 Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2005

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to __________

Commission file number 001-15543

PALATIN TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware 95-4078884
Indicate by check mark whether the Registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Check whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [X] No [ ]

As of May 6, 2005, 54,049,039 shares of the issuer's common stock, par value $.01 per share, were outstanding.

---

PALATIN TECHNOLOGIES, INC.

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Consolidated Balance Sheets as of March 31, 2005 and June 30, 2004 ................................................................. 2

Consolidated Statements of Operations for the Three and Nine Months ended March 31, 2005 and 2004 .................. 3

Consolidated Statements of Cash Flows (Unaudited) for the Nine Months ended March 31, 2005 and 2004 ............. 4

Notes to Consolidated Financial Statements ........................................... 5

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

SIGNATURES

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

PALATIN TECHNOLOGIES, INC.
Consolidated Balance Sheets
(unaudited)

<table>
<thead>
<tr>
<th></th>
<th>March 31, 2005</th>
<th>June 30, 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASSETS</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Current assets:

<table>
<thead>
<tr>
<th>Description</th>
<th>March 31, 2005</th>
<th>June 30, 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>$ 25,026,850</td>
<td>$ 17,947,076</td>
</tr>
<tr>
<td>Available for sale investments</td>
<td>2,386,071</td>
<td>2,465,350</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>1,489,170</td>
<td>-</td>
</tr>
<tr>
<td>Inventories</td>
<td>855,617</td>
<td>-</td>
</tr>
<tr>
<td>Prepaid expenses and other</td>
<td>954,902</td>
<td>428,917</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td><strong>30,712,610</strong></td>
<td><strong>20,841,343</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>March 31, 2005</th>
<th>June 30, 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property and equipment, net</td>
<td>6,026,841</td>
<td>6,356,089</td>
</tr>
<tr>
<td>Restricted cash</td>
<td>350,000</td>
<td>428,075</td>
</tr>
<tr>
<td>Other</td>
<td>837,580</td>
<td>174,930</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>37,927,031</strong></td>
<td><strong>27,800,437</strong></td>
</tr>
</tbody>
</table>

### LIABILITIES AND STOCKHOLDERS' EQUITY

#### Current liabilities:

<table>
<thead>
<tr>
<th>Description</th>
<th>March 31, 2005</th>
<th>June 30, 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital lease obligations, current portion</td>
<td>$ 11,100</td>
<td>$ 33,491</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>5,025,122</td>
<td>2,019,970</td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>1,756,668</td>
<td>2,461,605</td>
</tr>
<tr>
<td>Accrued compensation</td>
<td>300,000</td>
<td>599,600</td>
</tr>
<tr>
<td>Deferred revenue, current portion</td>
<td>4,340,324</td>
<td>242,000</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td><strong>11,433,214</strong></td>
<td><strong>5,356,666</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>March 31, 2005</th>
<th>June 30, 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital lease obligations, net of current portion</td>
<td>20,884</td>
<td>30,203</td>
</tr>
<tr>
<td>Deferred rent, net of current portion</td>
<td>2,912,874</td>
<td>3,026,928</td>
</tr>
<tr>
<td>Deferred revenue, net of current portion</td>
<td>9,724,483</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>24,091,455</strong></td>
<td><strong>8,413,797</strong></td>
</tr>
</tbody>
</table>

#### Commitments and contingencies (Note 4)

#### Stockholders' equity:

- **Preferred stock** of $.01 par value - authorized 10,000,000 shares; Series A Convertible; issued and outstanding 11,697 shares as of March 31, 2005 and June 30, 2004: 117, 117
- **Common stock** of $.01 par value - authorized 150,000,000 shares; issued and outstanding 54,049,039 and 52,790,589 shares as of March 31, 2005 and June 30, 2004, respectively: 540,490, 527,906
- **Additional paid-in capital**: 139,801,998, 136,148,482
- **Deferred compensation**: - (78,407)
- **Accumulated other comprehensive loss**: (114,051), (84,772)
- **Accumulated deficit**: (126,392,978), (117,126,686)

<table>
<thead>
<tr>
<th>Description</th>
<th>March 31, 2005</th>
<th>June 30, 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total stockholders' equity</strong></td>
<td><strong>13,835,576</strong></td>
<td><strong>19,386,640</strong></td>
</tr>
<tr>
<td><strong>Total liabilities and stockholders' equity</strong></td>
<td><strong>37,927,031</strong></td>
<td><strong>27,800,437</strong></td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these financial statements.
## PALATIN TECHNOLOGIES, INC.
### Consolidated Statements of Operations
(unaudited)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>REVENUES:</strong></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Product and royalty</td>
<td>$465,974</td>
<td>$-</td>
<td>$2,715,472</td>
<td>$-</td>
</tr>
<tr>
<td>Licenses, grants and</td>
<td>$2,340,869</td>
<td>180,754</td>
<td>9,396,719</td>
<td>2,304,819</td>
</tr>
<tr>
<td>contracts</td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>$2,806,843</td>
<td>180,754</td>
<td>12,112,191</td>
<td>2,304,819</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>OPERATING EXPENSES:</strong></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Cost of product and</td>
<td>91,206</td>
<td>-</td>
<td>471,441</td>
<td>-</td>
</tr>
<tr>
<td>royalty revenues</td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Research and development</td>
<td>4,854,417</td>
<td>7,127,006</td>
<td>16,619,541</td>
<td>17,959,723</td>
</tr>
<tr>
<td>General and administrative</td>
<td>1,958,738</td>
<td>1,164,992</td>
<td>5,297,633</td>
<td>4,168,322</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>6,904,361</td>
<td>8,291,998</td>
<td>22,388,615</td>
<td>22,128,045</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Loss from operations</strong></td>
<td>$(4,097,518)</td>
<td>$(8,111,244)</td>
<td>$(10,276,424)</td>
<td>$(19,823,226)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>OTHER INCOME (EXPENSE):</strong></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Investment income</td>
<td>161,169</td>
<td>88,297</td>
<td>440,803</td>
<td>261,389</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(3,907)</td>
<td>(4,535)</td>
<td>(10,946)</td>
<td>(16,302)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Total other income, net</strong></td>
<td>157,262</td>
<td>83,763</td>
<td>429,857</td>
<td>245,807</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Loss before income taxes</strong></td>
<td>(3,940,256)</td>
<td>(8,027,481)</td>
<td>(9,846,567)</td>
<td>(19,578,139)</td>
</tr>
<tr>
<td>Income tax benefit</td>
<td>-</td>
<td>-</td>
<td>580,275</td>
<td>240,836</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>NET LOSS</strong></td>
<td>$(3,940,256)</td>
<td>$(8,027,481)</td>
<td>$(9,266,292)</td>
<td>$(19,337,303)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Basic and diluted net loss per common share</td>
<td>$(0.07)</td>
<td>$(0.16)</td>
<td>$(0.17)</td>
<td>$(0.42)</td>
</tr>
<tr>
<td>Weighted average number of common shares outstanding used in computing basic and diluted net loss per</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The accompanying notes are an integral part of these financial statements.

