

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 1998

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 000-14242

CELSION CORPORATION

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(Exact name of registrant as specified in its charter)

Maryland

52-1256615

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State or other jurisdiction of  
incorporation or organization

(I.R.S. Employer Identification No.)

10220-I Old Columbia Road  
Columbia, Maryland

21046-1705

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (410) 290-5390

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$.01 per share

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(Title of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (ss. 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of December 24, 1998, 41,514,467 shares of the Registrant's Common Stock were issued and outstanding. As of December 24, 1998, the aggregate market value of voting stock held by non-affiliates of the Registrant was approximately \$7,338,926 based on the average of the closing bid and asked prices for the Registrant's Common Stock as quoted on the over-the-counter market.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated by reference in this Report on Form 10-K: None.

PART I

ITEM 1. BUSINESS

General

Celsion Corporation (the "Company") was incorporated in the State of Maryland in 1982 under the name A.Y. Cheung Associates, Inc. The Company changed its name to Cheung Laboratories, Inc. on June 31, 1984 and to Celsion Corporation on May 1, 1998. The Company is a biomedical research and development company headquartered in Columbia, Maryland, dedicated to creating and marketing medical treatment systems for cancer, benign prostatic hyperplasia ("BPH") and other diseases using focused heat energy.

Thermotherapy (also known as hyperthermia), or heat therapy, is an historically recognized successful method of treatment. In modern thermotherapy, a controlled heat dose is targeted to treatment sites using microwave and/or other energy for therapeutic benefits. Heat is a well-known treatment modality for cancer. In 23 worldwide independent studies on 2,234 tumors, heat plus radiation doubled the complete response rate of tumors (from 38% to 78%) compared to radiation alone. Complete response rate is defined as the total absence of a tumor for a minimum of two years. The same doubling of complete

response rate occurred with heat and chemotherapy. The past technical difficulty has been delivering a controlled amount of heat to internal tumors without burning surrounding healthy tissues. The Company has an exclusive license from the Massachusetts Institute of Technology ("MIT") for adaptive phase array ("APA") technology which the Company believes will overcome this problem.

The Company will therefore be concentrating its business on the development of two acquired technologies: (I) from MIT, APA targeting of microwave energy, which the Company believes will have broad cancer and other medical applications, and (ii) balloon catheter technology for enhanced thermotherapy of BPH and other genitourinary tract conditions. While the balloon catheter technology is related to the Company's previous BPH thermotherapy devices, the Company believes the APA technology has the potential to serve as the core technology for a broad array of medical devices.

MIT "Adaptive Phased Array" Technology

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- the Enabling Platform  
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In mid 1996, the Company obtained an exclusive license to a patented portfolio of MIT "adaptive phased array" technologies which were originally developed for the Strategic Defense Initiative (Star Wars) plans of the Department of Defense to track targets and to nullify the energy beam from enemy jamming equipment. The APA technology allows microwave energy to be accurately targeted deep within the body, resulting in heating a well defined target area without damaging surrounding tissue. On October 24, 1997, the Company entered into a revised exclusive license agreement with MIT covering the above mentioned patents in the 1996 agreement as well as an additional patent pending technology using the APA technology for activating thermo-sensitive liposomes.

The ability to selectively heat targeted internal areas of the human body will act as a technological platform on which the Company intends to capitalize, both in the near term and the long term. On September 17, 1997, the Food and Drug Administration (the "FDA") granted the Company a Premarketing Approval ("PMA") for its system of deep focused heat as a treatment modality to be used in conjunction with radiation for the treatment of recurrent surface and subsurface tumors. This approval was obtained as a supplement to an existing approval for the Microfocus 1000, a thermotherapy device that the Company has manufactured since 1989, albeit without the APA technology. This approval, obtained without clinical trials, allows the Company to immediately begin commercialization of the APA technology while concurrently pursuing expanded FDA approvals.

