PALATIN TECHNOLOGIES, INC.
(Exact name of small business issuer as specified in its charter)
As of May 14, 1997, 11,825,855 shares of the Issuer's common stock, par value $.01 per share, were outstanding.

Transitional Small Business Disclosure Format: [X] Yes    [ ] No

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## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

**PALATIN TECHNOLOGIES, INC.**  
(A Development Stage Enterprise)  
**CONSOLIDATED BALANCE SHEETS**  
(unaudited)

<table>
<thead>
<tr>
<th></th>
<th>March 31, 1997</th>
<th>June 30, 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$ 4,863,237</td>
<td>$ 6,791,300</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>267,870</td>
<td>4,574</td>
</tr>
<tr>
<td>Prepaid expenses and other</td>
<td>59,137</td>
<td>66,430</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total current assets</td>
<td>$ 5,190,244</td>
<td>$ 6,862,304</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment, net of accumulated depreciation of $222,174 and $183,535 as of March 31, 1997 and June 30, 1996, respectively</td>
<td>186,008</td>
<td>96,354</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intangibles, net of accumulated amortization of $98,782 and $91,336 as of March 31, 1997 and June 30, 1996, respectively</td>
<td>75,940</td>
<td>82,547</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$ 5,452,192</td>
<td>$ 7,041,205</td>
</tr>
<tr>
<td><strong>LIABILITIES AND STOCKHOLDERS' EQUITY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$ 216,572</td>
<td>$ 214,424</td>
</tr>
<tr>
<td>Accrued compensation owed to employees</td>
<td>$ 78,084</td>
<td></td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>311,048</td>
<td>655,197</td>
</tr>
<tr>
<td>Current portion of long term financing, including accrued interest of $352,829 and $38,912 as of March 31, 1997 and June 30, 1996, respectively</td>
<td>926,950</td>
<td>311,695</td>
</tr>
<tr>
<td>Senior bridge notes, including related party transaction of $110,000 as of June 30, 1996</td>
<td>1,100,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>1,464,570</td>
<td>2,359,400</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term financing, including accrued interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
——of $0 and $273,339 as of March 31, 1997 and
——June 30, 1996, respectively 968,527 1,727,619
——Deferred license revenue 550,000
——Notes payable to stockholders, including accrued
——interest of $41,979 and $35,979 as of
——March 31, 1997 and June 30, 1996, respectively 121,979 115,979
——Total liabilities 3,105,076 4,202,998

Stockholders' equity:
——Preferred stock, $.01, and 2,000,000 shares
——authorized, as of March 31, 1997 and June 30, 1996;
——and 30,630 and no shares issued as of March 31, 1997
——and June 30, 1996, respectively 3,221,120
——Common stock, $.01, and 25,000,000 shares authorized,
——as of March 31, 1997 and June 30, 1996; and
——11,753,978 and 11,538,777 issued as of March 31, 1997
——and June 30, 1996, respectively 117,540 115,388
——Treasury stock, 1,229 shares of Common Stock (1,667) (1,667)
——Additional paid in capital 11,018,039 10,804,394
——Common stock earned but not issued 279,278 53,030
——Unamortized deferred compensation (88,221)
——Deficit accumulated during the development stage (12,198,973) (8,132,938)
——Total stockholders' equity 2,347,116 2,838,207

—— $ 5,452,192 $ 7,041,295

The accompanying notes to consolidated financial statements are an integral part of these balance sheets.

PAlATIN TECHNOLOGIES, INC.
(A Development Stage Enterprise)
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
## REVENUES:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants and contracts</td>
<td>267,862</td>
<td>-</td>
<td>267,862</td>
<td>-</td>
<td>3,128,374</td>
</tr>
<tr>
<td>License fees and royalties</td>
<td>350,000</td>
<td>350,000</td>
<td></td>
<td></td>
<td>684,296</td>
</tr>
<tr>
<td>Sales</td>
<td>-</td>
<td>12,240</td>
<td>22,184</td>
<td>20,971</td>
<td>318,917</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total revenues</td>
<td>617,862</td>
<td>12,240</td>
<td>40,046</td>
<td>20,971</td>
<td>4,131,587</td>
</tr>
</tbody>
</table>

## EXPENSES:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Research and development</td>
<td>1,050,400</td>
<td>242,212</td>
<td>2,300,669</td>
<td>557,955</td>
<td>6,697,077</td>
</tr>
<tr>
<td>General and administrative</td>
<td>793,370</td>
<td>405,111</td>
<td>1,740,125</td>
<td>1,017,061</td>
<td>6,643,086</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total expenses</td>
<td>1,843,770</td>
<td>647,323</td>
<td>4,040,794</td>
<td>1,575,016</td>
<td>13,340,163</td>
</tr>
</tbody>
</table>

## OTHER INCOME (EXPENSES):

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Other income</td>
<td>36,330</td>
<td>-</td>
<td>159,023</td>
<td>-</td>
<td>230,403</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(84,927)</td>
<td>(143,465)</td>
<td>(301,200)</td>
<td>(348,121)</td>
<td>(1,344,386)</td>
</tr>
<tr>
<td>Placement agent commissions and fees on debt offering</td>
<td>(101,541)</td>
<td>(135,341)</td>
<td>(168,970)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merger costs</td>
<td>17,419</td>
<td>(9,611)</td>
<td>17,419</td>
<td>(9,611)</td>
<td>(457,581)</td>
</tr>
<tr>
<td>Restructuring charge</td>
<td>(24,309)</td>
<td>-</td>
<td>(114,309)</td>
<td>-</td>
<td>(450,006)</td>
</tr>
<tr>
<td>Net intangibles write down</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(259,334)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total other income (expenses)</td>
<td>(31,178)</td>
<td>(278,926)</td>
<td>(124,758)</td>
<td>(607,382)</td>
<td>(2,449,868)</td>
</tr>
</tbody>
</table>

## NET LOSS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1,257,086)</td>
<td>(914,009)</td>
<td>(3,525,506)</td>
<td>(2,161,427)</td>
<td>11,658,444</td>
</tr>
<tr>
<td>Weighted average number of common shares outstanding</td>
<td>11,745,837</td>
<td>1,294,792</td>
<td>11,618,271</td>
<td>1,290,451</td>
<td>1,948,514</td>
</tr>
<tr>
<td>Net loss per common share</td>
<td>(0.11)</td>
<td>(0.71)</td>
<td>(0.30)</td>
<td>(1.67)</td>
<td>(5.98)</td>
</tr>
</tbody>
</table>

The accompanying notes to consolidated financial statements are an integral part of these statements.
Inception

Nine Months Ended              (January 28, 1986)
March 31,                        through
1997             1996              March 31, 1997
--------------     --------------     --------------------

CASH FLOWS FROM OPERATING ACTIVITIES:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net loss</td>
<td>(3,525,506)</td>
<td>(2,161,428)</td>
<td>(11,658,444)</td>
</tr>
</tbody>
</table>

Adjustments to reconcile net loss to net cash used for operating activities:

<table>
<thead>
<tr>
<th>Description</th>
<th>1997</th>
<th>1996</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation and amortization</td>
<td>46,085</td>
<td>58,788</td>
<td>354,659</td>
</tr>
<tr>
<td>Interest expense on related-party debt</td>
<td>6,000</td>
<td>6,000</td>
<td>59,387</td>
</tr>
<tr>
<td>Accrued interest on long-term financing</td>
<td>226,248</td>
<td>247,407</td>
<td>1,022,286</td>
</tr>
<tr>
<td>Accrued interest on short-term financing</td>
<td>(100,000)</td>
<td>93,510</td>
<td>7,936</td>
</tr>
<tr>
<td>Intangibles and equipment write down</td>
<td>-</td>
<td>-</td>
<td>278,318</td>
</tr>
<tr>
<td>Deferred license revenue</td>
<td>550,000</td>
<td>550,000</td>
<td></td>
</tr>
<tr>
<td>Accretion of compensatory options and warrants</td>
<td>-</td>
<td>-</td>
<td>296,047</td>
</tr>
<tr>
<td>Settlement with consultant</td>
<td>-</td>
<td>-</td>
<td>(28,731)</td>
</tr>
<tr>
<td>Changes in certain operating assets and liabilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>(263,295)</td>
<td>(2,999)</td>
<td>(267,869)</td>
</tr>
<tr>
<td>Prepaid expenses and other</td>
<td>7,293</td>
<td>(12,761)</td>
<td>(59,137)</td>
</tr>
<tr>
<td>Intangibles</td>
<td>(839)</td>
<td>(15,833)</td>
<td>(428,177)</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>2,148</td>
<td>(82,329)</td>
<td>215,672</td>
</tr>
<tr>
<td>Accrued compensation owed to employees</td>
<td>(78,984)</td>
<td>27,126</td>
<td>16,548</td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>(344,149)</td>
<td>27,097</td>
<td>339,779</td>
</tr>
</tbody>
</table>

Net cash used for operating activities               | 3,358,021  | (1,815,422)| (9,185,648)|

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchases of property and equipment                   | (128,293)  | (9,513)    | (463,522)  |

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from notes payable, related party            |            |            | 302,000    |
Payments on notes payable, related party               | (302,000)  | (309,936)  |            |
Proceeds from senior bridge notes payable             | 1,850,000  | 1,850,000  |            |
Payments on senior bridge notes                        | (1,000,000) | (1,850,000)|            |
Proceeds from notes payable and long term financing   |            |            | 1,951,327  |
Payments on notes payable and long term financing      | (133,837)  | (45,000)   | (323,898)  |
Proceeds from paid in capital from common stock warrants | 9,999      | 109,999    |            |
Proceeds from common stock, stock option               |            |            |            |
issuances and preferred stock, net                    | 2,682,089  | 305,617    | 12,784,581 |
Purchase of treasury stock and fractional shares       |            |            | (1,667)    |

Net cash provided by financing activities             | 1,558,251  | 1,808,617  | 14,512,407 |

NET INCREASE (DECREASE) IN CASH                        | (1,928,063)| (16,318)   | 4,863,237  |
CASH and cash equivalents, beginning of period                  6,791,300             46,768                  -
--------------     --------------     ---------------
CASH and cash equivalents, end of period                     $  4,863,237        $    30,450       $  4,863,237
==============     ==============     ===============

The accompanying notes to consolidated financial statements are an integral part of these statements.

5

PALATIN TECHNOLOGIES, INC.
(A Development Stage Enterprise)
Notes to Consolidated Financial Statements (Unaudited)
For the Nine Months Ended March 31, 1997 and 1996

(1) Nature of Business

Through its wholly-owned subsidiary RhoMed Incorporated ("RhoMed"), Palatin Technologies, Inc. (the "Company") is a development-stage biopharmaceutical company dedicated to developing and commercializing products and technologies for diagnostic imaging, cancer therapy and ethical drug development utilizing peptide, monoclonal antibody and radiopharmaceutical technologies. The Company was incorporated under the laws of the State of Delaware on November 21, 1986. Since June 25, 1996, the effective date of the merger (the "Merger") of a wholly-owned subsidiary of the Company with and into RhoMed, all outstanding shares of RhoMed equity securities were exchanged for the Company's common stock, $.01 par value per share (the "Common Stock"). The business of RhoMed represents the on-going business of the Company.

As a result of the Merger, RhoMed became a wholly-owned subsidiary of the Company, with the holders of RhoMed preferred stock and RhoMed common stock (including the holders of "RhoMed Derivative Securities" as hereafter defined) receiving an aggregate of approximately 96% interest in the equity securities of the Company on a fully-diluted basis. Additionally, all warrants and options to purchase common stock of RhoMed outstanding immediately prior to the Merger (the "RhoMed Derivative Securities"), including without limitation, any rights underlying RhoMed's qualified or nonqualified stock option plans, were automatically converted into rights upon exercise to receive the Company's Common Stock in the same manner in which the shares of RhoMed common stock were converted. Since the former stockholders of RhoMed retained more than a 50% controlling interest in the surviving company (Palatin Technologies, Inc.), the Merger was accounted for as a reverse merger. The historical financial statements prior to June 25, 1996, are those of RhoMed, except that the net loss per common share has been stated on an as if converted basis.

Since its inception, RhoMed has devoted substantially all of
its efforts and resources to the research and development of its technology. RhoMed has experienced operating losses in each year since its inception and, as of March 31, 1997, the Company, including its wholly-owned subsidiary RhoMed, had a deficit accumulated during the development stage of $12,198,973. The Company expects to incur additional operating losses over the next several years and expects cumulative losses to increase as the Company’s research and development and clinical testing efforts continue and expand. The ultimate completion of the Company’s development projects is contingent upon a number of factors, including the successful completion of technology and product development, obtaining required regulatory approvals and additional financing and, ultimately, successfully commercializing its products and achieving profitable operations.

(2) Basis of Presentation

The accompanying financial statements have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “Commission”). Certain information and footnote disclosure normally included in the Company’s audited annual financial statements has been condensed or omitted in the Company’s interim financial statements. In the opinion of the Company, these financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of the Company as of March 31, 1997 and June 30, 1996, and the results of operations for the three and nine month periods ended March 31, 1997 and 1996 and cash flows for the nine months ended March 31, 1997 and 1996, and for the period from inception (January 28, 1986) to March 31, 1997. The results of operations for the interim period may not necessarily be indicative of the results of operations expected for the full year, except that the Company expects to incur a significant loss for the fiscal year ended June 30, 1997.

The accompanying financial statements and the related notes should be read in conjunction with the Company’s audited financial statements for the ten months ended June 30, 1996 and the fiscal years ended August 31, 1995 and 1994 filed with the Company’s Form 10-KSB for the transition period from September 1, 1995 to June 30, 1996.

(3) Summary of Significant Accounting Policies:

Research and Development Costs -- The costs of research and development activities are expensed as incurred.

Net Loss per Common Share -- Net loss per common share is calculated based upon the weighted average number of shares of Common Stock, on an as if converted basis, outstanding during
each period. All options and warrants were excluded in the
calculation of weighted average shares outstanding since their
inclusion would have had, in the aggregate, an anti-dilutive
effect.

In February 1997, the Financial Accounting Standards Board
issued Statement of Financial Accounting Standard No. 128 (SFAS
128), "Earnings per Share." The statement is effective for
financial statements for periods ending after December 15, 1997,
and changes the method in which earnings per share will be
determined. Adoption of this statement by the Company will not
have a material impact on earnings per share.

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

(4) Senior Bridge Notes:

On July 28, 1995, the Board of Directors of RhoMed
authorized an offering of up to 40 units at $25,000 per unit,
with each unit consisting of a $25,000 face amount Senior Bridge
Note and a Class A Warrant to purchase 75,000 shares of RhoMed
common stock (equivalent to 13,285 shares of Common Stock) at an
exercise price of $.01 per share (the "Class A Note and Warrant
Offering"). The Senior Bridge Notes sold in the Class A Note and
Warrant Offering (the "Senior Bridge Notes") bore interest at 1%
per month, and were payable, with accrued interest, one year from
the date of issuance. All of the 40 Class A Note and Warrant
Offering units were purchased with proceeds prior to commissions
and expenses of $1,000,000. In August and September of 1996, the
Senior Bridge Notes sold in the Class A Note and Warrant Offering
were repaid in full, totaling $1,000,000 of principal and
$120,000 of accrued interest.

(5) Series A Preferred Stock:

On December 2, 1996, the Company commenced an offering of
units of Series A Preferred Stock (the "Series A Offering") at a
price of $100,000 per unit, with each unit consisting of 1,000
shares of Series A Preferred Stock. As of March 31, 1997, the
Company had sold 30.63 units, representing 30,630 shares of
Series A Preferred Stock, for net proceeds to the Company of
$2,680,591, after deducting commission and other expenses of the
Series A Preferred Stock offering. The final closing on the
Series A Offering was effective as of May 9, 1997, with the
Company having sold an aggregate total of 137.78 units, representing 137,780 shares of Series A Preferred Stock, for gross proceeds of $13,778,000 and net proceeds to the Company of approximately $11,800,000, after deducting commission and other expenses of the Series A Offering.