### Table of Contents

PALATIN TECHNOLOGIES, INC.
Consolidated Statements of Cash Flows
(unaudited)

Nine Months Ended March 31,

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH FLOWS FROM OPERATING ACTIVITIES:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net loss</td>
<td>$(9,266,292)</td>
<td>$(19,337,303)</td>
</tr>
<tr>
<td>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>806,689</td>
<td>805,805</td>
</tr>
<tr>
<td>Stock-based compensation</td>
<td>(2,301)</td>
<td>858,982</td>
</tr>
<tr>
<td>Changes in certain operating assets and liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>(1,489,170)</td>
<td>(26,258)</td>
</tr>
<tr>
<td>Inventories</td>
<td>(855,617)</td>
<td>-</td>
</tr>
<tr>
<td>Prepaid expenses and other</td>
<td>(1,095,573)</td>
<td>183,039</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>3,005,152</td>
<td>909,699</td>
</tr>
<tr>
<td>Accrued expenses and other</td>
<td>(1,118,591)</td>
<td>(187,190)</td>
</tr>
<tr>
<td>Deferred revenues</td>
<td>13,822,807</td>
<td>(155,081)</td>
</tr>
<tr>
<td>Net cash provided by (used in) operating activities</td>
<td>3,807,104</td>
<td>(16,948,307)</td>
</tr>
</tbody>
</table>

| CASH FLOWS FROM INVESTING ACTIVITIES: |            |            |
| Sale or maturity of short-term investments | 50,005      | 50,049     |
| Purchases of property and equipment     | (474,127)  | (108,856)  |
| Net cash used in investing activities   | (424,122)  | (58,807)   |

| CASH FLOWS FROM FINANCING ACTIVITIES: |            |            |
| Payments on capital lease obligations  | (31,710)   | (150,210)  |
| Proceeds from common stock, stock option and warrant issuances, net | 3,728,502 | 26,100,972 |
| Net cash provided by financing activities | 3,696,792  | 25,950,762 |

NET INCREASE IN CASH AND CASH EQUIVALENTS

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7,079,774</td>
<td>8,943,648</td>
</tr>
</tbody>
</table>
CASH AND CASH EQUIVALENTS, beginning of period 17,947,076 14,294,603

CASH AND CASH EQUIVALENTS, end of period 25,026,850 23,238,251

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

Table of Contents

PALATIN TECHNOLOGIES, INC.
Notes to Consolidated Financial Statements
(unaudited)

(1) Organization:

Nature of Business — Palatin Technologies, Inc. (“Palatin” or the “Company”) is a biopharmaceutical company focused on discovering and developing melanocortin (“MC”)-based therapeutics, which the Company believes is one of the fastest growing areas of pharmaceutical research and development. The MC family of receptors has been identified with a variety of conditions and diseases, including sexual dysfunction, obesity, cachexia (extreme wasting, generally secondary to a chronic disease) and inflammation. The Company's objective is to become a worldwide leader in MC-based therapeutics by pursuing a strategy based on commercializing the Company's products under development and identifying new product targets through the utilization of the Company's patented drug discovery platform.

In July 2004, the Company received approval from the U.S. Food and Drug Administration (“FDA”) to market NeutroSpec(TM), the Company's proprietary radiolabeled monoclonal antibody product, for imaging and diagnosing equivocal appendicitis. NeutroSpec is marketed and distributed by the Company's strategic collaboration partner, Mallinckrodt Imaging, a business unit of Tyco Healthcare (“Mallinckrodt”). The Company is currently conducting additional clinical trials with NeutroSpec and evaluating its market potential as an imaging agent for other indications such as osteomyelitis (infection deep inside a bone), fever of unknown origin, post surgical infection, inflammatory bowel disease and pulmonary infection.

PT-141, the Company's lead therapeutic drug candidate, is a patented, nasally-administered peptide that is in clinical development for the treatment of both male and female sexual dysfunction. The Company completed various Phase 1 safety studies and Phase 2A and Phase 2B efficacy studies in male subjects and patients. The Company also completed a Phase 1 safety study in female subjects and a Phase 2A efficacy study in female patients with female sexual dysfunction.
In August 2004, the Company entered into a Collaborative Development and Marketing Agreement with King Pharmaceuticals, Inc. (“King”), a specialty pharmaceutical company, to jointly develop and commercialize PT-141. Pursuant to the terms of the agreement, King and Palatin will share all collaboration development and marketing costs and all collaboration net profits derived from net sales of PT-141 in North America based on an agreed percentage. King and Palatin currently plan to seek a partner for PT-141 for territories outside of North America and will jointly share in collaboration development and marketing costs and all collaboration revenues generated from those territories. Palatin has the option to create, with King, a urology specialty sales force to co-promote the product in the U.S. if the product is successfully developed and commercialized.

In addition, the Company has several preclinical drug candidates under investigation based on the MC family of receptors for various therapeutic indications including obesity, cachexia, and congestive heart failure.

Key elements of the Company's business strategy include: entering into alliances and partnerships with pharmaceutical companies to facilitate the development, manufacture, marketing, sale and distribution of the Company's product candidates under investigation, expansion of the Company's pipeline through the utilization of its MC expertise and patented drug discovery platform, opportunistic acquisition of synergistic products and technologies and partial funding of the Company's development and discovery programs with the cash flow from its NeutroSpec and PT-141 collaboration agreements.

Business Risk and Liquidity — The Company has incurred cumulative negative cash flows from operations since its inception, and has expended, and expects to continue to expend in the future, substantial funds to complete its planned product development efforts. As shown in the accompanying financial statements, the Company incurred a net loss of $9,266,292 for the nine months ended March 31, 2005 and has an accumulated deficit of $126,392,978 as of March 31, 2005. The Company anticipates incurring additional losses in the future as it conducts clinical trials for other indications of NeutroSpec and continues research and development of PT-141 and its MIDAS(TM)(Metal Ion-induced Distinctive Array of Structures) technology. To achieve profitability, the Company, alone or with others, must successfully develop and commercialize its technologies and proposed products, conduct successful pre-clinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture and market such technologies and proposed 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.