There are numerous technologies that currently exist or are being developed that can utilize the unique properties of the Company's heat delivery

technology, as well as numerous other applications dependent on the heat delivery technology that should evolve over time. Several of the leading applications that have been identified include:

(1) Tumor Ablation-Using Heat Alone

In the spring of 1998, animal studies were completed at Massachusetts General Hospital ("MGH") in Boston and Oxford University in the United Kingdom, confirming the system's ability to focus heat deep within the body. In August, 1998, Hammersmith Hospital in London received approval from its ethics committee to conduct human trials. At MGH's Center for Imaging and Pharmaceutical Research, animal studies were conducted under the direction of Dr. Gerald Wolf. The Company's treatment system was successfully demonstrated to completely ablate tumors in animals using heat alone. In this modality, the tumor is heated to 46(degree) - 48(degree) C (114(degree) - 118(degree) F) or hot enough to kill all cancer cells in one eight minute treatment session.

The Company's system is used in stand-alone mode, without radiation or chemotherapy. Following ablation of the tumor, a surgeon removes the dead tumor. This method of treatment eliminates the risk of surgical removal acting as a catalyst to produce new tumors. It also eliminates the need for destructive, unpleasant and expensive chemotherapy and/or radiation treatments. Whenever ablation is possible, the Company's system will be used without radiation or chemotherapy. The Company needs to obtain a new indication of use (that is, the ablation of breast tumors with heat alone) from the FDA for its already - PMA - approved equipment. Dr. Gerald Wolf of MGH is submitting an application for Investigational Device Exemption ("IDE") to the FDA and will oversee coming clinical trials at MGH, at Hammersmith Hospital London, and Columbia HCA's JFK Hospital in Palm Beach.

(2) Radiation Plus Deep Focused Heat - Doubles Complete Response Rate

The combination of thermotherapy (hyperthermia) and radiation is a significant market opportunity for the Company. Traditional radiation therapy is an expensive, multi-treatment process that is physically debilitating to the person receiving it, and has several inherent systemic limitations:

- S-phase cancer cells are resistant to radiation. (S phase cells represent about 40 percent of the cell cycle; tumoric cells go through a 24 hour cycle of S and G phases.) They are highly susceptible to destruction by heat; and
- Poorly oxygenated (hypoxic) cancer cells are resistant to radiation.

Thermotherapy is known to improve the chances of killing the cancer cells, because

- S-phase cancer cells missed by radiation can be killed by thermotherapy; and
- Thermotherapy increases the oxygenation of cancer cells making them more susceptible to radiation.

The dual treatment modality of thermotherapy and radiation has already been shown through 23 independent studies to double the complete response rates of sub-surface and surface cancers when used in conjunction with radiation or chemotherapy. To date, the problem with this dual treatment application has been the inability of the thermotherapy treatment to focus deep within the body. As stated earlier, the Company's APA technology provides a method through which this can now be accomplished.

(3) Chemotherapy Plus Deep Focused Heat-Doubles Complete Response Rate

Traditional chemotherapy is limited in its ability to kill cancer cells for two major reasons:

- Poor blood perfusion in the vicinity of tumor cells such that chemotherapy delivered through the blood stream does not reach the tumor; and

- Tumor cell pressure prevents chemotherapy from penetrating tumor cell membranes.

Thermotherapy improves the performance of chemotherapy in each of these areas by:

- Increasing the blood flow in the vicinity of tumors in the temperature range of 41(degree)C to 43(degree)C, thereby increasing the delivery of drugs to the tumor site;
- Decreasing the blood flow within the tumor itself to the point where the tumor is easily heated and killed at temperatures above 43(degree) C (tumor vascularity is not robust and does not expand significantly when heated), compared to normal tissue for which heat is easily removed and the tissue is protected; and
- Increasing the toxicity of the chemotherapy agent at 43(degree)C, compared to the toxicity of the same agent at 37(degree)C.

Animal and clinical trials for the combined modalities of chemotherapy and deep focused heat are planned to begin at leading hospitals in 1999.