Each share of Series A Preferred Stock is convertible, at the option of the holder thereof, into shares of Common Stock at a conversion price of $1.24. The $1.24 represents a discount of 15% to the average closing bid price of the Common Stock for the twenty (20) consecutive trading days immediately preceding the final closing. The 15% discount has been reflected in the Company's financial statements as a dividend to Series A Preferred Stock and an increase in the deficit accumulated during the development stage of $540,529. The Series A Preferred Stock also contains a reset mechanism (see Part II, Item 2, "Change in Securities"). The Series A Preferred Stock may be mandatorily converted by the Company, if, commencing May 9, 1998, the closing bid price of the Common Stock exceeds 200% of the then applicable conversion price for at least twenty (20) trading days in any thirty (30) consecutive trading day period ending three (3) days prior to the date of conversion.

In the event that the Company does not, by February 3, 1998, increase its authorized capital to at least that number of shares of Common Stock necessary for issuance upon exercise of all Series A Preferred Stock sold in the Series A Offering, the Company has agreed that the holders of Series A Preferred Stock shall be entitled, at the option of each holder to either: (i) require the Company to repurchase all shares of Series A Preferred Stock then held by such holder at $100.00 per share of Series A Preferred Stock, or (ii) require the Company to purchase at fair market value that portion of the shares which would have been issuable to the holder upon conversion but which the Company was unable to issue due to the lack of authorized and reserved shares of Common Stock. The fair market value per share of Common Stock shall be paid in cash, or, if the Company does not have sufficient cash, then with secured demand notes, the fair market value shall mean the closing bid price per share of the Common Stock as quoted on the OTC Bulletin Board for the trading day immediately preceding the conversion.

The securities offered in the Series A Offering have not been registered under the Securities Act of 1933, as amended, and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. The Company has agreed to file, no later than July 8, 1997, a registration statement under the Securities Act to
permit resales of the Common Stock issuable upon conversion of
the Series A Preferred Stock.

(6) Equipment:

Equipment consists of the following at March 31, 1997 and June
30, 1996:

<table>
<thead>
<tr>
<th></th>
<th>March 31, 1997</th>
<th>June 30, 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office equipment</td>
<td>$257,470</td>
<td>$202,960</td>
</tr>
<tr>
<td>Laboratory equipment</td>
<td>83,285</td>
<td>76,929</td>
</tr>
<tr>
<td>Leasehold improvements</td>
<td>67,427</td>
<td>--</td>
</tr>
<tr>
<td></td>
<td>--------------</td>
<td>--------------</td>
</tr>
<tr>
<td>Equipment at cost</td>
<td>$408,182</td>
<td>$279,889</td>
</tr>
<tr>
<td>Less: Accumulated</td>
<td></td>
<td></td>
</tr>
<tr>
<td>depreciation</td>
<td>$222,174</td>
<td>$183,535</td>
</tr>
<tr>
<td></td>
<td>--------------</td>
<td>--------------</td>
</tr>
<tr>
<td>$ 186,008</td>
<td>$ 96,354</td>
<td></td>
</tr>
</tbody>
</table>

(7) Commitments and Contingencies:

Leases -- The Company leases certain of its facilities and
equipment under noncancellable operating leases. In October 1996,
the lease on the facility in Albuquerque, New Mexico was extended
from March 31, 1997 until August 31, 1997, and in March 1997, the
lease was amended to provide for optional extensions through December
31, 1997. In March 1997, the Company entered into a ten-year lease
on research and development facilities in Edison, New Jersey, with
the lease term expected to commence in July 1997. Minimum future
lease payments escalate from approximately $116,000 per year to
$200,000 per year after the fifth year of the lease term. The lease
will expire in fiscal year 2007.

Merger Costs -- In conjunction with the Merger which occurred on
June 25, 1996, costs of $475,000 were charged to operations for the
ten months ended June 30, 1996. With no additional Merger costs
anticipated, the remaining accrual of $17,419 was written off as of
March 31, 1997.

Restructuring Charge -- In conjunction with the Company’s
decision to consolidate and relocate its research and development
facilities and executive offices in the New Jersey area, the Company
established a restructuring charge of $450,000. The restructuring
charge to date represents mainly severance costs, facility closing
expenses and recruiting fees. Included in accrued expenses at March
31, 1997, is $60,057 of this restructuring charge.

Item 2. Management’s Discussion and Analysis of Financial
Condition and Results of Operations.
General

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto filed as part of this Form 10-QSB. Unless otherwise indicated herein, all references to the Company include Palatin Technologies, Inc. and its wholly owned subsidiary, RhoMed.

Certain statements in the Company's Form 10-QSB contain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance, or achievements express or implied by such forward looking statement.

The Company's business is subject to significant risks, including the uncertainties associated with product development of pharmaceutical products, problems or delays with clinical trials, failure to receive or delays in receiving regulatory approval, lack of enforceability of patents and proprietary rights, industry capacity, industry trends, competition, material costs and availability, changes in business strategy or development plans, quality of management, availability of capital, availability of qualified personnel, the effect of government regulation and other risks detailed in the Company's Commission filings, including the Company's Form 10-KSB for the transition period from September 1, 1995 to June 30, 1996. The Company expects to incur substantial operating losses over the next several years due to continuing expenses associated with its research and development programs, including pre-clinical testing, clinical trials and manufacturing. Operating losses may also fluctuate from quarter to quarter as a result of differences in the timing of expenses incurred.

Results of Operations

Three and Nine Month Periods Ended March 31, 1997 Compared to Three and Nine Month Periods Ended March 31, 1996. During the three month period ended March 31, 1997, the Company discontinued the manufacture and sale of RhoChek, the sole product sold by the Company, due to insufficient sales. There were no revenues from the sale of products in the three month period ended March 31, 1997, compared to $12,240 in the three month period ended March 31, 1996. Revenues in the nine month period ended March 31, 1997 were $22,184 compared to $20,971 in the nine month period ended March 31, 1996. The Company anticipates no additional revenues from the sale of products in the current fiscal year.

In December 1996, the Company entered into a License Option Agreement ("Option Agreement") with Nihon Medi-Physics Ltd.
("Nihon"), pursuant to which the Company received, in January 1997, an initial payment of $900,000 net of Japanese withholding taxes of $100,000 (the "Initial Payment"). The Company has accounted for the Initial Payment in the period ended March 31, 1997 by recognizing license fee revenue of $350,000 and deferred license fee revenue of $550,000. The deferred license fee revenue will be recognized if a license agreement is consummated with Nihon or eliminated if the Company is required to repay certain monies to Nihon under the Option Agreement. There were no revenues from license fees in the three month period ended March 31, 1996.

During the three month period ended March 31, 1997, the Company had four Phase I grants under the Small Business Innovative Research program active with the National Institutes of Health of the Department of Health and Human Services. Grant revenue from these grants was $267,862 in the three month period ended March 31, 1997, compared to no revenues in the three month period ended March 31, 1996. Grant revenue in the nine month period ended March 31, 1997 was $267,862, compared to no revenues in the nine month period ended March 31, 1996. The Company has approximately $100,000 in additional grant revenue which can be drawn under the four Phase I grants. The Company recognizes the grant revenue at the time submissions are made to the respective government agencies for payment.

Research and development expenses increased to $1,050,400 for the three month period ended March 31, 1997 from $242,212 for the three month period ended March 31, 1996, with expenses of $2,300,669 for the nine month period ended March 31, 1997 compared to $557,955 for the nine month period ended March 31, 1996. The increase in expenses for both the current three and nine month periods is attributable to expansion in the scale of the Company's research and development operations, which expanded following completion of a Common Stock offering in June 1996. The Company substantially increased research and development spending, primarily relating to development of the LeuTech product for diagnostic imaging of infections, including increased expenses for manufacturing scale-up, consulting and clinical trials, and also relating to research expenses on the Company's MIDAS metallopeptide technology. The Company expects research and development expenses to continue to increase in future quarters as the Company expands manufacturing efforts and initiates clinical trials on the LeuTech product and significantly expands its efforts to develop the MIDAS metallopeptide technology including the hiring of scientists and the acquisition of equipment and supplies in conjunction with completion of the new research and development facility in Edison, New Jersey.

General and administrative expenses increased to $793,370 for the three month period ended March 31, 1997 from $405,111 for the three month period ended March 31, 1996, and increased to $1,740,125 for the nine month period ended March 31, 1997 from $1,017,061 for the nine month period ended March 31, 1996. The increase is attributable primarily to the hiring of certain key executives, the leasing of executive offices in New Jersey, and increased travel and consulting expenses. General and administrative expenses were also affected by the amortization of the value of options and warrants issued to consultants. General and administrative expenses are
expected to remain approximately at current levels through the remainder of fiscal year 1997.

Interest income was $36,330 and $159,023 for the three and nine month periods ended March 31, 1997, compared with no interest income for the three and nine month periods ended March 31, 1996. The interest income is primarily the result of interest on net proceeds from a Common Stock offering of approximately $8,400,000 completed in June 1996. Interest income is expected to increase in coming quarters as a result increased cash balances from the proceeds of the Series A Offering.

Interest expenses decreased to $84,927 for the three month period ended March 31, 1997 compared with $143,465 for the three month period ended March 31, 1996, and decreased to $301,200 from $348,121 for the nine month periods ended March 31, 1997 and 1996 respectively. Interest expense for the nine months ending March 31, 1997, is comprised of (i) interest on long-term financing provided by Aberlyn Holding Company, the principal and accrued interest of which totaled $1,905,477, (ii) interest on notes payable to stockholders, the principal amount of which is $80,000, and (iii) interest on Senior Bridge Notes which were repaid in full in the quarter ended September 30, 1996. Under an agreement with Aberlyn Holding Company, the accrued interest as of April 30, 1997, totaling $303,171, will be converted to Common Stock at a discounted rate, with the Company obligated to issue 255,641 shares of Common Stock in payment of accrued interest. As a result of repayment by the Company of the Senior Bridge Notes, the principal amount of which was $1,000,000, interest expense is expected to remain at current levels for the balance of the current fiscal year, and substantially below the levels for the prior fiscal year.

Net loss increased to $1,257,086 for the three month period ended March 31, 1997 compared with $914,009 for the three month period ended March 31, 1996, and increased to $3,525,506 for the nine month period ended March 31, 1997 compared to $2,161,427 for the nine month period ended March 31, 1996. The net loss per share decreased in both the three and nine month period ended March 31, 1997 compared to the prior year, a result related to the substantial increase in the weighted average shares outstanding. There were 11,745,837 shares of Common Stock outstanding in the three month period ended March 31, 1997 compared to 1,294,792 shares outstanding in the three month period ended March 31, 1996, and 11,618,271 shares outstanding in the nine month period ended March 31, 1997 compared to 1,290,451 shares outstanding in the nine month period ended March 31, 1996. The increase in the shares outstanding is primarily the result of issuance of 7,664,844 shares of Common Stock in connection with the sale of Common Stock completed in June 1996.

Liquidity and Capital Resources
Since its inception, the Company has incurred net operating losses and, as of March 31, 1997, had an accumulated deficit of $12,198,973. The Company has financed its net operating losses through March 31, 1997 by a series of debt and equity financings.

At March 31, 1997, the Company had cash and cash equivalents of $4,863,237. The cash is cash equivalents which are composed of: (i) the remaining net proceeds from the Company's offering of Common Stock in June 1996 which totaled approximately $8,400,000, (ii) the receipt from Nihon of $900,000 pursuant to the Agreement, and (iii) the net proceeds from the Company's Series A Offering of $2,680,591 as of March 31, 1997.

For the nine months ended March 31, 1997, the net decrease in cash amounted to $1,928,063. Cash used for operating activities was $3,358,021, net cash used for investing activities was $128,293, and cash provided by financing activities was $1,558,251, primarily from the proceeds from Series A Offering less repayment of the Senior Bridge Notes.

On December 2, 1996, the Company commenced the Series A Offering at a price of $100,000 per unit, with each unit consisting of 1,000 shares of Series A Preferred Stock. As of March 31, 1997, the Company had sold 30.63 units, representing 30,630 shares of Series A Preferred Stock, for net proceeds to the Company of $2,680,591, after deducting commission and other expenses of the Series A Offering. The final closing on the Series A Offering was effective as of May 9, 1997, with the Company having sold an aggregate total of 137.78 units, representing 137,780 shares of Series A Preferred Stock, for net proceeds to the Company of approximately $11,800,000, after deducting commission and other expenses of the Series A Offering.

Pursuant to the Option Agreement, Nihon can maintain its option to license certain products based on the Company's MIDAS metallopeptide technology provided Nihon makes certain milestone payments based on progress in product development. Nihon may exercise its right to negotiate a license at any time upon notice and payment of additional monies to the Company. In the event that the parties cannot agree on terms of a license agreement, then the Company will be required to repay certain monies to Nihon. There can be no assurance that the Company and Nihon will ever enter into a definitive license agreement, that additional payments provided for in the Option Agreement will be made, or that the strategic alliance between the Company and Nihon will result in the development or commercialization of any product.

Pursuant to the terms of the notes payable to stockholders ("Notes"), repayment of principal and interest is required 30
days after the completion of a fiscal year when the Company has net assets of at least $5,000,000.

In March 1997, the Company entered into a ten-year lease on research and development facilities in Edison, New Jersey, with the lease term expected to commence in July 1997. Minimum future lease payments escalate from approximately $116,000 per year to $200,000 per year after the fifth year of the lease term. The lease will expire in fiscal year 2007. The Company anticipates that the cost of tenant improvements, net of the landlord’s contribution, and acquisition of laboratory equipment may exceed $1,500,000.

Commencing May 1997, the Company’s monthly payments on long-term financing provided by Aberlyn Holding Company will increase to $91,695, representing payment of current interest and principal. The final monthly payment is scheduled to be made in April 1999.

The Company’s future capital requirements depend on numerous factors which cannot be quantified, including continued progress in its research and development activities, progress with pre-clinical studies and clinical trials, prosecuting and enforcing patent claims, technological and market developments, the ability of the Company to establish product development arrangements, the cost of manufacturing scale-up, effective marketing activities and arrangements, and licensing or acquisition activity.

The Company has been seeking and expects to continue to seek to license or acquire certain products and technologies. If the Company is successful in acquiring a product or technology, substantial funds may be required for such acquisition and subsequent development or commercialization. To date, the Company has not completed an acquisition and there can be no assurance that any acquisition will be consummated in the future.

The Company believes that the net proceeds from the Series A Offering of $11,800,000 as of May 9, 1997 and the Initial Payment received under the Option Agreement, together with its other cash, is sufficient to fund the Company’s projected debt obligations and fund projected operations through fiscal year 1998.

The Company anticipates incurring additional losses over at least the next several years, and such losses are expected to increase as the Company expands its research and development activities relating to its MIDAS metallopeptide technology and its radiolabeling technology. To achieve profitability, the Company, alone or with others, must successfully develop and commercialize its technologies and products, conduct pre-clinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture, introduce and market such
technologies and products. The time required to reach profitability is highly uncertain, and there can be no assurance that the Company will be able to achieve profitability on a sustained basis, if at all.

PART II - OTHER INFORMATION

Item 2. Change in Securities.