The Company has cash and cash equivalents of $25,026,850 and investments of $2,386,071 as of March 31, 2005. The Company expects that its existing capital resources will be adequate to fund the Company's projected operations through at least March 31, 2006, based on current and projected expenditure levels. Management plans to continue to refine its operations, control expenses, evaluate alternative methods to conduct its business, and seek
available and attractive sources of financing and sharing of development costs through strategic collaboration agreements or other resources. Should appropriate sources of financing not be available, management would delay certain clinical trials and research activities until such time as appropriate financing was available. There can be no assurance that the Company's financing efforts will be successful. If adequate funds are not available, the Company's financial condition will be materially and adversely affected.

Concentrations — Financial instruments that potentially subject the Company to concentrations of credit risk primarily consist of cash and cash equivalents, short-term investments and accounts receivable. The Company invests its excess cash and cash equivalents primarily in one money market fund sponsored by a highly-rated financial institution.

The Company's accounts receivable as of March 31, 2005 consist of amounts due from Mallinckrodt and King under its collaboration agreements.

Revenue from King represented 83% and 61% of the Company's total revenue in the three and nine months ended March 31, 2005, respectively, and revenue from Mallinckrodt represented 17% and 39% of the Company's total revenue in the three and nine months ended March 31, 2005, respectively. Revenue from Mallinckrodt represented 17% and 94% of the Company's revenue in the three and nine months ended March 31, 2004.

(2) BASIS OF PRESENTATION:

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnote disclosures required to be presented for complete financial statements. In the opinion of management, these financial statements contain all adjustments (consisting of only normal recurring adjustments) considered necessary to present fairly the Company's financial position as of March 31, 2005, its results of operations for the three and nine months ended March 31, 2005 and 2004 and its cash flows for the nine months ended March 31, 2005 and 2004. The results of operations for the three and nine month periods ended March 31, 2005 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 ending June 30, 2005.

The accompanying financial statements should be read in conjunction with the audited financial statements and notes thereto included in our annual report on Form 10-K, filed with the Securities and Exchange Commission, which includes financial statements as of June 30, 2004 and 2003 and for each of the three fiscal years ended June 30, 2004. Beginning with the Company's current fiscal year, the Company is no longer considered to be a development-stage enterprise for accounting purposes. As a result, certain related disclosures and cumulative amounts presented in prior years have been omitted, as they are no longer required.
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

*Investments* — The Company accounts for its investments in accordance with Statement of Financial Accounting Standards ("SFAS") 115, “Accounting For Certain Investments in Debt and Equity Securities.” The Company classifies such investments as available for sale investments and all such investments are recorded at fair value. The investments consist of mutual funds. Unrealized holding gains and losses, net of the related tax effect, if any, are excluded from earnings and are reported in other comprehensive loss and as a separate component of stockholders’ equity until realized. Interest on securities classified as available for sale is included in investment income. Realized gains and losses are recorded in the statement of operations in the period that the transaction occurs.

The following is a summary of available for sale investments as of March 31, 2005:

<table>
<thead>
<tr>
<th>Gross Cost</th>
<th>Gross Unrealized Gains</th>
<th>Gross Unrealized Losses</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual funds</td>
<td>$2,500,122</td>
<td>$ -</td>
<td>$ (114,051)</td>
</tr>
<tr>
<td>Total</td>
<td>$2,500,122</td>
<td>$ -</td>
<td>$ (114,051)</td>
</tr>
</tbody>
</table>

Inventories — The Company’s inventories are related to NeutroSpec. Inventories are valued at the lower of cost or market using the first-in, first-out method and exclude certain costs incurred prior to the FDA approval of NeutroSpec in July 2004, which were charged directly to research and development. As of March 31, 2005, all inventories consist of work-in-progress materials.

Deferred Charges — Certain license fee payments related to PT-141 and the Company’s collaborative agreement with King are being amortized over the period in which the Company performs certain development activities under the agreement.

Revenue Recognition — Product and royalty revenues consist of revenue from the sale
of NeutroSpec pursuant to our collaboration agreement with Mallinckrodt. Product revenues are recognized upon delivery to and acceptance of the product by Mallinckrodt, which is when title transfers. Upon acceptance of the product, Mallinckrodt does not have the right of return or right to cancel or terminate the sale. Royalty revenues are recognized based on Mallinckrodt’s reported net sales of product.

Revenue from corporate collaborations and licensing agreements consists of up-front fees, research and development funding, and milestone payments. Non-refundable up-front fees are deferred and amortized to revenue over the related performance period. The Company estimates the performance period as the period in which it performs certain development activities under the applicable agreement. The actual performance period may vary. The Company adjusts the performance period estimate based upon available facts and circumstances. Estimated reimbursements for research and development activities and government grants are recorded in the period that the Company performs the related activities under the terms of the applicable agreements. Revenue resulting from the achievement of milestone events stipulated in the applicable agreements is recognized when the milestone is achieved. Milestones are based on the occurrence of a substantive element specified in the contract or as a measure of substantive progress towards completion under the contract. Grant and other contract revenues are recognized as the Company provides the services stipulated in the underlying grants and/or contracts based on the time and materials incurred.

In August 2004, King paid the Company $20,000,000 at closing of the collaboration agreement and may pay potential milestone payments to the Company totaling up to $100,000,000 for achieving certain male erectile dysfunction (“ED”) and female sexual dysfunction (“FSD”) development and regulatory approval targets. After regulatory approval and commercialization of PT-141, King may also pay milestone payments to the Company totaling up to an additional $130,000,000 upon achieving specified annual North American net sales thresholds. A portion of the above milestones may be received in the form of equity contributions.

Of the $20,000,000 payment received at closing, $3,606,672 was recorded as an equity contribution and $16,393,328 was recorded as deferred revenue to be recognized as revenue over the remaining development term of this agreement. The amount attributable to the equity contribution was based on the estimated fair value of 1,176,125 shares of common stock and three-year warrants to purchase 235,225 shares of common stock at $4.25 per share which were issued to King. For the three and nine months ended March 31, 2005, the Company recognized $1,024,583 and $2,570,520, respectively, of the deferred revenue.

Research and Development Costs – The costs of research and development activities are charged to expense as incurred.

Stock Options – The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board Opinion (“APB”) 25, “Accounting for Stock Issued to Employees”, and related interpretations, to account for its fixed-plan stock options. Under this method, compensation cost is recorded only if the current market
price of the underlying stock on the date of grant exceeded the exercise price. SFAS 123, “Accounting for Stock-Based Compensation”, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by SFAS 123, as amended in SFAS 148, “Accounting for Stock-Based Compensation — Transition and Disclosure”, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS 123.

