not included)

1480 SOLDIERS FIELD ROAD, BRIGHTON, MASSACHUSETTS

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GUARANTY

FOR VALUE RECEIVED, and in consideration for and as an inducement to the Lessor to make the forgoing lease with Kalisto Biologicals, Inc., as Lessee, the undersigned Advanced Magnetics, Inc. 725 Concord Ave., Cambridge, MA 02138, unconditionally guarantees the full performance and observance of the provisions

of the lease to be performed and observed by Lessee, Lessee's successors' and assigns, and expressly agrees that the validity of this agreement and the obligations of the guarantor hereunder shall in no ways be terminated, affected or impaired by reason of the granting by the Lessor of any indulgences to Lessee or by reason of the assertion by Lessor against Lessee of any of the rights or remedies reserved to Lessor pursuant to the lease.

The undersigned guarantor has duly executed this instrument this 24th day of October, 1997.

-----  
Advanced Magnetics, Inc.  
By Jerome Goldstein its CEO & CHAIRMAN OF THE BOARD  
-----

COMMONWEALTH OF MASSACHUSETTS

ss. Middlesex

Date 10/24/97

Then personally appeared the above named JEROME GOLDSTEIN, and acknowledged the foregoing to be his free act and deed, before me,

/s/ Marlene Kaplan Goldstein

-----  
Notary Public  
My Commission Expires: 4/7/00

## EXHIBIT 11.1

## ADVANCED MAGNETICS, INC.

STATEMENT RE: COMPUTATION OF PER SHARE EARNINGS  
YEARS ENDED SEPTEMBER 30, 1997, 1996 AND 1995

	1997	1996	1995
	-----	-----	-----
Weighted average number of shares issued and outstanding.....	6,744,946	6,762,748	6,730,315
Assumed exercise of options reduced by the number of shares which could have been purchased with the proceeds of those options.....	60,286	--	140,524
Assumed exercise of warrants reduced by the number of shares which could have been purchased with the proceeds of those warrants.....	--	--	--
Weighted average number of common and equivalent shares.....	6,805,232	6,762,748*	6,870,839

\*Due to the net loss for fiscal 1996, computation of per share earnings includes only the weighted average number of shares issued and outstanding.

## CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the Registration Statements of Advanced Magnetics, Inc. on Form S-8 (File Nos. 33-8697, 33-13953, 33-40744, 33-46963, and 333-28417) of our report, dated November 6, 1997, on our audits of the financial statements of Advanced Magnetics, Inc. as of September 30, 1997 and 1996, and for the years ended September 30, 1997, 1996, and 1995, which report is incorporated by reference in this Annual Report on Form 10-K.

COOPERS & LYBRAND LLP

Boston, Massachusetts  
December 19, 1997

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