Common Stock. During the three months ended March 31, 1997 the Company sold the following shares of Common Stock which were not registered under the Securities Act:

<table>
<thead>
<tr>
<th>Date</th>
<th>Shares</th>
<th>Sold To</th>
<th>Offering Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 10, 1997</td>
<td>13,824</td>
<td>Warrant Holder</td>
<td>$750</td>
</tr>
<tr>
<td>February 14, 1997</td>
<td>13,824</td>
<td>Warrant Holder</td>
<td>$750</td>
</tr>
</tbody>
</table>

None of the shares of Common Stock were publicly offered or sold through underwriters, and no underwriting discounts or commissions were paid. The Company claimed exemption from registration pursuant to Section 4(2) of the Securities Act because each transaction was the sale of restricted stock to the exercising holder of a restricted warrant, not involving any public offering.

Series A Preferred Stock. On February 21, 1997 the Company sold units representing 30,630 shares of Series A Preferred Stock in its Series A Offering which were not registered under the Securities Act, pursuant to a private placement limited to accredited investors. The total offering price for the units was $3,063,000, with the placement agent receiving a nine percent (9%) commission, amounting to $275,670, a four percent (4%) non-accountable expense allowance, amounting to $122,520, and warrants issuable to the placement agent and its designees to purchase 3,063 shares of Series A Preferred Stock at an exercise price of $110 per share. The warrants are exercisable for five

(5) years commencing November 9, 1997. The Company claimed exemption from registration pursuant to Regulation D under the Securities Act because the Series A Offering was the sale of restricted securities to accredited investors, as defined in Rule 501 of Regulation D, and not involving any public offering.

Each share of Series A Preferred Stock is convertible, at the option of the holder thereof, into shares of Common Stock at a conversion price of $1.24. The $1.24 represents a discount of 15% to the average closing bid price of the Common Stock for the twenty (20) consecutive trading days immediately preceding the final closing. The 15% discount has been reflected in the
Company's financial statements as a dividend to Series A Preferred Stock and an increase in the deficit accumulated during the development stage of $540,529. The Series A Preferred Stock has a reset mechanism which provides that the conversion price is subject to adjustment on May 9, 1998 (the "Reset Date"), if the average closing bid price of the Common Stock for the thirty (30) consecutive trading days immediately preceding the Reset Date (the "Reset Trading Price") is less than 130% of the then applicable conversion price (a "Reset Event"). Upon the occurrence of a Reset Event, the then applicable conversion price will be reduced to the greater of (i) the Reset Trading Price divided by 1.3 and (ii) 50% of the then applicable conversion price. The conversion price is also subject to adjustment, under certain circumstances, upon the sale or issuance of Common Stock for consideration per share less than either (i) the conversion price in effect on the date of sale or issuance, or (ii) the market price of the Common Stock as of the date of the sale or issuance. Upon the occurrence of a merger, reorganization, consolidation, reclassification, stock dividend or stock split which will result in an increase or decrease in the number of shares of Common Stock outstanding the conversion price is subject to adjustment.

Series A Preferred Stock has a preference over Common Stock as to dividends and distributions. In addition, holders of Series A Preferred Stock vote on an "as if converted" basis with Common Stock as a single class (unless separate class voting is required by law), except that approval of holders of two-thirds of the Series A Preferred Stock then outstanding is required to approve (i) any alteration in the Company's charter documents or by-laws that would adversely affect the relative rights, preferences, qualifications, limitations or restrictions of the Series A Preferred Stock, (ii) the declaration or payment of any dividend on any other securities or the repurchase of any securities of the Company other than the Series A Preferred Stock, and (iii) the authorization or issuance, or increase of the authorized amount of, any security ranking prior to the Series A Preferred Stock as to liquidation, payment of dividends or distributions or voting rights.

Item 5. Other Information.

Effective as of May 9, 1996, the Company held the final closing and terminated its Series A Offering. An aggregate of 137.78 units were sold, representing 137,780 shares of Series A Preferred Stock, for gross proceeds of $13,778,000 and net proceeds to the Company of approximately $11,800,000, after deducting commission and other expenses of the Series A Offering. The issued Series A Preferred Stock is convertible to approximately 11,110,000 shares of Common Stock at the conversion price of $1.24.
Placed with accredited investors, the securities have not been registered under the Securities Act, and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. The Company has agreed, no later than July 8, 1997, to file a registration statement under the Securities Act to permit resales of the Common Stock issuable upon conversion of the Series A Preferred Stock.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits:

3.2 Bylaws of the Company
3.6 Certificate of Designation of Series A Convertible Preferred Stock of the Company, filed on February 21, 1997
4.6 Specimen Certificate for Series A Convertible Preferred Stock
10.26 1996 Stock Option Plan as Amended
27.1 Financial Data Schedule.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter for which this report is filed.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Palatin Technologies, Inc.
(Registrant)
BYLAWS OF THE COMPANY

ARTICLE I

OFFICES

SECTION 1.01. Registered Office. The registered office of PALATIN TECHNOLOGIES, INC. (the "Corporation") in the State of Delaware shall be at the principal office of The Corporation Trust Company in the City of Wilmington, County of New Castle, and the registered agent in charge thereof shall be The Corporation Trust Company.

SECTION 1.02. Other Offices. The Corporation may also have an office or offices at any other place or places within or without the State of Delaware as the Board of Directors of the Corporation (the "Board" may from time to time determine or the business of the Corporation may from time to time require
ARTICLE II

MEETINGS OF STOCKHOLDERS

SECTION 2.01. Annual Meetings. The annual meeting of stockholders of the Corporation for the election of directors of the Corporation ("Directors), and for the transaction of such other business as may properly come before such meeting, shall be held at such place, date and time as shall be fixed by the Board and designated in the notice or waiver of notice of such annual meeting; provided, however, that no annual meeting of stockholders need be held if all actions, including the election of Directors, required by the General Corporation Law of the State of Delaware (the "General Corporation Law") to be taken at such annual meeting are taken by written consent in lieu of meeting pursuant to Section 2.09 hereof.

SECTION 2.02. Special Meetings. Special meetings of stockholders for any purpose or purposes may be called by the Board or the Chairman of the Board, the President or the Secretary of the Corporation or by the recordholders of at least ten percent of the shares of common stock of the Corporation issued and outstanding ("Shares") and entitled to vote thereat, to be held at such place, date and time as shall be designated in the notice or waiver thereof.

SECTION 2.03. Notice of Meetings. (a) Except as otherwise provided by law, written notice of each annual or special meeting of stockholders stating the place, date and time of such meeting and, in the case of a special meeting, the purpose or purposes for which such meeting is to be held, shall be given personally or by first-class mail (airmail in the case of international communications) to each recordholder of Shares (a "Stockholder") entitled to vote thereat, not less than 10 nor more than 60 days before the date of such meeting. If mailed, such notice shall be deemed to be given when deposited in the United States mail, postage prepaid, directed to the Stockholder at such Stockholder's address as it appears on the records of the Corporation. If, prior to the time of mailing, the Secretary of the Corporation (the "Secretary") shall have received from any Stockholder a written request that notices intended for such Stockholder are to be mailed to some address other than the address that appears on the records of the Corporation, notices intended for such Stockholder shall be mailed to the address designated in such request.

(b) Notice of a special meeting of Stockholders may be given by the person or persons calling the meeting, or, upon the written request of such person or persons, such notice shall be given by the Secretary on behalf of such person or persons. If the person or persons calling a special meeting of Stockholders give notice thereof, such person or persons shall deliver a copy of such notice to the Secretary. Each request to the Secretary for the giving of notice of a special meeting of Stockholders shall state the purpose or purposes of such meeting.

SECTION 2.04. Waiver of Notice. Notice of any annual or special
meeting of Stockholders need not be given to any Stockholder who files a
written waiver of notice with the Secretary, signed by the person entitled to
notice, whether before or after such meeting. Neither the business to be
transacted at, nor the purpose of, any meeting of Stockholders need be
specified in any written waiver of notice thereof. Attendance of a
Stockholder at a meeting, in person or by proxy, shall constitute a waiver of
notice of such meeting, except when such Stockholder attends a meeting for the
express purpose of objecting, at the beginning of the meeting, to the
transaction of any business on the grounds that the notice of such meeting was
inadequate or improperly given.

SECTION 2.05. Adjournments. Whenever a meeting of Stockholders,
annual or special, is adjourned to another date, time or place, notice need
not be given of the adjourned meeting if the date, time and place thereof are
announced at the meeting at which the adjournment is taken. If the
adjournment is for more than 30 days, or if after the adjournment a new record
date is fixed for the adjourned meeting, a notice of the adjourned meeting
shall be given to each Stockholder entitled to vote thereat. At the adjourned
meeting, any business may be transacted which might have been transacted at
the original meeting.

SECTION 2.06. Quorum. Except as otherwise provided by law or the
Amended and Restated Certificate of Incorporation of the Corporation (the
"Certificate of Incorporation"), the recordholders of a majority of the Shares
entitled to vote thereat, present in person or by proxy, shall constitute a
quorum for the transaction of business at all meetings of Stockholders,
whether annual or special. If, however, such quorum shall not be present in
person or by proxy at any meeting of Stockholders, the Stockholders entitled
to vote thereat may adjourn the meeting from time to time in accordance with
Section 2.05 hereof until a quorum shall be present in person or by proxy.

SECTION 2.07. Voting. Each Stockholder shall be entitled to one
vote for each Share held of record by such Stockholder. Except as otherwise
provided by law or the Certificate of Incorporation, when a quorum is present
at any meeting of Stockholders, the vote of the recordholders of a majority of
the Shares constituting such quorum shall decide any question brought before
such meeting.

SECTION 2.08. Proxies. Each Stockholder entitled to vote at a
meeting of Stockholders or to express, in writing, consent to or dissent from
any action of Stockholders without a meeting may authorize another person or
persons to act for such Stockholder by proxy. Such proxy shall be filed with
the Secretary before such meeting of Stockholders or such action of
Stockholders without a meeting, at such time as the Board may require. No
proxy shall be voted or acted upon more than three years from its date, unless
the proxy provides for a longer period.

SECTION 2.09. Stockholders' Consent in Lieu of Meeting. Any action
required by the General Corporation Law to be taken at any annual or special
meeting of Stockholders, and any action which may be taken at any annual or
special meeting of Stockholders, may be taken without a meeting, without prior
notice and without a vote, if a consent in writing, setting forth the action
so taken, shall be signed by the recordholders of Shares having not less than
the minimum number of votes necessary to authorize or take such action at a meeting at which the recordholders of all Shares entitled to vote thereon were present and voted.

ARTICLE III

BOARD OF DIRECTORS

SECTION 3.01. General Powers. The business and affairs of the Corporation shall be managed by the Board, which may exercise all such powers of the Corporation and do all such lawful acts and things as are not by law, the Certificate of Incorporation or these By-laws directed or required to be exercised or done by Stockholders.

SECTION 3.02. Number and Term of Office. The number of Directors shall be five or such other number as shall be fixed from time to time by the Board. Directors need not be Stockholders. Directors shall be elected at the annual meeting of Stockholders or, if, in accordance with Section 2.01 hereof, no such annual meeting is held, by written consent in lieu of meeting pursuant to Section 2.09 hereof, and each Director shall hold office until his successor is elected and qualified, or until his earlier death or resignation or removal in the manner hereinafter provided.

SECTION 3.03. Resignation. Any Director may resign at any time by giving written notice to the Board, the Chairman of the Board of the Corporation (the "Chairman") or the Secretary. Such resignation shall take effect at the time specified in such notice or, if the time be not specified, upon receipt thereof by the Board, the Chairman or the Secretary, as the case may be. Unless otherwise specified therein, acceptance of such resignation shall not be necessary to make it effective.

SECTION 3.04. Removal. Any or all of the Directors may be removed, with or without cause, at any time by vote of the recordholders of a majority of the Shares then entitled to vote at an election of Directors, or by written consent of the recordholders of Shares pursuant to Section 2.09 hereof.

SECTION 3.05. Vacancies. Vacancies occurring on the Board as a result of the removal of Directors without cause may be filled only by vote of the recordholders of a majority of the Shares then entitled to vote at an election of Directors, or by written consent of such recordholders pursuant to Section 2.09 hereof. Vacancies occurring on the Board for any other reason, including, without limitation, vacancies occurring as a result of the creation of new directorships that increase the number of Directors, may be filled by such vote or written consent or by vote of the Board or by written consent of the Directors pursuant to Section 3.08 hereof. If the number of Directors then in office is less than a quorum, such other vacancies may be filled by vote of a majority of the Directors then in office or by written consent of all such Directors pursuant to Section 3.08 hereof. Unless earlier removed pursuant to Section 3.04 hereof, each Director chosen in accordance with this Section 3.05 shall hold office until the next annual election of Directors by the Stockholders and until his successor shall be elected and qualified.
SECTION 3.06. Meetings. (a) Annual Meetings. As soon as practicable after each annual election of Directors by the Stockholders, the Board shall meet for the purpose of organization and the transaction of other business, unless it shall have transacted all such business by written consent pursuant to Section 3.08 hereof.

(b) Other Meetings. Other meetings of the Board shall be held at such times as the Chairman, the President of the Corporation (the "President"), the Secretary or a majority of the Board shall from time to time determine.

(c) Notice of Meetings. The Secretary shall give written notice to each Director of each meeting of the Board, which notice shall state the place, date, time and purpose of such meeting. Notice of each such meeting shall be given to each Director, if by mail, addressed to him at his residence or usual place of business, at least two days before the day on which such meeting is to be held, or shall be sent to him at such place by telecopy, telegraph, cable, or other form of recorded communication, or be delivered personally or by telephone not later than the day before the day on which such meeting is to be held. A written waiver of notice, signed by the Director entitled to notice, whether before or after the time of the meeting referred to in such waiver, shall be deemed equivalent to notice. Neither the business to be transacted at, nor the purpose any meeting of the Board need be specified in any written waiver of notice thereof. Attendance of a Director at a meeting of the Board shall constitute a waiver of notice of such meeting, except as provided by law.

(d) Place of Meetings. The Board may hold its meetings at such place or places within or without the State of Delaware as the Board or the Chairman may from time to time determine, or as shall be designated in the respective notices or waivers of notice of such meetings.

(e) Quorum and Manner of Acting. One-third of the total number of Directors then in office (but in no event less than two if the total number of directorships, including vacancies, is greater than one and in no event a number less than one-third of the total number of directorships, including vacancies) shall be present in person at any meeting of the Board in order to constitute a quorum for the transaction of business at such meeting, and the vote of a majority of those Directors present at any such meeting at which a quorum is present shall be necessary for the passage of any resolution or act of the Board, except as otherwise expressly required by law, the Certificate of Incorporation or these By-laws. In the absence of a quorum for any such meeting, a majority of the Directors present thereat may adjourn such meeting from time to time until a quorum shall be present.

(f) Organization. At each meeting of the Board, one of the following shall act as chairman of the meeting and preside, in the following order of precedence:
(i) the Chairman;

(ii) the President;

(iii) any Director chosen by a majority of the Directors present.

The Secretary or, in the case of his absence, any person (who shall be an Assistant Secretary, if an Assistant Secretary is present) whom the chairman of the meeting shall appoint shall act as secretary of such meeting and keep the minutes thereof.