Table of Contents

The Company applies APB 25 and the related interpretations in accounting for its stock options. Had compensation cost for the Company’s common stock options been determined based upon the fair value of the options at the date of grant, as prescribed under SFAS 123, the Company’s net loss and net loss per common share would have been equal to the following pro forma amounts:

<table>
<thead>
<tr>
<th></th>
<th>Three Months Ended March 31,</th>
<th>Nine months ended March 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>Net loss:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>As reported</td>
<td>$(3,940,256)</td>
<td>$(8,027,481)</td>
</tr>
<tr>
<td>Stock-based employee compensation expense included in the determination of net loss as reported</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Impact of total stock-based compensation expense determined under fair-value-based method</td>
<td>(223,705)</td>
<td>(261,051)</td>
</tr>
<tr>
<td>Pro forma</td>
<td>$(4,163,961)</td>
<td>$(8,288,532)</td>
</tr>
</tbody>
</table>

Basic and diluted net loss per common share:

<table>
<thead>
<tr>
<th></th>
<th>Three Months Ended March 31,</th>
<th>Nine months ended March 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>As reported</td>
<td>$(0.07)</td>
<td>$(0.16)</td>
</tr>
<tr>
<td>Impact of SFAS 123</td>
<td>(0.01)</td>
<td>-</td>
</tr>
<tr>
<td>Pro forma</td>
<td>$(0.08)</td>
<td>$(0.16)</td>
</tr>
</tbody>
</table>

The assumptions used in the Black-Scholes option-pricing model are as follows: dividend yield of 0%; weighted average risk-free interest rate of approximately 4.5% and 3.7% in the three and nine months ended March 31, 2005, respectively, and 2.6% and 3.5% in the three and nine months ended March 31, 2004, respectively; expected volatility of approximately 87% and 89% in the three and nine months ended March 31, 2005, respectively, and 92% and 93% in the three and nine months ended March 31, 2004,
respectively; and an expected option life of seven years.

The Company accounts for options granted to consultants in accordance with EITF 96-18, “Accounting for Equity Instruments with Variable Terms That Are Issued for Consideration Other Than Employee Services.” The Company determines the value of consultants’ stock options utilizing the Black-Scholes option pricing model.

**Income Taxes** – The Company and its subsidiaries file consolidated federal and separate state income tax returns. The Company accounts for income taxes in accordance with SFAS 109, “Accounting for Income Taxes”, which requires, among other things, the use of the asset and liability method in computing deferred income taxes.

The Company provides for deferred income taxes relating to net operating loss and credit carryforwards and temporary differences in the recognition of income and expense items (primarily relating to accrued expenses, depreciation, amortization, certain leases and, in the fiscal year ending June 30, 2005, deferred revenue from King) for financial and tax reporting purposes. Such amounts are measured using current tax laws and regulations in accordance with the provisions of SFAS 109.

In accordance with SFAS 109, the Company has recorded a valuation allowance against the realization of its deferred tax assets. The valuation allowance is based on management’s estimates and analysis, which includes tax laws which may limit the Company’s ability to utilize its net operating loss and credit carryforwards.

**Net Loss per Common Share** – The Company applies SFAS 128, “Earnings per Share”, which requires dual presentation of basic and diluted earnings per share (“EPS”) for complex capital structures on the face of the statement of operations. Basic EPS is computed by dividing the income (loss) by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution from the exercise or conversion of securities into common stock, such as stock options and warrants. For the three and nine months ended March 31, 2005 and 2004, there were no dilutive effects of stock options or warrants as the Company incurred a net loss in each period. Common shares issuable upon conversion of Series A Convertible Preferred Stock and the exercise of outstanding options and warrants at prices ranging from $0.01 to $13.02 per share amounted to 13,039,115 at March 31, 2005.

**Other Comprehensive Loss** — Other comprehensive loss consists of the following:

<table>
<thead>
<tr>
<th></th>
<th>Three Months Ended March 31,</th>
<th>Nine months ended March 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>Net loss</td>
<td>$(3,940,256)</td>
<td>$(8,027,481)</td>
</tr>
</tbody>
</table>
Unrealized loss on investments          (14,083)          (3,643)         (29,279)         (125,321)

                      -------------    -------------    -------------     -------------
Comprehensive loss                 $ (3,954,339)    $ (8,031,124)    $ (9,295,571)     $(19,462,624)
                      =============    =============    =============     =============

Use of Estimates – The preparation of consolidated financial statements in conformity with U.S. 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.

Recently Issued Accounting Standards – In March 2004, the Financial Accounting Standards Board revised SFAS 123 by issuing SFAS 123(R), “Share-Based Payment.” SFAS 123(R) replaces SFAS 123 and APB 25 and establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements, measured by the fair value of the equity or liability instruments issued, and is effective as of the fiscal year that begins after June 15, 2005 for public entities. The Company has previously disclosed the pro forma impact on its earnings of adopting the fair value method of accounting for stock-based compensation under SFAS 123 in notes to its Consolidated Financial Statements for the years ended June 30, 2004, 2003, and 2002 and the pro forma impact on the three and nine months ended March 31, 2005 is shown above. The fair-value-based method of SFAS 123 is similar in most respects to the fair-value-based method under SFAS 123(R), however certain transition rules of SFAS 123(R) may affect the impact on the Company's consolidated financial position or results of operations. Such impact, if any, on the Company's consolidated financial position or results of operations has not yet been determined.

(4) COMMITMENTS AND CONTINGENCIES:

Arbitration — On October 29, 2004, Competitive Technologies, Inc. ("CTI") commenced an arbitration with the Company before the American Arbitration Association to settle assertions of breach of the terms of the Company's license agreement with CTI. In the arbitration demand, CTI alleges it is owed $4,000,000, or 20% of the $20,000,000 received by the Company upon the closing of the Company's Collaborative Development and Marketing Agreement with King.

A dispute exists between CTI and the Company concerning the interpretation of this license agreement related to whether PT-141 is a Licensed Product and to amounts that may be owed to CTI thereunder. The license agreement provides for binding arbitration as the remedy for dispute resolution. Palatin disputes CTI's assertions and believes the Company has meritorious defenses. Palatin intends to vigorously defend itself in arbitration and assert all rights accorded it, including under the license agreement and at law.

Lease agreement — The Company has entered into a ten-year lease agreement for
additional office space adjacent to its current facilities. Upon commencement of the lease term, minimum annual lease payments will amount to approximately $210,000 in each of the first five years and $240,000 thereafter.