(4) Heat Sensitive Liposomes (Thermalsomes(TM)) - Targeted and Highly Effective Drug Delivery

One of the initial adjunct opportunities for this patented technology relates to temperature sensitive liposomes (Thermalsomes(TM)) that are being developed at Duke University. Thermalsomes(TM) are microscopic man-made lipid particles (organic compounds including fats, fat-like compounds and steroids) that can be engineered to encapsulate drugs, creating new pharmaceuticals with enhanced efficacy, better safety or both. Toxicity of effective drugs can be mitigated through Thermalsomes(TM) technology.

For application to the human body, the Thermalsomes(TM) are injected into the blood stream. As the Thermalsomes(TM) circulate repeatedly within the small arteries, arterioles, and capillaries, the drug contents of the Thermalsomes(TM) are released in significantly higher levels in areas that have been heated for 30 to 60 minutes, than in areas that do not receive heat. Hence, the Thermalsome(TM) technology is enabled by the Company's thermotherapy treatment modality. Together, these two treatment modalities are expected to release toxins almost exclusively into the targeted area, rather than across the entire circulatory system. This is a fundamental distinction between traditional chemotherapy and Thermalsome(TM) induced, thermotherapy enhanced chemotherapy.

In addition to the increased efficacy, there is potential for great improvement in the life process of chemotherapy patients. Chemotherapy is essentially a poisoning of the body with toxins that attack cancerous cells more readily than normal cells. The side effects include nausea, vomiting, and exhaustion - all side effects of the body being poisoned. If the poisoning can be limited to the tumoric area, and performed only once (due to the increased efficacy) as is possible with the Thermalsome(TM) related treatments, chemotherapy should cease to be the horrid, debilitating process that it is today.

(5) Gene Therapy - Making Tumors Susceptible to Eradication

Another application of the APA technology relates to gene therapy. The Company has been collaborating with a researcher who has developed heat sensitive, genetic biological modifiers which suppress a tumor's resistance to heat, radiation and chemotherapy damage. In clinical applications to management of cancer, the biological modifiers can be attached to a heat shock promoter to form a gene therapy construct. The construct can be delivered to deep seated tumors. The action of focused heat will release and trigger the action of the modifier, thus weakening the tumor's resistance to therapy and greatly enhancing the effectiveness of the combination therapy approach using heat in conjunction with radiation or chemotherapy. Recently, a patent application has been filed by the researcher's institution and the Company has entered into negotiation for the exclusive rights to license the technology for commercial use.

## Projected Deep Focused Heat Product Line

The Company has current plans to produce three specialized thermotherapy products, each utilizing the APA technology for specific deep seated tumors and one BPH product utilizing the balloon catheter technology developed by MMTC, Inc. ("MMTC") and licensed to the Company.

Breast cancer treatment equipment. The Company's breast cancer treatment line will be the first of the three deep-seated cancer treatment product lines introduced into the market. According to the American Cancer Society, breast cancer is the most prevalent cancer in the U.S. with over 183,000 new cases diagnosed each year. It has been suggested that this form of cancer may eclipse cardiovascular disease as the leading cause of death for American women. The Company's strategy for breast cancer treatment will focus on ablation death of tumors.

Early stage breast cancer accounts for two thirds of the breast cancers in the U.S. today. This form of breast cancer is presently treated via mastectomy, the removal of the entire breast, or via lumpectomy, the removal of the tumor and surrounding tissue. In lumpectomy, the area at the edge of the removed tissue is examined for the existence of cancerous cells, and if any are found, the procedure is repeated. Full breast radiation or chemotherapy usually follows this procedure in order to destroy any cancer cells that may not have been captured by the surgical procedure or that may have been spread during the procedure.

The Company's breast cancer treatment system is intended for use prior to lumpectomy to completely destroy the cancerous tissue, making the surgery safer and reducing the size of the lumpectomy procedure. Initially, radiation therapy or chemotherapy will follow the lumpectomy as is the current practice. However, the Company expects, with FDA approval of the Company's breast cancer treatment system, that neither radiation nor chemotherapy will be required for use with the Company's system. The Company believes thermal ablation will offer a safe and thorough treatment in stand-alone mode, eliminating the necessity for radiation or chemotherapy and their debilitating side effects. This alteration in standard practice requires additional clinical trials for FDA clearance.