SECTION 3.07. Committees of the Board. The Board may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of one or more Directors. The Board may designate one or more Directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of such committee. In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another Director to act at the meeting in the place of any such absent or disqualified member. Any committee of the Board, to the extent provided in the resolution of the Board designating such committee, shall have and may exercise all the powers and authority of the Board in the management of the business and affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it; provided, however, that no such committee shall have such power or authority in reference to amending the Certificate of Incorporation (except that such a committee may, to the extent authorized in the resolution or resolutions providing for the issuance of shares of stock adopted by the Board as provided in Section 151(a) of the General Corporation Law, fix the designations and any of the preferences or rights of such shares relating to dividends, redemption, dissolution, any distribution of assets of the Corporation or the conversion into, or the exchange of such shares for, shares of any other class or classes of stock, of the Corporation or fix the number of shares of any series of stock or authorize the increase or decrease of the shares of any series), adopting an agreement of merger or consolidation under Section 251 or 252 of the General Corporation Law, recommending to the Stockholders the sale, lease or exchange of all or substantially all the Corporation's property and assets, recommending to the Stockholders a dissolution of the Corporation or the revocation of a dissolution, or amending these By-laws; provided further, however, that, unless expressly so provided in the resolution of the Board designating such committee, no such committee shall have the power or authority to declare a dividend, to authorize the issuance of stock, or to adopt a certificate of ownership and merger pursuant to Section 253 of the General Corporation Law. Each committee of the Board shall keep regular minutes of its proceedings and report the same to the Board when so requested by the Board.
SECTION 3.08. Directors' Consent in Lieu of Meeting. Any action required or permitted to be taken at any meeting of the Board or of any committee thereof may be taken without a meeting, without prior notice and without a vote, if a consent in writing setting forth the action so taken, shall be signed by all the members of the Board or such committee and such consent is filed with the minutes of the proceedings of the Board or such committee.

SECTION 3.09. Action by Means of Telephone or Similar Communications Equipment. Any one or more members of the Board, or of any committee thereof, may participate in a meeting of the Board or such committee by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting by such means shall constitute presence in person at such meeting.

SECTION 3.10. Compensation. Unless otherwise restricted by the Certificate of Incorporation, the Board may determine the compensation of Directors. In addition, as determined by the Board, Directors may be reimbursed by the Corporation for their expenses, if any, in the performance of their duties as Directors. No such compensation or reimbursement shall preclude any Director from serving the Corporation in any other capacity and receiving compensation therefor.

ARTICLE IV

OFFICERS

SECTION 4.01. Officers. The officers of the Corporation shall be the Chairman, the President, the Secretary and a Treasurer and may include one or more Vice Presidents and one or more Assistant Secretaries and an Assistant Treasurer. Any two or more offices may be held by the same person.

SECTION 4.02. Authority and Duties. All officers shall have such authority and perform such duties in the management of the Corporation as may be provided in these By-laws or, to the extent not so provided, by resolution of the Board.

SECTION 4.03. Term of Office. Resignation and Removal. (a) Each officer shall be appointed by the Board and shall hold office for such term as may be determined by the Board. Each officer shall hold office until his successor has been appointed and qualified or his earlier death or resignation or removal in the manner hereinafter provided. The Board may require any officer to give security for the faithful performance of his duties.

(b) Any officer may resign at any time by giving written notice to the Board, the Chairman, the President or the Secretary. Such resignation shall take effect at the time specified in such notice or, if the time be not specified, upon receipt thereof by the Board, the Chairman, the President or
the Secretary, as the case may be. Unless, otherwise specified therein, acceptance of such resignation shall not be necessary to make it effective.

(c) All officers and agents appointed by the Board shall be subject to removal, with or without cause, at any time by the Board or by the action of the recordholders of a majority of the Shares entitled to vote thereon.

SECTION 4.04. Vacancies. Any vacancy occurring in any office of the Corporation, for any reason, shall be filled by action of the Board. Unless earlier removed pursuant to Section 4.03 hereof, any officer appointed by the Board to fill any such vacancy shall serve only until such time as the unexpired term of his predecessor expires unless reappointed by the Board.

SECTION 4.05. The Chairman. The Chairman shall have the power to call special meetings of Stockholders, to call special meetings of the Board and, if present, to preside at all meetings of Stockholders and all meetings of the Board. The Chairman shall perform all duties incident to the office of Chairman of the Board and all such other duties as may from time to time be assigned to him by the Board or these By-laws. The office of Chairman of the Board may be filled by two individuals serving simultaneously and who shall be referred to collectively as Co-Chairmen and who shall each individually be referred to as a Co-Chairman.

SECTION 4.06. The President. The President shall be the chief executive officer of the Corporation and shall have general and active management and control of the business and affairs of the Corporation, subject to the control of the Board, and shall see that all orders and resolutions of the Board are carried into effect. The President shall perform all duties incident to the office of President and all such other duties as may from time to time be assigned to him by the Board or these By-laws.

SECTION 4.07. Vice Presidents. Vice Presidents, if any, in order of their seniority or in any other order determined by the Board, shall generally assist the President and perform such other duties as the Board or the President shall prescribe, and in the absence or disability of the President, shall perform the duties and exercise the powers of the President.

SECTION 4.08. The Secretary. The Secretary shall, to the extent practicable, attend all meetings of the Board and all meetings of Stockholders and shall record all votes and the minutes of all proceedings in a book to be kept for that purpose, and shall perform the same duties for any committee of the Board when so requested by such committee. He shall give or cause to be given notice of all meetings of Stockholders and of the Board, shall perform such other duties as may be prescribed by the Board, the Chairman or the President and shall act under the supervision of the Chairman. He shall keep in safe custody the seal of the Corporation and affix the same to any instrument that requires that the seal be affixed to it and which shall have been duly authorized for signature in the name of the Corporation and, when so affixed, the seal shall be attested by his signature or by the signature of the Treasurer of the Corporation (the "Treasurer") or an Assistant Secretary or the Assistant Treasurer of the Corporation (the Assistant Treasurer") of
the Corporation. He shall keep in safe custody the certificate books and stockholder records and such other books and records of the Corporation as the Board, the Chairman or the President may direct and shall perform all other duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the Board, the Chairman or the President.

SECTION 4.09. Assistant Secretaries. Assistant Secretaries of the Corporation ("Assistant Secretaries"), if any, in order of their seniority or in any other order determined by the Board, shall generally assist the Secretary and perform such other duties as the Board or the Secretary shall prescribe, and, in the absence or disability of the Secretary, shall perform the duties and exercise the powers of the Secretary.

SECTION 4.10. Treasurer. The Treasurer shall have the care and custody of the funds of the Corporation and shall deposit such funds in such banks or other depositories as the Board, or any officer or officers, or any officer and agent jointly, duly authorized by the Board, shall, from time to time, direct or approve. He shall disburse the funds of the Corporation under the direction of the Board and the President. He shall keep a full and accurate account of all moneys received and paid on account of the Corporation and shall render a statement of his accounts whenever the Board, the Chairman or the President shall so request. He shall perform all other necessary actions and duties in connection with the administration of the financial affairs of the Corporation and shall generally perform all the duties usually appertaining to the office of treasurer of a corporation. When required by the Board, he shall give bonds for the faithful discharge of his duties in such sums and with such sureties as the Board shall approve.

SECTION 4.11. Assistant Treasurer. The Assistant Treasurer of the Corporation shall generally assist the Treasurer and perform such other duties as the Board or the Treasurer shall prescribe, and, in the absence or disability of the Treasurer, shall perform the duties and exercise the powers of the Treasurer.

ARTICLE V

CHECKS, DRAFTS, NOTES, AND PROXIES

SECTION 5.01. Checks, Drafts and Notes. All checks, drafts and other orders for the payment of money, notes and other evidences of indebtedness issued in the name of the Corporation shall be signed by such officer or officers, agent or agents of the Corporation and in such manner as shall be determined, from time to time, by resolution of the Board.

SECTION 5.02. Execution of Proxies. The Chairman or the President, or, in the absence or disability of both of them, any Vice President, may authorize, from time to time, the execution and issuance of proxies to vote shares of stock or other securities of other corporations held of record by
the Corporation and the execution of consents to action taken or to be taken
by any such corporation. All such proxies and consents, unless otherwise
authorized by the Board, shall be signed in the name of the Corporation by the
Chairman, the President or any Vice President.

ARTICLE V

SHARES AND TRANSFERS OF SHARES

SECTION 6.01. Certificates Evidencing Shares. Shares shall be
evidenced by certificates in such form or forms as shall be approved by the
Board. Certificates shall be issued in consecutive order and shall be
numbered in the order of their issue, and shall be signed by the Chairman, the
President or any Vice President and by the Secretary, any Assistant Secretary,
the Treasurer or the Assistant Treasurer. If such a certificate is manually
signed by one such officer, any other signature on the certificate may be a
facsimile. In the event any such officer who has signed or whose facsimile
signature has been placed upon a certificate shall have ceased to hold such
office or to be employed by the Corporation before such certificate is issued,
such certificate may be issued by the Corporation with the same effect as if
such officer had held such office on the date of issue.

SECTION 6.02. Stock Ledger. A stock ledger in one or more
counterparts shall be kept by the Secretary, in which shall be recorded the
name and address of each person, firm or corporation owning the Shares
evidenced by each certificate evidencing Shares issued by the Corporation, the
number of Shares evidenced by each such certificate, the date of issuance
thereof and, in the case of cancellation, the date of cancellation. Except as
otherwise expressly required by law, the person in whose name Shares stand on
the stock ledger of the Corporation shall be deemed the owner and recordholder
thereof for all purposes.

SECTION 6.03. Transfers of Shares. Registration of transfers of
Shares shall be made only in the stock ledger of the Corporation upon request
of the registered holder of such shares, or of his attorney thereunto
authorized by power of attorney duly executed and filed with the Secretary,
and upon the surrender of the certificate or certificates evidencing such
Shares properly endorsed or accompanied by a stock power duly executed,
together with such proof of the authenticity of signatures as the Corporation
may reasonably require.

SECTION 6.04. Addresses of Stockholders. Each Stockholder shall
designate to the Secretary an address at which notices of meetings and all
other corporate notices may be served or mailed to such Stockholder, and, if
any Stockholder shall fail to so designate such an address, corporate notices
may be served upon such Stockholder by mail directed to the mailing address,
if any, as the same appears in the stock ledger of the Corporation or at the
last known mailing address of such Stockholder.

SECTION 6.05. Lost, Destroyed and Mutilated Certificates. Each
recordholder of Shares shall promptly notify the Corporation of any loss,
destruction or mutilation of any certificate or certificates evidencing any Share or Shares of which he is the recordholder. The Board may, in its discretion, cause the Corporation to issue a new certificate in place of any certificate theretofore issued by it and alleged to have been mutilated, lost, stolen or destroyed, upon the surrender of the mutilated certificate or, in the case of loss, theft or destruction of the certificate, upon satisfactory proof of such loss, theft or destruction, and the Board may, in its discretion, require the recordholder of the Shares evidenced by the lost, stolen or destroyed certificate or his legal representative to give the Corporation a bond sufficient to indemnify the Corporation against any claim made against it on account of the alleged loss, theft or destruction of any such certificate or the issuance of such new certificate.

SECTION 6.06. Regulations. The Board may make such other rules and regulations as it may deem expedient, not inconsistent with these By-laws, concerning the issue, transfer and registration of certificates evidencing Shares.

SECTION 6.07. Fixing Date for Determination of Stockholders of Record. In order that the Corporation may determine the Stockholders entitled to notice of or to vote at any meeting of Stockholders or any adjournment thereof, or to express consent to, or to dissent from, corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the Board may fix, in advance, a record date, which shall not be more than 60 nor less than 10 days before the date of such meeting, nor more than 60 days prior to any other such action. A determination of the Stockholders entitled to notice of or to vote at a meeting of Stockholders shall apply to any adjournment of such meeting; provided, however, that the Board may fix a new record date for the adjourned meeting.

ARTICLE VII

SEAL I

SECTION 7.01. Seal. The Board may approve and adopt a corporate seal, which shall be in the form of a circle and shall bear the full name of the Corporation, the year of its incorporation and the words "Corporate Seal Delaware".

ARTICLE VIII

FISCAL YEAR

SECTION 8.01. Fiscal Year. The fiscal year of the Corporation
shall end on the thirty-first day of December of each year unless changed by resolution of the Board.

ARTICLE IX

INDEMNIFICATION AND INSURANCE

SECTION 9.01. Indemnification. (a) The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

(b) The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys’ fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation unless and only to the extent that the Court of Chancery of the State of Delaware or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

(c) To the extent that a director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in defense of any
action, suit or proceeding referred to in Section 9.01(a) and (b) of these By-laws, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

(d) Any indemnification under Section 9.01(a) and (b) of these By-laws (unless ordered by a court) shall be made by the Corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in Section 9.01(a) and (b) of these By-laws. Such determination shall be made (i) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (ii) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (iii) by the stockholders of the Corporation.

(e) Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation pursuant to this Article IX. Such expenses (including attorneys' fees) incurred by other employees and agents may be so paid upon such terms and conditions, if any, as the Board deems appropriate.

(f) The indemnification and advancement of expenses provided by, or granted pursuant to, other Sections of this Article IX shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any law, by-law, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in an official capacity and as to action in another capacity while holding such office.

(g) For purposes of this Article IX, references to "the Corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, employees or agents so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this Article IX with respect to the resulting or surviving corporation as he would have with respect to such constituent corporation if its separate existence had continued.

(h) For purposes of this Article IX, references to "other enterprises" shall include employee benefit plans; references to "fines" shall
include any excise taxes assessed on a person with respect to an employee benefit plan; and references to "serving at the request of the Corporation" shall include any service as a director, officer, employee or agent of the Corporation which imposes duties on, or involves service by, such director, officer, employee or agent with respect to any employee benefit plan, its participants, or beneficiaries; and a person who acted in good faith and in a manner he reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the Corporation" as referred to in this Article IX.

(i) The indemnification and advancement of expenses provided by, or granted pursuant to, this Article IX shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

SECTION 9.02. Insurance for Indemnification. The Corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability under the provisions of Section 145 of the General Corporation Law.

ARTICLE X

AMENDMENTS

SECTION 10.01. Amendments. Any By-law (including these By-laws) may be adopted, amended or repealed by the vote of the recordholders of a majority of the Shares then entitled to vote at an election of Directors or by written consent of Stockholders pursuant to Section 2.09 hereof, or by vote of the Board or by a written consent of Directors pursuant to Section 3.08 hereof.
CERTIFICATE OF DESIGNATIONS

of

SERIES A CONVERTIBLE PREFERRED STOCK

of

PALATIN TECHNOLOGIES, INC.

Pursuant to Section 151 of the
General Corporation Law of the State of Delaware

PALATIN TECHNOLOGIES, INC., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), does hereby certify that, pursuant to the authority conferred on the Board of Directors of the Corporation by the Certificate of Incorporation, as amended to date (the "Certificate of Incorporation"), of the Corporation and in accordance with Section 151 of the General Corporation Law of the State of Delaware, the Board of Directors of the Corporation adopted the following resolution establishing a series of 264,000 shares of Preferred Stock of the Corporation designated as "Series A Convertible Preferred Stock":

RESOLVED, that pursuant to the authority conferred on the Board of Directors of this Corporation by the Certificate of Incorporation, a series of Preferred Stock, par value $.01 per share, of the Corporation is hereby established and created, and that the designation and number of shares thereof and the voting and other powers, preferences and relative, participating, optional or other rights of the shares of such series and the qualifications, limitations and restrictions thereof are as follows:

SERIES A CONVERTIBLE PREFERRED STOCK

1. Designation and Amount. There shall be a series of Preferred Stock designated as "Series A Convertible Preferred Stock" and the number of shares constituting such series shall be 264,000. Such
series is referred to herein as the "Series A Preferred Stock". Such number of shares of Series A Preferred Stock may be increased prior to the Final Closing Date (as defined below) or decreased by resolution of the Board of Directors of the Corporation; provided, however, that no decrease shall reduce the number of shares of Series A Preferred Stock to less than the number of shares then issued and outstanding.