Table of Contents

(5) RECLASSIFICATION:

Property and equipment, net, consists of the following:

<table>
<thead>
<tr>
<th>March 31,</th>
<th>June 30,</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>2004</td>
</tr>
<tr>
<td>-----------------</td>
<td>-------------------</td>
</tr>
<tr>
<td>Office equipment</td>
<td>$ 1,172,789</td>
</tr>
<tr>
<td>Laboratory</td>
<td>2,374,136</td>
</tr>
<tr>
<td>equipment</td>
<td></td>
</tr>
<tr>
<td>Leasehold</td>
<td>6,168,331</td>
</tr>
<tr>
<td>improvements</td>
<td></td>
</tr>
<tr>
<td>-----------------</td>
<td>-------------------</td>
</tr>
<tr>
<td></td>
<td>9,715,256</td>
</tr>
<tr>
<td>Less: Accumulated</td>
<td>(3,688,415)</td>
</tr>
<tr>
<td>depreciation</td>
<td></td>
</tr>
<tr>
<td>and amortization</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$ 6,026,841</td>
</tr>
<tr>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>

The Company moved into its current research and office facilities in 2002. Prior to the current quarter, the Company classified tenant improvement allowances provided by its landlord as a reduction of leasehold improvements on its consolidated balance sheets. The Company has determined that leasehold improvements should be recorded on a gross basis, and the allowance received should be recorded as a deferred rent liability. Accordingly, the Company has increased leasehold improvements by approximately $3,100,000, net of accumulated amortization, as of March 31, 2005 and recorded a deferred rent liability in a like amount. The deferred rent liability will be amortized over the lease term as a reduction of rent expense and the addition to leasehold improvements will be amortized over the useful life of the improvement. The June 30, 2004 consolidated balance sheet has been similarly reclassified, with leasehold improvements being increased by approximately $3,420,000 and a deferred rent liability being recorded in a like amount. In addition, the cash flow statements for the nine months ended March 31, 2005 and 2004 have been reclassified to include the amortization of the leasehold improvement with depreciation and amortization and the deferred rent liability with accrued expenses and other.
The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements filed as part of this report.

Statements in this quarterly report on Form 10-Q, as well as oral statements that may be made by Palatin or by officers, directors, or employees of Palatin acting on Palatin’s behalf, that are not historical facts constitute “forward-looking statements” which are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”). The forward-looking statements in this quarterly report on Form 10-Q do not constitute guarantees of future performance. Investors are cautioned that statements in this quarterly report on Form 10-Q that are not strictly historical statements including, without limitation, current or future financial performance, management’s plans and objectives for future operations, clinical trials and results, product plans and performance, management’s assessment of market factors, as well as statements regarding the strategy and plans of the Company and its strategic partners, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that could cause the actual results of the Company to be materially different from historical results or from any results expressed or implied by such forward-looking statements. The Company’s future operating results are subject to risks and uncertainties and are dependent upon many factors, including, without limitation, the risks identified in our annual report on Form 10-K for the fiscal year ended June 30, 2004, as well as in our other Securities and Exchange Commission filings.

We expect to incur additional losses in the future as we conduct FDA required post-marketing studies related to the approval of NeutroSpec for diagnosis of appendicitis and expand clinical trials for other indications of NeutroSpec and continue research and development of PT-141 and our MIDAS technology. Operating losses may fluctuate from quarter to quarter as a result of differences in the timing of when we incur expenses.

Critical Accounting Policies and Estimates

We have prepared the accompanying consolidated financial statements in conformity with U.S. generally accepted accounting principles, which require 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.

Our significant accounting policies and our commitments and contingencies are described in the “Notes to Consolidated Financial Statements” contained in our annual report on Form 10-K for the fiscal year ended June 30, 2004. We believe that our accounting policies and estimates relating to revenue recognition, accrued expenses and stock-based compensation charges are the most critical.

Revenue Recognition

Revenue from corporate collaborations and licensing agreements consists of up-front
fees, research and development funding, and milestone payments. Non-refundable up-front fees are deferred and amortized to revenue over the related performance period. We consider our performance period to be the initial research term. The actual performance period may vary. We will adjust the performance period estimate based upon available facts and circumstances. As a result of such adjustments, the period over which such deferred revenue will be recognized may change.

**Accrued Expenses**

A significant portion of our development activities are performed by third-parties. We review the activities performed under significant contracts each quarter and accrue expenses and the amount of any reimbursement to be received from our collaborators based upon the estimated amount of work completed.

**Stock-based Compensation**

Stock-based compensation to consultants and advisors and pro forma disclosures of stock-based compensation to employees includes the fair value of options granted calculated using the Black-Scholes method, which requires us to estimate interest rates, volatility and expected option lives. In addition, certain options are subject to periodic remeasurement over the vesting period as services are rendered, based on changes in the fair value of our common stock. As a result, stock-based compensation charges may vary significantly from period to period.

Table of Contents

Overview

We are primarily focused on discovering and developing melanocortin (“MC”)-based therapeutics, which we believe is one of the fastest growing areas of pharmaceutical research and development. The MC family of receptors has been identified with a variety of conditions and diseases, including sexual dysfunction, obesity, cachexia (extreme wasting, generally secondary to a chronic disease) and inflammation. Our objective is to become a worldwide leader in MC-based therapeutics by pursuing a strategy based on commercializing our products under development and identifying new product targets through the utilization of our patented drug discovery platform.

In August 2004, we entered into a collaboration agreement with King Pharmaceuticals, Inc. (“King”), a specialty pharmaceutical company, to jointly develop and commercialize PT-141, our lead therapeutic drug candidate for the treatment of both male and female sexual dysfunction.

In July 2004, we received approval from the FDA to market NeutroSpec™, our proprietary radiolabeled monoclonal antibody product, for imaging equivocal appendicitis in patients. NeutroSpec is marketed and distributed by our strategic collaboration partner, Mallinckrodt Imaging, a business unit of Tyco Healthcare (“Mallinckrodt”).
Our near-term business strategy focuses on the continued development of PT-141 and supporting the commercial sale of NeutroSpec. Our long-term business strategy includes the advancement of our preclinical product pipeline and identification of new product targets through the utilization of our patented drug discovery platform, moving towards the commercialization of a broad portfolio of therapeutic products. Key elements of our business strategy include:

- Selectively entering into alliances and partnerships with pharmaceutical companies to facilitate the development, manufacture, marketing, sale and distribution of our product candidates under investigation;
- Expansion of our pipeline through the utilization of our MC expertise and patented drug discovery platform;
- Opportunistic acquisition of synergistic products and technologies; and
- Partial funding of our development and discovery programs with the cash flow from our NeutroSpec and PT-141 collaboration agreements.

We incorporated in Delaware in 1986 and commenced operations in the biopharmaceutical area in 1996. Our executive offices and research facility are located at 4C Cedar Brook Drive, Cranbury, New Jersey 08512 and our telephone number is (609) 495-2200. We maintain an Internet site at http://www.palatin.com, where among other things, we make available free of charge on and through this website our directors’ and officers’ Forms 3, 4 and 5, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) and Section 16 of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our website and the information contained therein or connected thereto shall not be deemed to be incorporated into this quarterly report on Form 10-Q.