The Company recently completed animal trials of its prototype clinical breast cancer treatment system at MGH. The results verified that the Company's APA technology accurately focused heat exactly where targeted, and that it is possible to ablate tumors with the Company's equipment. Dr. Gerald Wolf of MGH is submitting an application for IDE to the FDA to start Phase I human clinical trials. Subject to FDA approval and funding availability, the Company anticipates the clinical trials will begin in the first quarter of 1999. A second prototype clinical breast cancer treatment system at Oxford University in the United Kingdom was used to successfully conduct tests on large animals. Hammersmith Hospital in London has received approval from its ethics committee to start human clinical trials with the same breast cancer treatment system tested in Oxford University. Subject to funding availability, it is anticipated that the human clinical trials in Hammersmith Hospital will begin in the second quarter of 1999.

Another potential application of the breast cancer treatment system is preventing breast cancer with heat alone. Dr. Wolf and MGH have filed an application with the United States Patent and Trademark Office to obtain a patent to ablate the milk ducts and milk glands in women's breasts using the Company's APA treatment system. Since approximately 95% or more of all breast cancers originate in these areas, their ablation is expected to remove these potential sources of breast tumors.

Prostate cancer treatment equipment. There are over 163,000 new cases of prostate cancer diagnosed in the United States each year. Building on its experience in BPH treatment, the Company is planning prostate cancer thermotherapy equipment as the second of its APA product line. Although the Company has developed several critical components of this equipment, hospital research is not expected to begin prior to year 2000.

Deep seated tumor treatment equipment. The third planned APA product will be for thermotherapy of deep seated tumors, including liver, pancreas, colon and lung cancers. It is expected that this equipment will also permit treatment on other cancer sites including the head, neck and limbs.

#### MMTC Benign Prostatic Hyperplasia Technology

##### - Major Treatment

#### BPH Background

BPH is a non-cancerous urological disease in which the prostate enlarges and constricts the urethra. Symptoms associated with BPH affect the quality of life of millions of sufferers worldwide, and BPH can lead to irreversible bladder or kidney damage. The prostate is a walnut-size gland surrounding the male urethra that produces seminal fluid and plays a key role in sperm preservation and transportation. As the prostate expands, it compresses or constricts the urethra, thereby restricting the normal passage of urine. This restriction of the urethra may require a patient to exert excessive bladder pressure to urinate. Since the urination process is one of the body's primary means of cleansing impurities, the inability to urinate adequately increases the possibility of infection and bladder and kidney damage.

Because BPH is an age-related disorder, its incidence increases as the population ages. As many as 27 million men between the age of 50 and 80 in the United States alone suffer from BPH. As the population continues to age, the prevalence of BPH will continue to increase dramatically. By age 55, fifty percent of all men, and by age 80, eighty percent of all men, will have BPH.

Like cancer, BPH historically has been treated by surgical intervention or by drug therapy. The primary surgical treatment for BPH is transurethral resection of the prostate ("TURP"), a procedure in which the prostatic urethra and surrounding diseased tissue in the prostate are trimmed, thereby widening the urethral channel for urine flow. While the TURP procedure typically has been considered the most effective treatment available, the procedure has many shortcomings which undermine its value. A large number of patients who undergo TURP encounter significant complications, which can include painful urination, infection, impotence, incontinence, and excessive bleeding. Furthermore, the cost of the TURP procedure is also very high, ranging from \$8,000 to \$12,000, including hospital stay. This high cost also fails to reflect the cost of lost work time and reduction in quality of life. Finally, the TURP procedure is time consuming, requiring hospitalization for up to three days.

Other less radical surgical procedures are available in addition to the TURP procedure. Interstitial RF Therapy and Laser Therapies are surgical procedures which employ concentrated radio frequency waves or laser radiation instead of a surgical knife. There is minimal bleeding and damage to the urethra associated with these procedures. However, the adverse side effects and costs associated with surgery remain.