2. Dividends and Distributions. (a) Subject to the prior and superior rights of the holders of any shares of any series or class of capital stock ranking prior and superior to the shares of Series A Preferred Stock with respect to dividends, the holders of shares of Series A Preferred Stock shall be entitled to receive, as, when and if declared by the Board of Directors of the Corporation, out of assets legally available for that purpose, dividends or distributions in cash, stock or otherwise.

(b) The Corporation shall not declare any dividend or distribution on any Junior Stock (as defined below) or any other capital stock of the Company unless and until a special dividend or distribution of $100.00 per share (subject to appropriate adjustment to reflect any stock split, combination, reclassification or reorganization of the Series A Preferred Stock) has been declared and paid on the Series A Preferred Stock. In the event such special dividend or distribution is declared and paid on the Series A Preferred Stock, an aggregate per share dividend or distribution equal to (i) $100.00 divided by (ii) the effective Conversion Rate at the time of such special dividend or distribution on the Series A Preferred Stock may be declared and paid on the Common Stock. Except as aforesaid, the Corporation shall not declare any dividend or distribution on any Junior Stock, unless the Corporation shall, concurrently with the declaration of such dividend or distribution on the Junior Stock, declare a like dividend or distribution, as the case may be, on the Series A Preferred Stock, which in the case of dividends or distributions on Common Stock or Junior Stock convertible into Common Stock, shall be in an amount per share equal to at least (x) the amount of the dividend or distribution per share of Common Stock multiplied by (y) the effective Conversion Rate at the time of such dividend or distribution.

(c) Any dividend or distribution (other than that referenced in the first sentence of Section 2(b)) payable to the holders of the Series A Preferred Stock pursuant to this Section 2 shall be paid to such holders at the same time as the dividend or distribution on the Junior Stock or any other capital stock of the Company by which it is measured is paid.

(d) All dividends or distributions declared upon the Series A Preferred Stock shall be declared pro rata per share.

(e) Any reference to "distribution" contained in this Section 2 shall not be deemed to include any distribution made in connection with or in lieu of any Liquidation Event (as defined below).
(f) "Junior Stock" shall mean the Common Stock and any shares of preferred stock of any series or class of the Corporation, whether presently outstanding or hereafter issued, which are junior to the shares of Series A Preferred Stock with respect to (i) the distribution of assets on any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, (ii) dividends and (iii) voting.

3. Liquidation Preference. (a) In the event of a (i) liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, (ii) a sale or other disposition of all or substantially all of the assets of the Corporation or (iii) any consolidation, merger, combination, reorganization or other transaction in which the Corporation is not the surviving entity or the shares of Common Stock constituting in excess of 50% of the voting power of the Corporation are exchanged for or changed into stock or securities of another entity, cash and/or any other property (a "Merger Transaction") (subparagraphs (i), (ii) and (iii) being collectively referred to as a "Liquidation Event"), after payment or provision for payment of debts and other liabilities of the Corporation, the holders of the Series A Preferred Stock then outstanding shall be entitled to be paid out of the assets of the Corporation available for distribution to its stockholders, whether such assets are capital, surplus, or earnings, before any payment or declaration and setting apart for payment of any amount shall be made in respect of any Junior Stock or any other capital stock of the Company, an amount equal to $100.00 per share plus an amount equal to all declared and unpaid dividends thereon; provided, however, in the case of a Merger Transaction, such $100.00 per share may be paid in cash, property (valued as provided in Section 3(b)) and/or securities (valued as provided in Section 3(b)) of the entity surviving such Merger Transaction. If upon any Liquidation Event, whether voluntary or involuntary, the assets to be distributed to the holders of the Series A Preferred Stock shall be insufficient to permit the payment to such stockholders of the full preferential amounts aforesaid, then all of the assets of the Corporation to be distributed shall be so distributed ratably to the holders of the Series A Preferred Stock on the basis of the number of shares of Series A Preferred Stock held. A consolidation or merger of the Corporation with or into another corporation, other than in a transaction described in this Section 3(a) above, shall not be considered a liquidation, dissolution or winding up of the Corporation or a sale or other disposition of all or substantially all of the assets of the Corporation and accordingly the Corporation shall make appropriate provision to ensure that the terms of this Certificate of Designations survive any such transaction. All shares of Series A Preferred Stock shall rank as to payment upon the occurrence of any Liquidation Event senior to the Common Stock as provided herein and, unless the terms of such series shall provide otherwise, senior to all other series of the Corporation's preferred stock.
(b) Any securities or other property to be delivered to the holders of the Series A Preferred Stock pursuant to Section 3(a) hereof shall be valued as follows:

(i) Securities not subject to an investment letter or other similar restriction on free marketability:

(A) If traded on a securities exchange or on Nasdaq (as defined below), or if actively traded over-the-counter, the value shall be deemed to be the Market Price (as defined below) of the securities as of the third day prior to the date of valuation.

(B) If there is no such active public market for the securities, the value shall be the Fair Market Value (as defined below) of the securities.

"Market Price" of a security shall mean the average Closing Bid Price (as defined below) of such security, for twenty (20) consecutive trading days, ending with the day prior to the date as of which the Market Price is being determined.

"Fair Market Value" of any asset (including any security) means the fair market value thereof as mutually determined by the Corporation and the holders of a majority (measured in terms of voting power) of the outstanding Series A Preferred Stock.

The "Closing Bid Price" for any security for each trading day shall be the reported closing bid price of such security on the national securities exchange on which such security is listed or admitted to trading, or, if such security is not listed or admitted to trading on any national securities exchange, shall mean the reported closing bid price of such security on the Nasdaq SmallCap Market or the Nasdaq National Market System (collectively referred to as, "Nasdaq") or, if such security is not listed or admitted to trading on any national securities exchange or quoted on Nasdaq, shall mean the reported closing bid price of such security on the principal securities exchange on which such security is listed or admitted to trading (based on the aggregate dollar value of all securities listed or admitted to trading) or, if such security is not listed or admitted to trading on a national securities exchange, quoted on Nasdaq or listed or admitted to trading on any other securities exchange, shall mean the closing bid price in the over-the-counter market as furnished by any NASD member firm selected from time to time by the Corporation for that purpose.

"Trading day" shall mean a day on which the securities exchange or NASDAQ used to determine the Closing Bid Price is open for the transaction of business or the reporting of trades or, if the Closing Bid Price is not so determined, a day on which such securities exchange is open for the transaction of business.
(ii) For securities for which there is an active public market but which are subject to investment letter or other restrictions on free marketability, the value shall be the Fair Market Value thereof, determined by discounting appropriately the Market Price thereof.

(iii) For all other securities, the value shall be the Fair Market Value thereof.

If the holders of a majority of the Series A Preferred Stock and the Corporation are unable to reach agreement on any valuation matter, such valuation shall be submitted to and determined by a nationally recognized independent investment bank selected by the Board of Directors of the Corporation and the holders of a majority of the Series A Preferred Stock (or, if such selection cannot be agreed upon promptly, or in any event within ten days, then such valuation shall be made by a nationally recognized independent investment banking firm selected by the American Arbitration Association in New York City in accordance with its rules).


(a) Right of Conversion. The shares of Series A Preferred Stock shall be convertible, in whole or in part, at the option of the holder thereof and upon notice to the Corporation as set forth in Section 4(b) below, into fully paid and nonassessable shares of Common Stock and such other securities and property as hereinafter provided. The initial conversion price per share of Common Stock is $1.78 (the "Conversion Price") and shall be subject to adjustment as provided herein. The rate at which each share of Series A Preferred Stock is convertible at any time into Common Stock (the "Conversion Rate") shall be determined by dividing the then existing Conversion Price into $100.00.

Subject to adjustment pursuant to the provisions of Section 4(c) below, in the event that the Conversion Price in effect at the time of each Interim Closing Date (as defined below) and the Final Closing Date (as defined below) is greater than 90% of the Market Price (as defined in Section 3(b)) of the Common Stock as of (x) any interim closing date of the issuance and sale of the Series A Preferred Stock (each an "Interim Closing Date") or (y) the final closing date of the issuance and sale of the Series A Preferred Stock (the "Final Closing Date") pursuant to the subscription agreements entered into in connection therewith, then the Conversion Price shall be adjusted to equal 90% of the lesser of any such Market Price. If there is any change in the Conversion Price as a result of the preceding sentence, then the Conversion Rate shall be changed accordingly as set forth above. For purposes of this Section 4, in the event the prices referenced in the definition of Closing Bid Price in Section 3(b) cannot be determined, the Market Price of the Common Stock shall be deemed to be the Fair Market Value (as defined in Section 3(b)) of the Common Stock as of the date of determination.
The Board of Directors of the Corporation, or a committee designated by it for such purpose, may specify an initial conversion price applicable to the shares of Series A Preferred Stock issued at any closing lower than the initial conversion price that would otherwise obtain pursuant to the preceding paragraphs and, in the event an initial conversion price is so specified, it shall be applicable to all shares of the Series A Preferred Stock.

The Corporation shall prepare a certificate signed by the Chairman or President, and by the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary, of the Corporation setting forth the Conversion Rate as of the Final Closing Date, showing in reasonable detail the facts upon which such adjusted Conversion Rate is based, and such certificate shall forthwith be filed with the transfer agent of the Series A Preferred Stock. A notice stating that the Conversion Rate has been adjusted pursuant to the second preceding paragraph, or that no adjustment is necessary, and setting forth the Conversion Rate in effect as of the Final Closing Date shall be mailed as promptly as practicable after the Final Closing Date by the Corporation to all record holders of the Series A Preferred Stock at their last addresses as they shall appear in the stock transfer books of the Corporation.

(b) Conversion Procedures. Any holder of shares of Series A Preferred Stock desiring to convert such shares into Common Stock shall surrender the certificate or certificates evidencing such shares of Series A Preferred Stock at the office of the transfer agent for the Series A Preferred Stock, which certificate or certificates, if the Corporation shall so require, shall be duly endorsed to the Corporation or in blank, or accompanied by proper instruments of transfer to the Corporation or in blank, accompanied by irrevocable written notice to the Corporation that the holder elects so to convert such shares of Series A Preferred Stock and specifying the name or names (with address) in which a certificate or certificates evidencing shares of Common Stock are to be issued. The Corporation need not deem a notice of conversion to be received unless the holder complies with all the provisions hereof. The Corporation will instruct the transfer agent (which may be the Corporation) to make a notation of the date that a notice of conversion is received, which date shall be deemed to be the date of receipt for purposes hereof.

The Corporation shall, as soon as practicable after such deposit of certificates evidencing shares of Series A Preferred Stock accompanied by the written notice and compliance with any other conditions herein contained, deliver at such office of such transfer agent to the person for whose account such shares of Series A Preferred Stock were so surrendered, or to the nominee or nominees of such person, certificates evidencing the number of full shares of Common Stock to which such person shall be entitled as aforesaid, together with a cash adjustment of any fraction of a share as hereinafter provided. Subject to the following provisions of this paragraph, such conversion shall be
deemed to have been made as of the date of such surrender of the shares of Series A Preferred Stock to be converted, and the person or persons entitled to receive the Common Stock deliverable upon conversion of such Series A Preferred Stock shall be treated for all purposes as the record holder or holders of such Common Stock on such date; provided, however, that the Corporation shall not be required to convert any shares of Series A Preferred Stock while the stock transfer books of the Corporation are closed for any purpose, but the surrender of Series A Preferred Stock for conversion during any period while such books are so closed shall become effective for conversion immediately upon the reopening of such books as if the surrender had been made on the date of such reopening, and the conversion shall be at the conversion rate in effect on such date. No adjustments in respect of any dividends on shares surrendered for conversion or any dividend on the Common Stock issued upon conversion shall be made upon the conversion of any shares of Series A Preferred Stock.

All notices of conversion shall be irrevocable; provided, however, that if the Corporation has sent notice of an event pursuant to Section 4(f) hereof, a holder of Series A Preferred Stock may, at its election, provide in its notice of conversion that the conversion of its shares of Series A Preferred Stock shall be contingent upon the occurrence of the record date or effectiveness of such event (as specified by such holder), provided that such notice of conversion is received by the Corporation prior to such record date or effective date, as the case may be.

(c) Adjustment of Conversion Rate and Conversion Price.

(i) Except as otherwise provided herein, in the event the Corporation shall, at any time or from time to time after the date hereof, (1) sell or issue any shares of Common Stock for a consideration per share less than either (i) the Conversion Price in effect on the date of such sale or issuance or (ii) the Market Price of the Common Stock as of the date of the sale or issuance, (2) issue any shares of Common Stock as a stock dividend to the holders of Common Stock, or (3) subdivide or combine the outstanding shares of Common Stock into a greater or lesser number of shares (any such sale, issuance, subdivision or combination being herein called a “Change of Shares”), then, and thereafter upon each further Change of Shares, the Conversion Price in effect immediately prior to such Change of Shares shall be changed to a price (rounded to the nearest cent) determined by multiplying the Conversion Price in effect immediately prior thereto by a fraction, the numerator of which shall be the sum of the number of shares of Common Stock outstanding immediately prior to the sale or issuance of such additional shares or such subdivision or combination and the number of shares of Common Stock which the aggregate consideration received (determined as provided in subsection 4(c)(v)(F) below) for the issuance of such additional shares would purchase at the greater of (i) the Conversion Price in effect on the date of such issuance or (ii) the Market Price as of such date, and the denominator of which shall be the
number of shares of Common Stock outstanding immediately after the sale
or issuance of such additional shares or such subdivision or
combination. Such adjustment shall be made successively whenever such
an issuance is made.

(ii) In case of any reclassification, capital
reorganization or other change of outstanding shares of Common Stock, or
in case of any consolidation or merger of the Corporation with or into
another corporation (other than a consolidation or merger in which the
Corporation is the continuing corporation and which does not result in
any reclassification, capital reorganization or other change of
outstanding shares of Common Stock other than the number thereof), or in
case of any sale or conveyance to another corporation of the property of
the Corporation as, or substantially as, an entirety (other than a
sale/leaseback, mortgage or other financing transaction), the
Corporation shall cause effective provision to be made so that each
holder of a share of Series A Preferred Stock shall be entitled to
receive, upon conversion of such share of Series A Preferred Stock, the
kind and number of shares of stock or other securities or property
(including cash) receivable upon such reclassification, capital
reorganization or other change, consolidation, merger, sale or
conveyance by a holder of the number of shares of Common Stock into
which such share of Series A Preferred Stock was convertible immediately
prior to such reclassification, capital reorganization or other change,
consolidation, merger, sale or conveyance. Any such provision shall
include provision for adjustments that shall be as nearly equivalent as
may be practicable to the adjustments provided for in this Section 4(c).
The Corporation shall not effect any such consolidation, merger or sale
unless prior to or simultaneously with the consummation thereof the
successor (if other than the Corporation) resulting from such
consolidation or merger or the corporation purchasing assets or other
appropriate corporation or entity shall assume, by written instrument
executed and delivered to the transfer agent for the Series A Preferred
Stock (the "Transfer Agent"), the obligation to deliver to the holder of
each share of Series A Preferred Stock such shares of stock, securities
or assets as, in accordance with the foregoing provisions, such holders
may be entitled to purchase and the other obligations under this
Agreement. The foregoing provisions shall similarly apply to successive
reclassifications, capital reorganizations and other changes of
outstanding shares of Common Stock and to successive consolidations,
mergers, sales or conveyances.

(iii) If, at any time or from time to time, the Corporation
shall issue or distribute to the holders of shares of Common Stock
evidence of its indebtedness, any other securities of the Corporation or
any cash, property or other assets (excluding an issuance or
distribution governed by one of the preceding subsections of this
Section 4(c) and also excluding cash dividends or cash distributions
paid out of net profits legally available therefor in the full amount
thereof (any such non-excluded event being herein called a "Special
Dividend")), then in each case the holders of the Series A Preferred
Stock shall be entitled to a proportionate share of any such Special
Dividend as though they were the holders of the number of shares of
Common Stock of the Corporation into which their shares of Series A
Preferred Stock are convertible as of the record date fixed for the
determination of the holders of Common Stock of the Corporation entitled
to receive such Special Dividend.