Products and Technologies in Research and Development

We are concentrating our efforts on the following proposed products and indications:

PT-141. PT-141, our lead therapeutic drug candidate, is a patented, nasally administered peptide that is in clinical development for the treatment of both male and female sexual dysfunction. PT-141 is a synthetic analog of the naturally occurring hormone alpha-MSH (melanocyte-stimulating hormone). It is an MC receptor based therapeutic. The MSH class of hormones are potent regulators of a variety of physiological and behavioral functions, including the natural physiological sexual response. Our research suggests that PT-141 works through activation of MC receptors in the central nervous system rather than acting directly on the vascular system, which is a different mechanism of action from currently marketed male Erectile Dysfunction (“ED”) therapies. As a result, it may offer significant safety and therapeutic benefits over currently marketed products.

We have completed various Phase 1 safety studies and Phase 2A and Phase 2B efficacy
studies in male subjects and patients. We plan to initiate an additional Phase 2B efficacy study in male patients with ED during the second half of calendar year 2005. We have completed a Phase 1 safety study in female subjects and a Phase 2A efficacy study in female patients with Female Sexual Dysfunction (“FSD”).

**Collaborative Development and Marketing Agreement with King.** In August 2004, we entered into a collaboration agreement with King to jointly develop and commercialize PT-141. Pursuant to the terms of the agreement, we will share all collaboration development and marketing costs and all collaboration net profits derived from net sales of PT-141 in North America based on an agreed percentage. We currently plan to seek a partner for PT-141 for territories outside of North America with whom we would jointly share in collaboration development and marketing costs and all collaboration revenues generated from those territories. However, there can be no assurance that we will be able to enter into any such alliance or arrangement on terms acceptable to us or at all.

**Table of Contents**

King paid us $20.0 million at closing and may pay potential milestone payments to Palatin totaling up to $100.0 million for achieving certain ED and FSD development and regulatory approval targets. After regulatory approval and commercialization of PT-141, King may also pay milestone payments to us totaling up to an additional $130.0 million upon achieving specified annual North American net sales thresholds. A portion of the above milestones may be received in the form of equity contributions.

ED is defined as the consistent inability to attain and maintain an erection sufficient for sexual intercourse. The condition is correlated with increasing age, cardiovascular disease, hypertension, diabetes, hyperlipidemia and smoking. In addition, certain prescription drugs and psychogenetic issues may contribute to ED. According to the Massachusetts Male Aging Study, more than 50% of men aged 40-70 report episodes of ED and more than 30 million men in the United States may be afflicted with some form of ED, with less than 20% seeking treatment. The current market size for ED is estimated to be more than $2 billion per year. FSD is a multifactorial condition that has anatomical, physiological, medical, psychological and social components. Studies estimate FSD is prevalent in approximately 50% of women over the age of 30 and that greater than 35 million women in the United States may be afflicted with some form of FSD. FSD includes disorders associated with desire, arousal, orgasm and pain. There is tremendous competition to develop, market and sell drugs for the treatment of ED and FSD.

**NeutroSpec™.** NeutroSpec includes a radioactive technetium-labeled anti-CD 15 monoclonal antibody which selectively binds to a type of white blood cell, neutrophils, involved in the immune response. When injected into the blood stream, NeutroSpec binds to neutrophils accumulated at the infection site, labeling these cells with a radioactive tracer. As a result, physicians can rapidly image and locate an infection using a gamma camera, a common piece of hospital equipment that detects radioactivity within the body. NeutroSpec offers the advantage of direct injection and in vivo labeling of white blood
cells, leading to a rapid and highly specific functional image of an infection in less than an hour, whereas the current standard of care, ex vivo radiolabeled white blood cells, requires a blood sample to be taken from the patient, processed by a nuclear pharmacy and then re-injected into the patient, with diagnostic images usually not available until 12-24 hours later.

In July 2004, we received approval from the FDA to market NeutroSpec, a novel imaging agent, indicated for imaging of patients with equivocal signs and symptoms of appendicitis who are five years of age or older. NeutroSpec is marketed and distributed by our strategic collaboration partner, Mallinckrodt.

We are also conducting additional clinical trials with NeutroSpec to evaluate its market potential as an imaging agent for other indications such as osteomyelitis (infection deep inside a bone), fever of unknown origin, post-surgical abscess, inflammatory bowel disease and pulmonary imaging.

_Strategic Collaboration Agreement with Mallinckrodt._ On May 13, 2002, we entered into an agreement with Mallinckrodt to amend our Strategic Collaboration Agreement dated as of August 17, 1999. Under the terms of the original agreement, in addition to other provisions, Mallinckrodt paid us a licensing fee of $0.5 million and an additional $13.0 million to purchase 700,000 restricted unregistered shares of our preferred stock. We shared NeutroSpec development expenses prior to FDA approval equally with Mallinckrodt. Mallinckrodt agreed to pay us milestone payments of an additional $10.0 million on FDA approval of the first NeutroSpec indication and on attainment of certain sales goals following product launch. We agreed to be responsible for the manufacture of NeutroSpec and Mallinckrodt agreed to pay us a transfer price on each product unit transferred to Mallinckrodt and a royalty on the net sales of NeutroSpec.

Under the terms of the amended agreement, Mallinckrodt committed up to an additional $3.2 million, subject to certain conditions and attaining certain milestones, to offset a portion of the estimated expenses associated with completing the FDA review process. Additionally, timing of the original $10.0 million in milestone payments was revised to coincide with NeutroSpec’s FDA approval and achievement of future sales goals. The $3.2 million has been paid in full and we received a $2.0 million milestone payment upon FDA approval.

Each year, more than 250,000 Americans are diagnosed with the infection, acute appendicitis. A timely and accurate diagnosis of this infection is crucial to ensure timely treatment and to prevent complications for the patient. A delay can entail hospital observation, outpatient treatment or surgery and can lead to increased risk of peritonitis, sepsis and other complications. Conversely, a misdiagnosed patient may experience unneeded hospital observation or unneeded surgery, which is expensive, inconvenient and utilizes limited resources. Every year, more than 350,000 patients present with equivocal appendicitis — this is when a specific diagnosis is uncertain and further testing is needed. In this situation, it is not always clear if the patient has appendicitis or another medical problem; nor is it exactly clear where the site of infection is located.

We believe that NeutroSpec may improve patient diagnosis for appendicitis and that it
has the potential to improve diagnosis of other acute and chronic infections, such as osteomyelitis, fever of unknown origin, post-surgical abscess, inflammatory bowel disease and pulmonary imaging. In 2003, over 700,000 patients were diagnosed with NeutroSpec’s target indications.

Table of Contents

MIDAS™ (Metal Ion-induced Distinctive Array of Structures). MIDAS is a proprietary platform technology that allows us to routinely design and synthesize novel pharmaceuticals that mimic the activity of peptides, but which we believe offer significant advantages to conventional protein or peptide-based drugs. MIDAS uses metal ions to fix the three-dimensional shape of peptides, forming conformationally rigid molecules that remain folded specifically in their active forms. These MIDAS molecules are simple to synthesize, are chemically and proteolytically stable, and have the potential to be orally bioavailable. Moreover, unlike most other drug discovery approaches, we believe that MIDAS is unique in that it can be used to generate either receptor antagonists (drugs that block a particular metabolic response) or agonists (drugs that promote a particular metabolic response). In addition, MIDAS molecules are information-rich and provide data on structure-activity relationships that can be used to design small molecule, non-peptide drugs.

We have initiated a MIDAS program to discover and develop compounds that interact with the MC family of receptors. MC receptors regulate a diverse array of functions such as pigmentation, adrenocortical function, immune modulation, sexual arousal and energy maintenance. Based on this effort, we have identified several MIDAS molecules that are now in preclinical development as potential treatments for sexual dysfunction, obesity, cachexia and inflammation. We expect to file an Investigational New Drug Application (“IND”) for at least one of these preclinical compounds to initiate clinical testing within the next 12 months.

We have identified a series of lead compounds that decrease food intake and body weight in normal and genetically-obese animals. In January 2005, we announced that data on this activity of our lead series of MC receptor, small molecule agonists, under development for the treatment of obesity, were presented at the 2005 Keystone Symposia on Obesity: Molecular Physiology and Genetics of the Control of Body Weight.

Generation of commercially viable protein and peptide drug molecules with desirable properties continues to be arduous, expensive and labor-intensive. We believe that our MIDAS technology would simplify the development process by eliminating many of the inherent limitations associated with peptides and proteins. We intend to seek to enter into strategic alliances or collaborative arrangements to provide additional financial and technical resources for MIDAS development. However, there can be no assurance that we will be able to enter into any such alliance or arrangement.

Results of Operations

Product and Royalty Revenues – For the three and nine months ended March 31, 2005, we recognized product and royalty revenues of $0.5 million and $2.7 million, respectively, related to NeutroSpec, pursuant to our collaboration agreement with Mallinckrodt. The Company received FDA approval to market NeutroSpec in July 2004. Accordingly, there was no product revenue or royalty revenue recognized for the three and nine months ended March 31, 2004.

Licenses, Grants and Contracts – For the three and nine months ended March 31, 2005, we recognized $2.3 million and $9.4 million, respectively, in licenses, grants and contracts revenue consisting primarily of (i) $2.3 million and $7.4 million, respectively, under our collaboration agreement with King related to PT-141, which commenced in August 2004, and (ii) $0 and $2.0 million related to NeutroSpec pursuant to our collaboration agreement with Mallinckrodt. For the three and nine months ended March 31, 2004, we recognized $0.2 and $2.3 million, respectively, in contract revenue, primarily related to NeutroSpec pursuant to our collaboration agreement with Mallinckrodt. The Company expects to continue to earn contract revenue from King as the development of PT-141 continues, in the form of reimbursement of shared development costs and the recognition of deferred license fees. The Company may also earn contract revenue from Mallinckrodt and King based on the attainment of certain development milestones.

Cost of Product and Royalty Revenues – For the three and nine months ended March 31, 2005, we recognized $0.1 million and $0.5 million, respectively, in cost of product and royalty revenues related to NeutroSpec, which was approved by the FDA in July 2004. There was no corresponding cost of product revenues or royalties for the three and nine months ended March 31, 2004. Prior to the FDA approval of NeutroSpec in July 2004, all costs associated with the manufacturing of NeutroSpec were included in research and development expenses when incurred, including costs of usable raw materials and finished goods in inventory at the date of approval. As we use and sell this inventory, the cost of product revenues we recognize will exclude amounts previously expensed. Therefore, we expect our cost of product revenue to increase significantly in future periods as this inventory is consumed and replaced.

Table of Contents

Research and Development – Research and development expenses (“R&D”) amounted to $4.9 million and $16.6 million for the three and nine months ended March 31, 2005, respectively, compared to $7.1 million and $18.0 million for the three and nine months ended March 31, 2004, respectively, reflecting lower spending on NeutroSpec, which was approved by the FDA in July 2004. In the nine months ended March 31, 2005, increased expenses for the Company's PT-141 development program in the first two fiscal quarters partially offset lower NeutroSpec spending. For the three and nine months ended March 31, 2005, research and development spending on NeutroSpec decreased $1.4 million and
$4.6 million, respectively, from the three and nine months ended March 31, 2004. The three and nine month periods of fiscal 2004 included greater nonclinical development spending, prior to FDA approval in July 2004, particularly related to processes for the manufacturing of drug product. We anticipate incurring additional development expenses to evaluate NeutroSpec's market potential as an imaging agent for other indications such as osteomyelitis (infection deep inside a bone), fever of unknown origin, post surgical infection, inflammatory bowel disease and pulmonary infection. Research and development expenses related to PT-141 decreased approximately $1.0 million for the three months ended March 31, 2005 compared to the prior year period, reflecting higher costs of drug product and clinical study expenses in the 2004 period. However, for the nine months ended March 31, 2005, costs of processing drug product, including manufacturing, analytical and process development and equipment costs, increased approximately $2.1 million over 2004 due to spending in the first two quarters of this fiscal year. The Company expects to continue to incur significant research and development expenses on these programs and on its MIDAS program. The amount and timing of such expenses will depend on a number of factors described in our annual report on Form 10-K for the fiscal year ended June 30, 2004, including the results of the Company's research activities, its collaboration agreements and the availability and sources of financing.

**General and Administrative** – General and administrative expenses increased to $2.0 million and $5.3 million for the three and nine months ended March 31, 2005, respectively, compared to $1.2 million and $4.2 million for the three and nine months ended March 31, 2004, respectively, due to the general expansion of the Company's business activities, particularly personnel and consulting costs. In the nine month period, such increases were partially offset by lower stock-based compensation charges.

**Income Taxes** – Income tax benefits of $0 and $0.6 million in the three and nine months ended March 31, 2005 and $0 and $0.2 million in the three and nine months ended March 31, 2004 relate to the sale of New Jersey state net operating loss carryforwards and research and development credits. Such sales, if any, occur once a year. The amount of such losses and tax credits we may sell depends on annual pools and allocations established by the State of New Jersey.

**Liquidity and Capital Resources**

Since inception, we have incurred net operating losses, primarily related to spending on our research and development programs. As of March 31, 2005, we had an accumulated deficit of $126.4 million. We have financed our net operating losses through March 31, 2005 primarily through equity financings and revenue received under collaborative agreements. As of March 31, 2005, we had cash and cash equivalents of $25.0 million and short-term investments of $2.4 million.