(iv) After each adjustment of the Conversion Price pursuant to this Section 4(c), the Corporation will promptly prepare a certificate signed by the Chairman or President, and by the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary, of the Corporation setting forth:
(i) the Conversion Price as so adjusted,

(ii) the Conversion Rate corresponding to such Conversion and (iii) a brief statement of the facts accounting for such adjustment. The Corporation will promptly file such certificate with the Transfer Agent and cause a brief summary thereof to be sent by ordinary first class mail to each registered holder of Series A Preferred Stock at his last address as it shall appear on the registry books of the Transfer Agent. No failure to mail such notice nor any defect therein or in the mailing thereof shall affect the validity of such adjustment. The affidavit of an officer of the Transfer Agent or the Secretary or an Assistant Secretary of the Corporation that such notice has been mailed shall, in the absence of fraud, be prima facie evidence of the facts stated therein. The Transfer Agent may rely on the information in the certificate as true and correct and has no duty or obligation to independently verify the amounts or calculations set forth therein.

(v) For purposes of Section 4(c)(i) hereof, the following provisions (A) to (F) shall also be applicable:

(A) The number of shares of Common Stock deemed outstanding at any given time shall include all shares of capital stock convertible into or exchangeable for Common Stock and all shares of Common Stock issuable upon the exercise of any convertible debt, warrants outstanding on the date thereof and options outstanding on the date thereof.

(B) No adjustment of the Conversion Price shall be made unless such adjustment would require an increase or decrease of at least $.01 in such price; provided that any adjustments which by reason of this clause (B) are not required to be made shall be carried forward and shall be made at the time of and together with the next subsequent adjustment which, together with any adjustment(s) so carried forward, shall require an increase or decrease of at least $.01 in the Conversion Price then in effect hereunder.

(C) In case of (1) the sale by the Corporation (including as a component of a unit) of any rights or warrants to subscribe for or purchase, or any options for the purchase of, Common Stock or any securities convertible into or exchangeable for Common Stock (such securities convertible, exercisable or exchangeable into Common Stock being herein called "Convertible Securities"), or (2) the issuance by the Corporation, without the receipt by the Corporation of any consideration therefor, of any rights or warrants to subscribe for or purchase, or any options for the purchase of, Common Stock or Convertible Securities, whether or not such rights, warrants or options,
or the right to convert or exchange such Convertible Securities, are immediately exercisable, and the consideration per share for which Common Stock is issuable upon the exercise of such rights, warrants or options or upon the conversion or exchange of such Convertible Securities (determined by dividing (x) the minimum aggregate consideration, as set forth in the instrument relating thereto without regard to any antidilution or similar provisions contained therein for a subsequent adjustment of such amount, payable to the Corporation upon the exercise of such rights, warrants or options, plus the consideration received by the Corporation for the issuance or sale of such rights, warrants or options, plus, in the case of such Convertible Securities, the minimum aggregate amount, as set forth in the instrument relating thereto without regard to any antidilution or similar provisions contained therein for a subsequent adjustment of such amount, of additional consideration, if any, other than such Convertible Securities, payable upon the conversion or exchange thereof, by (y) the total maximum number, as set forth in the instrument relating thereto without regard to any antidilution or similar provisions contained therein for a subsequent adjustment of such amount, of shares of Common Stock issuable upon the exercise of such rights, warrants or options or upon the conversion or exchange of such Convertible Securities issuable upon the exercise of such rights, warrants or options) is less than either the Conversion Price or the Market Price of the Common Stock as of the date of the issuance or sale of such rights, warrants or options, then such total maximum number of shares of Common Stock issuable upon the exercise of such rights, warrants or options or upon the conversion or exchange of such Convertible Securities (as of the date of the issuance or sale of such rights, warrants or options) shall be deemed to be "Common Stock" for purposes of Section 4(c)(i) hereof and shall be deemed to have been sold for an amount equal to such consideration per share and shall cause an adjustment to be made in accordance with Section 4(c)(i).

(D) In case of the sale by the Corporation of any Convertible Securities, whether or not the right of conversion or exchange thereunder is immediately exercisable, and the price per share for which Common Stock is issuable upon the conversion or exchange of such Convertible Securities (determined by dividing (x) the total amount of consideration received by the Corporation for the sale of such Convertible Securities, plus the minimum aggregate amount, as set forth in the instrument relating thereto without regard to any antidilution or similar provisions contained therein for a subsequent adjustment of such amount, of additional consideration, if any, other than such Convertible Securities, payable upon the conversion or exchange thereof, by (y) the total maximum number, as set forth in the instrument relating thereto without regard to any antidilution or similar provisions contained therein for a subsequent adjustment of such amount, of shares of Common Stock issuable upon the conversion or exchange of such Convertible Securities) is less than either the Conversion Price or the Market Price of the Common Stock as of the date of the sale of such Convertible
Securities, then such total maximum number of shares of Common Stock issuable upon the conversion or exchange of such Convertible Securities (as of the date of the sale of such Convertible Securities) shall be deemed to be "Common Stock" for purposes of Section 4(c)(i) hereof and shall be deemed to have been sold for an amount equal to such consideration per share and shall cause an adjustment to be made in accordance with Section 4(c)(i).

(E) In case the Corporation shall modify the rights of conversion, exchange or exercise of any of the securities referred to in (C) and (D) above or any other securities of the Corporation convertible, exchangeable or exercisable for shares of Common Stock, for any reason other than an event that would require adjustment to prevent dilution, so that the consideration per share received by the Corporation after such modification is less than either the Conversion Price or the Market Price as of the date prior to such modification, then such securities, to the extent not theretofore exercised, converted or exchanged, shall be deemed to have expired or terminated immediately prior to the date of such modification and the Corporation shall be deemed for purposes of calculating any adjustments pursuant to this Section 4(c) to have issued such new securities upon such new terms on the date of modification. Such adjustment shall become effective as of the date upon which such modification shall take effect. On the expiration or cancellation of any such right, warrant or option or the termination or cancellation of any such right to convert or exchange any such Convertible Securities, the Conversion Price then in effect hereunder shall forthwith be readjusted to such Conversion Price as would have obtained (a) had the adjustments made upon the issuance or sale of such rights, warrants, options or Convertible Securities been made upon the basis of the issuance of only the number of shares of Common Stock theretofore actually delivered (and the total consideration received therefor) upon the exercise of such rights, warrants or options or upon the conversion or exchange of such Convertible Securities and (b) had adjustments been made on the basis of the Purchase Price as adjusted under clause (a) for all transactions (which would have affected such adjusted Purchase Price) made after the issuance or sale of such rights, warrants, options or Convertible Securities.

(F) In case of the sale of any shares of Common Stock, any Convertible Securities, any rights or warrants to subscribe for or purchase, or any options for the purchase of, Common Stock or Convertible Securities, the consideration received by the Corporation therefor shall be deemed to be the gross sales price therefor without deducting therefrom any expense paid or incurred by the Corporation or any underwriting discounts or commissions or concessions paid or allowed by the Corporation in connection therewith. In the event that any securities shall be issued in connection with any other securities of the Corporation, together comprising one integral transaction in which no specific consideration is allocated among the securities, then each of such securities shall be deemed to have been issued for such
consideration as the Board of Directors of the Corporation determines in good faith; provided, however that if holders of in excess of 10% of the then outstanding Series A Preferred Stock disagree with such determination, the Corporation shall retain an independent investment banking firm for the purpose of obtaining an appraisal.

(vi) Notwithstanding any other provision hereof, no adjustment to the Conversion Price will be made

(A) upon the exercise of any of the options outstanding on the date hereof under the Corporation's existing stock option plans; or

(B) upon the issuance or exercise of options which may hereafter be granted with the approval of the Board of Directors, or exercised, under the Corporation's 1996 Stock Option Plan or under any other employee benefit plan of the

Company to officers, directors or employees, but only with respect to such options as are exercisable at prices no lower than the Closing Bid Price (or, if the prices referenced in the definition of Closing Bid Price cannot be determined, the Fair Market Value) of the Common Stock as of the date of grant thereof; or

(C) upon the sale of any shares of Common Stock, warrants to purchase Common Stock or Convertible Securities in a firm commitment underwritten public offering, including, without limitation, shares sold upon the exercise of any overallotment option granted to the underwriters in connection with such offering; or

(D) upon issuance or exercise of the Placement Warrants (in each case as defined in the placement agency agreement between the Corporation and the placement agent for sales of the Series A Preferred Stock), or upon the issuance or conversion of the Preferred Stock included in Liquidity Enhanced Exchangeable Preferred Stock Units of the Company issued (i) on or prior to the Final Closing Date or (ii) pursuant to the exercise of the Placement Warrants, or

(E) upon the issuance or sale of Common Stock or Convertible Securities pursuant to the exercise of any rights, options or warrants to receive, subscribe for or purchase, or any options for the purchase of, Common Stock or Convertible Securities, whether or not such rights, warrants or options were outstanding on the date of the original sale of the Series A Preferred Stock or were thereafter issued or sold, provided that an adjustment was either made or not required to be made in accordance with Section 4(c)(i) in connection with the issuance or sale of such securities or any modification of the terms thereof; or

(F) upon the issuance or sale of Common Stock upon conversion or exchange of any Convertible Securities, provided that any adjustments required to be made upon the issuance or sale of such Convertible Securities or any modification of the terms thereof were so made, and
whether or not such Convertible Securities were outstanding on the date of the original sale of the Series A Preferred Stock or were thereafter issued or sold.

Section 4(c)(v)(E) shall nevertheless apply to any modification of the rights of conversion, exchange or exercise of any of the securities referred to in (A) through (C) or, to the extent effected with respect to less than all of the outstanding Series A Preferred Stock, as the case may be, (D) above other than automatic modifications made pursuant to applicable anti-dilution provisions with respect to such securities.

(vii) As used in this Section 4(c), the term "Common Stock" shall mean and include the Corporation's Common Stock authorized on the date of the original issue of the Units and shall also include any capital stock of any class of the Corporation thereafter authorized which shall not be limited to a fixed sum or percentage in respect of the rights of the holders thereof to participate in dividends and in the distribution of assets upon the voluntary liquidation, dissolution or winding up of the Corporation; provided, however, that the shares issuable upon conversion of the Series A Preferred Stock shall include only shares of such class designated in the Corporation's Certificate of Incorporation as Common Stock on the date of the original issue of the Units or (i), in the case of any reclassification, change, consolidation, merger, sale or conveyance of the character referred to in Section 4(c)(ii) hereof, the stock, securities or property provided for in such section or (ii), in the case of any reclassification or change in the outstanding shares of Common Stock issuable upon conversion of the Series A Preferred Stock as a result of a subdivision or combination or consisting of a change in par value, or from par value to no par value, or from no par value to par value, such shares of Common Stock as so reclassified or changed.

(ix) Any determination as to whether an adjustment in the Conversion Price in effect hereunder is required pursuant to Section 4(c), or as to the amount of any such adjustment, if required, shall be binding upon the holders of the Series A Preferred Stock and the Company if made in good faith by the Board of Directors of the Company.

(d) No Fractional Shares. No fractional shares or scrip representing fractional shares of Common Stock shall be issued upon conversion of shares of Series A Preferred Stock. If more than one certificate evidencing shares of Series A Preferred Stock shall be surrendered for conversion at one time by the same holder, the number of full shares issuable upon conversion thereof shall be computed on the basis of the aggregate number of shares of Series A Preferred Stock so surrendered. Instead of any fractional share of Common Stock which would otherwise be issuable upon conversion of any shares of Series A Preferred Stock, the Corporation shall pay a cash adjustment in respect of such fractional interest in an amount equal to the same fraction of the Market Price as of the close of business on the day of conversion.
Reservation of Shares; Transfer Taxes; Etc. The Corporation shall at all times reserve and keep available, out of its authorized and unissued shares of Common Stock, solely for the purpose of effecting the conversion of the Series A Preferred Stock, such number of shares of its Common Stock free of preemptive rights as shall be sufficient to effect the conversion of all shares of Series A Preferred Stock from time to time outstanding. The Corporation shall authorize and reserve a sufficient number of shares of the Common Stock to permit the conversion in full of the Series A Preferred Stock (including in the event of a Reset Event, as defined in Section 5). The Corporation shall use its best efforts to effect such authorization by the date which is 90 days following the Final Closing Date but in any event no later than the date which is 270 days following the Final Closing Date. If such authorization is not effected by the date which is 270 days following the Final Closing Date, the holder shall be entitled at its option, to require the Corporation to repurchase the shares of Series A Preferred Stock then held by such holder at $100.00 per share. In the event that on the date that a holder of Series A Preferred Stock elects to convert such holder's shares of Series A Preferred Stock the Corporation has not authorized and reserved a sufficient number of shares of Common Stock to permit such conversion in full, the holder will be entitled upon conversion to receive the fair market value per share of Common Stock on account of the shares which would have been issuable to the holder upon conversion but which the Corporation was unable to issue due to the lack of authorized and reserved shares. The fair market value shall be paid in cash, or, if the Corporation does not have sufficient cash, then with secured demand notes. Fair market value per share of Common Stock for purposes of this Section 4(e) shall mean the Closing Bid Price per share of the Common Stock for the trading day immediately preceding the conversion. The Corporation shall use its best efforts from time to time, in accordance with the laws of the State of Delaware, to increase the authorized number of shares of Common Stock if at any time the number of shares of authorized, unissued and unreserved Common Stock shall not be sufficient to permit the conversion of all the then-outstanding shares of Series A Preferred Stock (including in the event of a Reset Event, (as defined in Section 5).

The Corporation shall pay any and all issue or other taxes that may be payable in respect of any issue or delivery of shares of Common Stock on conversion of the Series A Preferred Stock. The Corporation shall not, however, be required to pay any tax which may be payable in respect of any transfer involved in the issue or delivery of Common Stock (or other securities or assets) in a name other than that in which the shares of Series A Preferred Stock so converted were registered, and no such issue or delivery shall be made unless and until the person requesting such issue has paid to the Corporation the amount of such tax or has established, to the satisfaction of the Corporation, that such tax has been paid.
(f) Prior Notice of Certain Events. In case:

(i) the Corporation shall declare any dividend (or any other distribution); or

(ii) the Corporation shall authorize the granting to the holders of Common Stock of rights or warrants to subscribe for or purchase any shares of stock of any class or of any other rights or warrants; or

(iii) of any reclassification of Common Stock (other than a subdivision or combination of the outstanding Common Stock, or a change in par value, or from par value to no par value, or from no par value to par value); or

(iv) of any consolidation or merger (including, without limitation, a Merger Transaction) to which the Corporation is a party and for which approval of any stockholders of the Corporation shall be required, or of the sale or transfer of all or substantially all of the assets of the Corporation or of any compulsory share exchange whereby the Common Stock is converted into other securities, cash or other property; or

(v) of the voluntary or involuntary dissolution, liquidation or winding up of the Corporation (including, without limitation, a Liquidation Event);

then the Corporation shall cause to be filed with the transfer agent for the Series A Preferred Stock, and shall cause to be mailed to the holders of record of the Series A Preferred Stock, at their last addresses as they shall appear upon the stock transfer books of the Corporation, at least 20 days prior to the applicable record date hereinafter specified, a notice stating (x) the date on which a record (if any) is to be taken for the purpose of such dividend, distribution or granting of rights or warrants or, if a record is not to be taken, the date as of which the holders of Common Stock of record to be entitled to such dividend, distribution, rights or warrants are to be determined and a description of the cash, securities or other property to be received by such holders upon such dividend, distribution or granting of rights or warrants or (y) the date on which such reclassification, consolidation, merger, sale, transfer, share exchange, dissolution, liquidation or winding up or other Liquidation Event is expected to become effective, the date as of which it is expected that holders of Common Stock of record shall be entitled to exchange their shares of Common Stock for securities or other property deliverable upon such exchange, dissolution, liquidation or winding up or other Liquidation Event and the consideration, including securities or other property, to be received by such holders upon such exchange; provided, however, that no failure to mail such notice or any defect therein or in
the mailing thereof shall affect the validity of the corporate action required to be specified in such notice.

(g) Other Changes in Conversion Rate. The Corporation from time to time may increase the Conversion Rate by any amount for any period of time if the period is at least 20 days and if the increase is irrevocable during the period. Whenever the Conversion Rate is so increased, the Corporation shall mail to holders of record of the Series A Preferred Stock a notice of the increase at least 15 days before the date the increased Conversion Rate takes effect, and such notice shall state the increased Conversion Rate and the period it will be in effect.

The Corporation may make such increases in the Conversion Rate, in addition to those required or allowed by this Section 4, as shall be determined by it, as evidenced by a resolution of the Board of Directors, to be advisable in order to avoid or diminish any income tax to holders of Common Stock resulting from any dividend or distribution of stock or issuance of rights or warrants to purchase or subscribe for stock or from any event treated as such for income tax purposes.

Notwithstanding anything to the contrary herein, in no case shall the Conversion Price be adjusted to an amount less than $.01 per share, the current par value of the Common Stock into which the Series A Preferred Stock is convertible.

(h) Ambiguities/Errors. The Board of Directors of the Corporation shall have the power to resolve any ambiguity or correct any error in the provisions relating to the convertibility of the Series A Preferred Stock, and its actions in so doing shall be final and conclusive.

5. Conversion Price Reset Event. The Conversion Price (subject to the adjustments pursuant to the provisions of Section 4(c) above), is subject to adjustment on the date which is twelve (12) months after the Final Closing Date (the "Reset Date") if the average Closing Bid Price of the Common Stock for the thirty (30) consecutive trading days immediately preceding the Reset Date (the "Reset Trading Price") is less than 130% of the then applicable Conversion Price (a "Reset Event"). Upon a Reset Event, the then applicable Conversion Price shall be reduced to equal the greater of (i) the Reset Trading Price divided by 1.3 and (ii) 50% of the then applicable Conversion Price. If there is any change in the Conversion Price as a result of the preceding sentence, then the Conversion Rate shall be changed accordingly as set forth above. The Corporation shall prepare a certificate signed by the principal financial officer of the Corporation setting forth the Conversion Rate as of the Reset Date, showing in reasonable detail the facts upon which such Conversion Rate is based, and such certificate shall forthwith be filed with the transfer agent of the Series A Preferred Stock. A notice stating that the Conversion Rate has been adjusted pursuant to this paragraph, or that no adjustment is necessary,
and setting forth the Conversion Rate in effect as of the Reset Date shall be mailed as promptly as practicable after the Reset Date by the Corporation to all record holders of the Series A Preferred Stock at their last addresses as they shall appear in the stock transfer books of the Corporation.

6. Mandatory Conversion. At any time on or after the date that is 12 months after the Final Closing Date, the Corporation, at its option, may cause the Series A Preferred Stock to be converted in whole, or in part, on a pro rata basis, into fully paid and nonassessable shares of Common Stock at the then effective Conversion Rate and such other securities and property as herein provided if the Closing Bid Price of the Common Stock (or, if the prices referenced in the definition of Closing Bid Price cannot be determined, the Fair Market Value (as defined in Section 3(b)) of the Common Stock) shall have exceeded 200% of the then applicable Conversion Price for at least 20 trading days in any 30 consecutive trading day period ending three days prior to the date of conversion. Any shares of Series A Preferred Stock so converted shall be treated as having been surrendered by the holder thereof for conversion pursuant to Section 4 on the date of such mandatory conversion (unless previously converted at the option of the holder).

Not more than 60 nor less than 20 days prior to the date of any such mandatory conversion, notice by first class mail, postage prepaid, shall be given to the holders of record of the Series A Preferred Stock to be converted, addressed to such holders at their last addresses as shown on the stock transfer books of the Corporation. Each such notice shall specify the date fixed for conversion, the place or places for surrender of shares of Series A Preferred Stock, and the then effective Conversion Rate pursuant to Section 4.

Any notice which is mailed as herein provided shall be conclusively presumed to have been duly given by the Corporation on the date deposited in the mail, whether or not the holder of the Series A Preferred Stock receives such notice; and failure properly to give such notice by mail, or any defect in such notice, to the holders of the shares to be converted shall not affect the validity of the proceedings for the conversion of any other shares of Series A Preferred Stock. On or after the date fixed for conversion as stated in such notice, each holder of shares called to be converted shall surrender the certificate evidencing such shares to the Corporation at the place designated in such notice for conversion. Notwithstanding that the certificates evidencing any shares properly called for conversion shall not have been surrendered, the shares shall no longer be deemed outstanding and all rights whatsoever with respect to the shares so called for conversion (except the right of the holders to convert such shares upon surrender of their certificates therefor) shall terminate.


(a) General. Except as otherwise provided herein, in the Certificate of Incorporation or the By-laws or as required by applicable law, the holders of shares of Series A Preferred Stock, the holders of shares of Common Stock and the holders of any other class or series of
shares entitled to vote with the Common Stock shall vote together as one class on all matters submitted to a vote of stockholders of the Corporation. In any such vote, each share of Series A Preferred Stock shall entitle the holder thereof to cast the number of votes equal to the number of votes which could be cast in such vote by a holder of the Common Stock into which such share of Series A Preferred Stock is convertible (regardless of whether the Corporation has sufficient authorized Shares of Common Stock to issue upon the conversion of all outstanding Series A Preferred Stock) on the record date for such vote, or if no record date has been established, on the date such vote is taken. Any shares of Series A Preferred Stock held by the Corporation or any entity controlled by the Corporation shall not have voting rights hereunder and shall not be counted in determining the presence of a quorum.

(b) Class Voting Rights. In addition to any vote specified in Section 7(a), so long as 50% of the shares of Series A Preferred Stock (including those shares of Series A Preferred Stock issued or issuable upon the exercise of the warrants issued to Paramount Capital, Inc., the placement agent in connection with the offer and sale of the Series A Preferred Stock or any other options for the purchase of Series A Preferred Stock) shall be outstanding, the Corporation shall not, without the affirmative vote or consent of the holders of at least 66.67% of all outstanding Series A Preferred Stock voting separately as a class, (i) amend, alter or repeal any provision of the Certificate of Incorporation, or the Bylaws of the Corporation so as adversely to affect the relative rights, preferences, qualifications, limitations or restrictions of the Series A Preferred Stock, (ii) declare or pay any dividend or distribution on any securities of the Corporation other than the Series A Preferred Stock pursuant to and accordance with the provisions of this Certificate of Designations, or authorize the repurchase of any securities of the Corporation other than the Series A Preferred Stock pursuant to and accordance with the provisions of this Certificate of Designations, or authorize the repurchase of any securities of the Corporation, or (iii) authorize or issue, or increase the authorized amount of, any security ranking prior to the Series A Preferred Stock (A) upon a Liquidation Event or (B) with respect to the payment of any dividends or distributions or (C) with respect to voting rights. The vote as contemplated herein shall specifically not be required for (x) issuances of Common Stock or capital stock of the Corporation on parity with the Series A Preferred Stock, (y) the authorization, issuance or increase in the amount of the Series A Preferred Stock prior to the Final Closing Date or (z) any consolidation or merger of the Corporation with or into another corporation in which the Corporation is not the surviving entity, a sale or transfer of all or part of the Corporation’s assets for cash, securities or other property, or a compulsory share exchange.

8. Outstanding Shares. For purposes of this Certificate of Designations, all shares of Series A Preferred Stock shall be deemed outstanding except (i) from the date, or the deemed date, of surrender of certificates evidencing shares of Series A Preferred Stock, all shares of Series A Preferred Stock converted into Common Stock, (ii)
from the date of registration of transfer, all shares of Series A Preferred Stock held of record by the Corporation or any subsidiary of the Corporation and (iii) any and all shares of Series A Preferred Stock held in escrow prior to delivery of such stock by the Corporation to the initial beneficial owners thereof.

9. Status of Acquired Shares. Shares of Series A Preferred Stock received upon conversion pursuant to Section 4 or Section 5 or Section 6 or otherwise acquired by the Corporation will be restored to the status of authorized but unissued shares of Preferred Stock, without designation as to class, and may thereafter be issued, but not as shares of Series A Preferred Stock.

10. Preemptive Rights. The Series A Preferred Stock is not entitled to any preemptive or subscription rights in respect of any securities of the Corporation.

11. No Amendment or Impairment. The Corporation shall not amend its Certificate of Incorporation or participate in any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, for the purpose of avoiding or seeking to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in carrying out all such action as may be reasonably necessary or appropriate in order to protect the rights of the holders of the Series A Preferred Stock against impairment.

12. Severability of Provisions. Whenever possible, each provision hereof shall be interpreted in a manner as to be effective and valid under applicable law, but if any provision hereof is held to be prohibited by or invalid under applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity, without invalidating or otherwise adversely affecting the remaining provisions hereof. If a court of competent jurisdiction should determine that a provision hereof would be valid or enforceable if a period of time were extended or shortened or a particular percentage were increased or decreased, then such court may make such change as shall be necessary to render the provision in question effective and valid under applicable law.
IN WITNESS WHEREOF, Palatin Technologies, Inc. has caused this certificate to be signed on its behalf by Edward J. Quilty, its Chairman and Chief Executive Officer, this 21 day of February, 1997.

PALATIN TECHNOLOGIES, INC.

By: /s/ Edward J. Quilty

------------------------
Name: Edward J. Quilty
Title: Chairman and Chief Executive Officer

ATTEST:

/s/ John J. McDonough

------------------------
Secretary

EX-4.6
4
SPECIMEN CERTIFICATE FOR SERIES A CONVERTIBLE PREFERRED STOCK

PREFERRED STOCK

PREFERRED STOCK
This Certifies That

________________________________________

is the record owner of

________________________________________

fully paid and non-assessable shares of Series A Convertible Preferred Stock of Palatin Technologies, Inc. transferable on the books of the Corporation by the holder hereof in person or by Attorney upon surrender of this Certificate properly endorsed.

Witness the seal of the Corporation and the signatures of its duly authorized officers.

Dated


PALATIN TECHNOLOGIES, INC.
CORPORATE SEAL
1986
DELAWARE

Chairman                 Secretary

THE SHARES OF STOCK REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT") OR ANY OTHER APPLICABLE SECURITIES LAWS, HAVE BEEN ISSUED IN RELIANCE UPON EXEMPTIONS FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS, AND MAY NOT BE
OFFERED, SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO (1) AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, OR (2) AN OPINION OF COUNSEL, SATISFACTORY TO THE CORPORATION, THAT AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS IS AVAILABLE.

A portion of the stock represented by this certificate is subject to the lock-up provisions set forth in section 1.18 of the subscription agreement relating to such stock between the holder of this certificate and the Corporation, and may not be sold or otherwise disposed of without the prior written consent of Paramount Capital, Inc.

The Corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences, and relative, participating, optional, or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

For Value Received, (I/we) sell, assign and transfer to
- 
- 
- shares of the Series A Convertible Preferred Stock represented by this Certificate, and appoint 
- 
- to transfer the said Stock on the books of Palatin Technologies, Inc. with full power of substitution in the premises.

Social Security Number or Employer Identification Number of transferee, if known:

Dated

NOTICE: THE SIGNATURE(S) ON THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME(S) WRITTEN UPON THE FACE OF THE CERTIFICATE, IN EVERY PARTICULAR, WITHOUT ALTERATION OR ENLARGEMENT, OR ANY CHANGE WHATSOEVER.

EX-10.26
5
1996 STOCK OPTION PLAN AS AMENDED
1. Purpose.

The purposes of the 1996 Stock Option Plan (the "Plan") are to induce certain employees, consultants and directors to remain in the employ or service, or to continue to serve as directors, of Palatin Technologies, Inc. (the "Company") and its present and future subsidiary corporations (each a "Subsidiary"), as defined in Section 424(f) of the Internal Revenue Code of 1986, as amended (the "Code"), to attract new individuals to enter into such employment or service and to encourage such individuals to secure or increase on reasonable terms their stock ownership in the Company. The Board of Directors of the Company (the "Board") believes that the granting of stock options (the "Options") under the Plan will promote continuity of management and increased incentive and personal interest in the welfare of the Company by those who are or may become primarily responsible for shaping and carrying out the long range plans of the Company and securing its continued growth and financial success. Options granted hereunder are intended to be either (a) "incentive stock options" (which term, when used herein, shall have the meaning ascribed thereto by the provisions of Section 422(b) of the Code) or (b) options which are not incentive stock options ("non-incentive stock options") or (c) a combination thereof, as determined by the Committee (the "Committee") referred to in Section 4 hereof at the time of the grant thereof.

2. Effective Date of the Plan.

The Plan became effective on August 28, 1996, by action of the Board, subject to ratification by stockholders of the Company.

3. Stock Subject to Plan.

2,000,000 of the authorized but unissued shares of the Common Stock, $0.01 par value, of the Company (the "Common Stock") are hereby reserved for issue upon the exercise of Options granted under the Plan; provided, however, that the number of shares so reserved may from time to time be reduced to the extent that a corresponding number of issued and outstanding shares of the Common Stock are purchased by the Company and set aside for issue upon the exercise of Options. If any Options expire or terminate for any reason without having been exercised in full, the unpurchased shares subject thereto shall again be available for the purposes of the Plan.

4. Committee.

The Committee shall consist of two or more members of the Board both or all of whom shall be "non-employee directors" within the meaning of Rule 16b-3(b)(3)(i) promulgated under the Securities Exchange Act of 1934, as amended.
(the "Exchange Act") and "outside directors" within the contemplation of Section 162(m)(4)(C)(i) of the Code. The President of the Company shall also be a member of the Committee, ex-officio, whether or not he or she is otherwise eligible to be a member of the Committee. The Committee shall be appointed annually by the Board, which may at any time and from time to time remove any members of the Committee, with or without cause, appoint additional members to the Committee and fill vacancies, however caused, in the Committee. In the event that no Committee shall have been appointed, the Board shall serve as the Committee. A majority of the members of the Committee shall constitute a quorum. All determinations of the Committee shall be made by a majority of its members present at a meeting duly called and held. Any decision or determination of the Committee reduced to writing and signed by all of the members of the Committee shall be fully as effective as if it had been made at a meeting duly called and held.

5. Administration.

Subject to the express provisions of the Plan, the Committee shall have complete authority, in its discretion, to interpret the Plan, to prescribe, amend and rescind rules and regulations relating to it, to determine the terms and provisions of the respective option agreements or certificates (which need not be identical), to determine the individuals (each a "Participant") to whom and the times and the prices at which Options shall be granted, the periods during which each Option shall be exercisable, the number of shares of the Common Stock to be subject to each Option and whether such Option shall be an incentive stock option or a non-incentive stock option and to make all other determinations necessary or advisable for the administration of the Plan. In making such determinations, the Committee may take into account the nature of the services rendered by the respective employees and consultants, their present and potential contributions to the success of the Company and the Subsidiaries and such other factors as the Committee in its discretion shall deem relevant. The Committee's determination on the matters referred to in this Section 5 shall be conclusive. Any dispute or disagreement which may arise under or as a result of or with respect to any Option shall be determined by the Committee, in its sole discretion, and any interpretations by the Committee of the terms of any Option shall be final, binding and conclusive.