Our product candidates are at various stages of research and development and some may never be successfully developed or commercialized. We received regulatory approval to market and sell NeutroSpec for diagnosis of appendicitis, and we will need regulatory approval to market and sell PT-141, MIDAS products and NeutroSpec for other indications. PT-141, MIDAS products and NeutroSpec for other indications will require significant
further research, development and testing. We may experience uncertainties, delays, difficulties and expenses commonly experienced by early stage biopharmaceutical companies, which may include unanticipated problems and additional costs relating to:

- the development and testing of products in animals and humans;
- product approval or clearance;
- regulatory compliance;
- good manufacturing practices;
- intellectual property rights;
- product introduction; and
- marketing, sales and competition.

Table of Contents

Failure to obtain timely regulatory approval for our other products and indications would impact our ability to increase sales and could make it more difficult to attract investment capital for funding our operations. Any of these possibilities could materially and adversely affect our operations.

In July 2004, we received approval from the FDA to market NeutroSpec. Approval of NeutroSpec does not assure the product’s commercial success. If NeutroSpec does not achieve adequate market acceptance, our financial condition and results of operations will be adversely affected.

During the nine months ended March 31, 2005, our operating activities provided net cash of $3.8 million. During the nine months ended March 31, 2004, our operating activities used net cash of $16.9 million. The difference is primarily the result of cash received under our collaboration agreement with King, which was completed in August 2004.

During the nine months ended March 31, 2005 and 2004, cash used in investing activities was $0.4 million and $0.1 million, respectively, consisting of capital expenditures, net of cash received upon maturity of investments. As a result of planned increases in its development and other business activities and related employment, the Company intends to expand its facilities in Cranbury, NJ. The Company projects that related capital expenditures will be completed by June 30, 2005 and will amount to approximately $1.0 million, a portion of which is included in the nine-month 2005 results.

During the nine months ended March 31, 2005, net cash provided by financing activities was $3.7 million, due primarily to proceeds from the issuance of common stock and warrants to King and the exercise of options and warrants. During the nine months ended March 31, 2004, net cash provided by financing activities was $26.0 million, primarily from a private placement of common stock and warrants completed in January 2004, which resulted in net proceeds to the Company of approximately $21.0 million.
We are, and expect to continue, actively searching for certain products and technologies to license or acquire, now or in the future. If we are successful in identifying a product or technology for acquisition, we may require substantial funds for such an acquisition and subsequent development or commercialization. We do not know whether any acquisition will be consummated in the future.

We have incurred cumulative negative cash flows from operations since our inception, and have expended, and expect to continue to expend in the future, substantial funds to complete our planned product development efforts. We expect that our existing capital resources will be adequate to fund our projected operations through at least March 31, 2006, based on current and projected expenditure levels. No assurance can be given that we will not consume a significant amount of our available resources before that time. We plan to continue to refine our operations, control expenses, evaluate alternative methods to conduct our business and seek available and attractive sources of financing and sharing of development costs through strategic collaboration agreements or other resources. Should appropriate sources of financing not be available, we would delay certain trials and research activities until such time as appropriate financing was available.

We anticipate incurring additional losses over at least the next few years. To achieve profitability, we, alone or with others, must successfully develop and commercialize our technologies and proposed products, conduct pre-clinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture and market such technologies and proposed products. The time required to reach profitability is highly uncertain, and we do not know whether we will be able to achieve profitability on a sustained basis, if at all.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk. Our exposure to market risk related to changes in interest rates relates primarily to our investment portfolio. We invest in instruments that meet high credit quality standards, and with respect to our investments, we limit the amount of credit exposure as to any one issue, issuer and type.

As of March 31, 2005, our cash and cash equivalents were $25.0 million and our investments, which consisted of mutual funds, were $2.4 million. Due to the average maturity and conservative nature of our investment portfolio, we do not believe that short term fluctuations in interest rates would materially affect the value of our investments.

Foreign Currency Risk. A significant portion of the cost of manufacturing NeutroSpec is denominated in Euros. Therefore, a fluctuation in exchange rates between the Euro and the U.S. dollar would affect the Company's future cost of product revenues. The impact on the Company's future results of operations of any such change will be dependent on the volume and timing of the Company's future purchases. In addition, the Company incurs certain research and development costs denominated in foreign currency, which fluctuate from period to period.

As of March 31, 2005, the amount of accounts payable and accrued expenses denominated in Euros was approximately $655,000. Percentage increases in the U.S. dollar
cost of Euros would result in corresponding increases in such liabilities. The Company has not hedged its exposures to foreign exchange fluctuations. However, the Company monitors its foreign-currency denominated liabilities and commitments on an ongoing basis and may enter into hedging transactions in the future.

Table of Contents

Item 4. Controls and Procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e) and 15d-15(e), as of March 31, 2005. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were adequate and effective to ensure that material information relating to Palatin was made known to them by others within Palatin, particularly during the period in which this quarterly report on Form 10-Q was being prepared. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that materially affected or that are reasonably likely to materially affect our internal control over financial reporting.

Table of Contents

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

On October 29, 2004, Competitive Technologies, Inc. (“CTI”) commenced an arbitration with us before the American Arbitration Association to settle assertions of breach of the terms of our license agreement with CTI. In the arbitration demand, as a result of the closing of the Company’s Collaborative Development and Marketing Agreement, CTI alleges “damages in the amount of at least $4.0 million, plus interest, costs and attorneys’ fees. CTI reserves the right to adjust the claimed damages if additional information is discovered during the course of the arbitration.”

A dispute exists between CTI and us concerning the interpretation of this license agreement related to whether PT-141 is a Licensed Product and amounts that may be owed to CTI thereunder. The license agreement provides for binding arbitration as the remedy for dispute resolution. We dispute CTI’s assertions and believe we have meritorious defenses. We intend to vigorously defend ourselves in arbitration and assert all rights accorded to us, including under the license agreement and at law. We believe that the ultimate resolution of this matter will not have a material adverse effect on our financial position or results of operations.
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.


Exhibits filed with this report:

3.01 Certificate of Incorporation as amended on May 5, 2005

31.1 Certifications of Chief Executive Officer

31.2 Certifications of Chief Financial Officer

32.1 Certification by CEO pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification by CFO pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002
EXHIBIT INDEX

3.01 Certificate of Incorporation as amended on May 5, 2005

31.1 Certifications of Chief Executive Officer

31.2 Certifications of Chief Financial Officer

32.1 Certification by CEO pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification by CFO pursuant to 18 U.S.C. Section 1350, as added by Section 906 of the Sarbanes-Oxley Act of 2002