6. Eligibility.

A. An Option may be granted only to (i) an employee or consultant of the Company or a Subsidiary, (ii) a director of the Company who is not employed by the Company or any of the Subsidiaries (a "Non-Employee Director") and (iii) employees of a corporation or other business enterprise which has been acquired by the Company or a Subsidiary, whether by exchange or purchase of stock, purchase of assets, merger or reverse merger or otherwise, who hold options with respect to the stock of such corporation which the Company has agreed to assume or for which the Company has agreed to provide substitute options.
B. (i) On August 28, 1996, each Non-Employee Director shall be granted an Option (a "Non-Employee Director's Formula Option") to purchase 20,000 shares of the Common Stock at the initial per share option price equal to the fair market value of a share of the Common Stock on the date of grant.

(ii) At the first meeting of the Board immediately following the annual meeting of the Stockholders of the Company held in 1997, and at the first meeting of the Board immediately following each subsequent annual meeting of the Stockholders of the Company, each Non-Employee Director shall be granted an Option (a "Non-Employee Director's Formula Option") to purchase 10,000 shares of the Common Stock at the initial per share option price equal to the fair market value of a share of the Common Stock on the date of grant.

(iii) Each Non-Employee Director who becomes a director subsequent to the adoption date of the Plan, and prior to the date of any annual meeting of the Shareholders of the Company, shall be granted, on the date he or she becomes a director, an Option (a "Non-Employee Director's Formula Option") to purchase the number of shares of the Common Stock equal to the product of (i) 10,000 and (ii) a fraction, the numerator of which is the number of full calendar months prior to the next scheduled annual meeting of Shareholders and the denominator of which is 12, at the initial per share option price equal to the fair market value of a share of the Common Stock on the date of grant.

(iv) A Non-Employee Director may not exercise a Non-Employee Director's Formula Option during the period commencing on the date of the granting of such Option to him or her and ending on the day next preceding the first anniversary of such date. A Non-Employee Director may (i) during the period commencing on the first anniversary of the date of the granting of a Non-Employee Director's Formula Option to him or her and ending on the day next preceding the second anniversary of such date, exercise such Option with respect to one-fourth of the shares granted thereby, (ii) during the period commencing on such second anniversary and ending on the day next preceding the third anniversary of the date of the granting of such Option, exercise such Option with respect to one-half of the shares granted thereby, (iii) during the period commencing on such third anniversary and ending on the date next preceding the fourth anniversary of the date of the granting of such Option, exercise such Option with respect to three-fourths of the shares granted thereby and (iv) during the period commencing on such fourth anniversary and ending on the date of the expiration of such Option, exercise such Option with respect to all of the shares granted thereby.

7. Option Prices.

A. Except as otherwise provided in Section 17, the initial per share option price of any Option shall be the price determined by the Committee, but not less than the fair market value of a share of the Common Stock on the date of grant; provided, however, that, in the case of a Participant who owns (within the meaning of Section 424(d) of the Code) more than 10% of the total
combined voting power of the Common Stock at the time an Option which is an incentive stock option is granted to him or her, the initial per share option price shall not be less than 110% of the fair market value of a share of the Common Stock on the date of grant.

B. For all purposes of the Plan, the fair market value of a share of the Common Stock on any date shall be determined by the Committee as follows:

(i) If the Common Stock is listed on the OTC Electronic Bulletin Board, its fair market value shall be the closing selling price on such date for the Common Stock as reported on the OTC Electronic Bulletin Board. If there are no sales of the Common Stock on that date, then the reported closing selling price for the Common Stock on the next preceding date for which such closing selling price is quoted shall be determinative of fair market value; or,

(ii) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation, the Nasdaq National Market System or the Nasdaq SmallCap Market System, its fair market value shall be the reported closing selling price for the Common Stock on the principal securities exchange or national market system on which the Common Stock is at such date listed for trading. If there are no sales of Common Stock on that date, then the reported closing selling price for the Common Stock on the next preceding day for which such closing selling price is quoted shall be determinative of fair market value; or,

(iii) If the Common Stock is not traded on the OTC Electronic Bulletin Board, an exchange, or a national market system, its fair market value shall be determined in good faith by the Committee, and such determination shall be conclusive and binding on all persons.

8. Option Term.

Participants shall be granted Options for such term as the Committee shall determine, not in excess of ten years from the date of the granting thereof; provided, however, that, except as otherwise provided in Section 17, in the case of a Participant who owns (within the meaning of Section 424(d) of the Code) more than 10% of the total combined voting power of the Common Stock of the Company at the time an Option which is an incentive stock option is granted to him or her, the term with respect to such Option shall not be in excess of five years from the date of the granting thereof; provided, further, however, that the term of each Non-Employee Director's Formula Option shall be ten years from the date of the granting thereof.


A. Except as otherwise provided in Section 17, the aggregate fair market value of the shares of the Common Stock for which any Participant may be
granted incentive stock options which are exercisable for the first time in any calendar year (whether under the terms of the Plan or any other stock option plan of the Company) shall not exceed $100,000.

B. Except as otherwise provided in Section 17, no Participant shall, during any fiscal year of the Company, be granted Options to purchase more than 500,000 shares of the Common Stock.

10. Exercise of Options.
   A. Except as otherwise provided in Section 17 and except as otherwise determined by the Committee at the time of the grant of an Option other than a Non-Employee Director's Formula Option, a Participant may not exercise an Option during the period commencing on the date of the granting of such Option to him or her and ending on the day next preceding the first anniversary of such date. Except as otherwise set forth in Sections 9A and 17 and in the preceding sentence, a Participant may (i) during the period commencing on the first anniversary of the date of the granting of an Option to him or her and ending on the day next preceding the second anniversary of such date, exercise such Option with respect to one-fourth of the shares granted thereby, (ii) during the period commencing on such second anniversary and ending on the day next preceding the third anniversary of the date of the granting of such Option, exercise such Option with respect to one-half of the shares granted thereby, (iii) during the period commencing on such third anniversary and ending on the date next preceding the fourth anniversary of the date of the granting of such Option, exercise such Option with respect to three-fourths of the shares granted thereby and (iv) during the period commencing on such fourth anniversary and ending on the date of the expiration of such Option, exercise such Option with respect to all of the shares granted thereby.

   B. Except as hereinbefore otherwise set forth, an Option may be exercised either in whole at any time or in part from time to time.

   C. An Option may be exercised only by a written notice of intent to exercise such Option with respect to a specific number of shares of the Common Stock and payment to the Company of the amount of the option price for the number of shares of the Common Stock so specified.

   D. Except in the case of a Non-Employee Director's Formula Option, the Board may, in its discretion, permit any Option to be exercised, in whole or in part, prior to the time when it would otherwise be exercisable.

   E. Notwithstanding any other provision of the Plan to the contrary, including, but not limited to, the provisions of Section 10D, if any Participant shall have effected a "Hardship Withdrawal" from a "401(k) Plan" maintained by the Company and/or one or more of the Subsidiaries, then, during the period of one year commencing on the date of such Hardship Withdrawal, such Participant may not exercise any Option. For the purpose of this
paragraph E, a Hardship Withdrawal shall mean a distribution to a Participant provided for in Reg. Sec. 1.401(k)-1(d)(1)(ii) promulgated under Section 401(k)(2)(B)(i)(iv) of the Code and a 401(k) Plan shall mean a plan which is a "qualified plan" within the contemplation of section 401(a) of the Code which contains a "qualified cash or deferred arrangement" within the contemplation of section 401(k)(2) of the Code.

11. Transferability.

   No Option shall be assignable or transferable except by will and/or by the laws of descent and distribution and, during the life of any Participant, each Option granted to him or her may be exercised only by him or her.

12. Termination of Employment.

   A. In the event a Participant leaves the employ of the Company and the Subsidiaries or ceases to serve as a consultant to the Company and/or as a Non-Employee Director of the Company, whether voluntarily or otherwise, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been canceled shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of 90 days after the date of such Participant's termination of employment or service and the date of termination specified in such Option. Notwithstanding the foregoing, if a Participant's employment by the Company and the Subsidiaries or service as a consultant and/or as a Non-Employee Director of the Company is terminated for "cause" (as defined herein), each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall, to the extent not theretofore exercised, terminate forthwith.

   B. For purposes of the foregoing, the term "cause" shall mean: (i) the commission by a Participant of any act or omission that would constitute a crime under federal, state or equivalent foreign law, (ii) the commission by a Participant of any act of moral turpitude, (iii) fraud, dishonesty or other acts or omissions that result in a breach of any fiduciary or other material duty to the Company and/or the Subsidiaries or (iv) continued alcohol or other substance abuse that renders a Participant incapable of performing his or her material duties to the satisfaction of the Company and/or the Subsidiaries.

13. Adjustment of Number of Shares.

   A. In the event that a dividend shall be declared upon the Common Stock payable in shares of the Common Stock, the number of shares of the Common Stock then subject to any Option and the number of shares of the Common Stock reserved for issuance in accordance with the provisions of the Plan but not yet covered by an Option and the number of shares set forth in Sections 6B and 9B shall be adjusted by adding to each share the number of shares which would
be distributable thereon if such shares had been outstanding on the date fixed for determining the stockholders entitled to receive such stock dividend. In the event that the outstanding shares of the Common Stock shall be changed into or exchanged for a different number or kind of shares of stock or other securities of the Company or of another corporation, whether through reorganization, recapitalization, stock split-up, combination of shares, sale of assets, merger or consolidation in which the Company is the surviving corporation, then, there shall be substituted for each share of the Common Stock then subject to any Option and for each share of the Common Stock reserved for issuance in accordance with the provisions of the Plan but not yet covered by an Option and for each share of the Common Stock referred to in Sections 6B and 9B, the number and kind of shares of stock or other securities into which each outstanding share of the Common Stock shall be so changed or for which each such share shall be exchanged.

B. In the event that there shall be any change, other than as specified in Section 13, in the number or kind of outstanding shares of the Common Stock, or of any stock or other securities into which the Common Stock shall have been changed, or for which it shall have been exchanged, then, if the Committee shall, in its sole discretion, determine that such change equitably requires an adjustment in the number or kind of shares then subject to any Option and the number or kind of shares reserved for issuance in accordance with the provisions of the Plan but not yet covered by an Option and the number or kind of shares referred to in Sections 6B and 9B, such adjustment shall be made by the Committee and shall be effective and binding for all purposes of the Plan and of each stock option agreement or certificate entered into in accordance with the provisions of the Plan.

C. In the case of any substitution or adjustment in accordance with the provisions of this Section 13, the option price in each stock option agreement or certificate for each share covered thereby prior to such substitution or adjustment shall be the option price for all shares of stock or other securities which shall have been substituted for such share or to which such share shall have been adjusted in accordance with the provisions of this Section 13.

D. No adjustment or substitution provided for in this Section 13 shall require the Company to sell a fractional share under any stock option agreement or certificate.

E. In the event of the dissolution or liquidation of the Company, or a merger, reorganization or consolidation in which the Company is not the surviving corporation, then, except as otherwise provided in the second sentence of Section 13A, each Option, to the extent not theretofore exercised, shall terminate forthwith.


A. Unless the shares to be issued upon the exercise of an Option by a Participant shall be registered prior to the issuance thereof under the
Securities Act of 1933, as amended, such Participant will, as a condition of
the Company's obligation to issue such shares, be required to give a
representation in writing that he or she is acquiring such shares for his or
her own account as an investment and not with a view to, or for sale in
connection with, the distribution of any thereof.

B. In the event of the death of a Participant, a condition of
exercising any Option shall be the delivery to the Company of such tax waivers
and other documents as the Committee shall determine.

C. In the case of each non-incentive stock option, a condition of
exercising the same shall be the entry by the person exercising the same into
such arrangements with the Company with respect to withholding as the
Committee may determine.

15. No Stockholder Status.

Neither any Participant nor his or her legal representatives, legatees or
distributees shall be or be deemed to be the holder of any share of the Common
Stock covered by an Option unless and until a certificate for such share has
been issued. Upon payment of the purchase price thereof, a share issued upon
exercise of an Option shall be fully paid and non-assessable.


Neither the existence of the Plan nor any Option shall in any way affect
the right or power of the Company or its stockholders to make or authorize any
or all adjustments, recapitalizations, reorganizations or other changes in the
Company's capital structure or its business, or any merger or consolidation of
the Company, or any issue of bonds, debentures, preferred or prior preference
stock ahead of or affecting the Common Stock or the rights thereof, or
dissolution or liquidation of the Company, or any sale or transfer of all or
any part of its assets or business, or any other corporate act or proceeding
whether of a similar character or otherwise.

17. Options Granted in Connection With Acquisitions.

In the event that the Committee determines that, in connection with the
acquisition by the Company or a Subsidiary of another corporation which will
become a Subsidiary or division of the Company or a Subsidiary (such
corporation being hereafter referred to as an "Acquired Subsidiary"), Options
may be granted hereunder to employees and other personnel of an Acquired
Subsidiary in exchange for then outstanding options to purchase securities of
the Acquired Subsidiary. Such Options may be granted at such option prices,
may be exercisable immediately or at any time or times either in whole or in
part, and may contain such other provisions not inconsistent with the Plan, or
the requirements set forth in Section 19 that certain amendments to the Plan be approved by the stockholders of the Company, as the Committee, in its discretion, shall deem appropriate at the time of the granting of such Options.

18. No Employment or Service Right.

Neither the existence of the Plan nor the grant of any Option shall require the Company or any Subsidiary to continue any Participant in the employ of the Company or such Subsidiary or require the Company to continue any Participant as a director of the Company.

19. Termination and Amendment of the Plan.

The Board may at any time terminate the Plan or make such modifications of the Plan as it shall deem advisable; provided, however, that the Board may not without further approval of the holders of a majority of the shares of the Common Stock present in person or by proxy at any special or annual meeting of the stockholders, increase the number of shares as to which Options may be granted under the Plan (as adjusted in accordance with the provisions of Section 13), or change the manner of determining the option prices, or extend the period during which an Option may be granted or exercised; provided, however, the provisions of the Plan governing the grant of Non-Employee Director's Formula Options may not be amended except by the vote of a majority of the members of the Board and by the vote of a majority of the members of the Board who are employees of the Company or a Subsidiary and shall not be amended more than once every six months, other than to comport with changes in the Code, the Employee Retirement Income Security Act of 1974 or the Rules of the Securities and Exchange Commission promulgated under Section 16 of the Exchange Act. Except as otherwise provided in Section 13, no termination or amendment of the Plan may, without the consent of the Participant to whom any Option shall theretofore have been granted, adversely affect the rights of such Participant under such Option.

20. Expiration and Termination of the Plan.

The Plan shall terminate on August 27, 2006 or at such earlier time as the Board may determine. Options may be granted under the Plan at any time and from time to time prior to its termination. Any Option outstanding under the Plan at the time of the termination of the Plan shall remain in effect until such Option shall have been exercised or shall have expired in accordance with its terms.
This schedule contains summary financial information extracted from financial statements for the nine month period ended March 31, 1996 and is qualified in its entirety by reference to such financial statements.

| Date       | 9-MOS | JUN 30-1997 | JUL 1-1996 | MAR 31-1997 | 4,863,237 | 0 | 267,870 | 0 | 5,190,244 | 408,182 | 222,174 | 5,452,192 | 1,464,570 | 1,090,506 | 0 | 3,221,120 | 117,540 | (991,544) | 5,452,192 | 22,184 | 640,046 | 0 | 4,040,794 | 0 | 0 | 301,200 | 0 | 0 | (3,525,596) | 0 | 0 | 0 |
END PRIVACY ENHANCED MESSAGE