Drug therapy has emerged as an alternative to surgery in the last several years. There are several drugs available for BPH treatment, the two most widely prescribed drugs being Hytrin and Proscar. Hytrin works by relaxing certain involuntary muscles surrounding the urethra, thereby easing urinary flow, and Proscar is intended to actually shrink the enlarged gland. Drugs, however, offer only modest relief (60% of drug patients stop within the first year) and cost hundreds of dollars per year. In short, neither the surgical nor the medicinal treatments available for BPH provide satisfactory, cost-effective solutions to BPH.

Thermotherapy or high heat treatment using microwaves is another new alternative treatment approach. In May 1996, the FDA approved a microwave-based BPH treatment device manufactured by EDAP Technomed, Inc. ("Technomed"), called Prostatron. The FDA has recently approved another similar microwave treatment device manufactured by Urologix, another thermotherapy company. However, due to the high treatment temperatures used, there is no immediate objective and/or subjective relief, and a large percentage of the treated patients will require a post retention catheter due to the prostatic swelling caused by the intensity of the heat used.

#### MMTC Technology--Combination of Heat and Compression

On August 23, 1996, the Company acquired a patented compression technology from MMTC, which has been incorporated into a device to be utilized with the catheter used in the Company's existing Microfocus BPH system. The device consists of a microwave antenna combined with a balloon dilation ("angioplasty") mechanism which expands to compress the walls of the urethra as the prostate is heated. The combined use of balloon angioplasty and microwave heating provides a dual modality treatment approach which, it is believed, will provide significantly improved treatment benefits over the "heat alone" systems currently available commercially. First, the heat and compression create a natural strong-walled "stent" in the urethra, thus permitting immediate relief. Second, the system's relatively low temperature (43(degree)C to 45(degree)C) is sufficient to kill prostatic cells outside the urethra but not high enough to cause swelling in the urethra as is often associated with competitive treatments using high temperatures and no compression. The Company prototype clinical BPH treatment system has been successfully used in animal research conducted at the Montefiore Medical Center, under the direction of Dr. Arnold Melman, Chairman of the Department of Urology. A natural "stent" was indeed observed after treatment in the urethra of the animals. In June 1998, the Company received IDE approval from the FDA for human clinical trials. The Phase I clinical trial is currently underway at Montefiore Medical Center under Dr. Melman's supervision.

On December 1, 1997, the Company entered into an amended License agreement to give the Company rights to two additional patents of which one was recently approved November 17, 1997. These additional patents related to an innovative approach to monitor and control intra-prostatic temperatures using a radiometer apparatus. The combination of these two patents and the one received in 1996 is expected to enhance the safety and efficacy of the Company's BPH system.

In 1995, only 17% of the total men suffering with BPH symptoms were treated for the disease. The Company believes that this number will be greatly increased with the introduction of the Company's BPH treatment device that improves on the major drawbacks of the current treatment methods. These drawbacks include issues such as extended procedure stays, required catheterization and a worsening of conditions immediately after the procedure.

The Company believes that its new proprietary BPH device confronts each one of these drawbacks and delivers a treatment that is performed on an outpatient basis (1-2 hours), does not require post-treatment catheterization and delivers immediate relief that permits urination as soon as the procedure is completed.

The Company's original Microfocus BPH systems utilize a non-surgical catheter-based therapy that incorporates proprietary microwave technology and is designed to preferentially heat diseased areas of the prostate to a temperature sufficient to cause cell death in those areas. The original systems do not utilize MMTC's patented balloon catheter compression technology. The Company does not have an IDE or PMA on the original BPH System and it is therefore not currently available for commercial distribution in the United States. However, the Microfocus BPH System is manufactured in Canada and is approved for export from Canada. The original systems will be discontinued as the new balloon catheter equipment becomes commercially available, subject to FDA approval.

#### Marketing Strategy

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The emphasis of the Company's marketing strategy for its new products will be to maintain ongoing cash streams by selling disposable procedure kits and by charging a per treatment fee. Hospitals, clinics, Health Maintenance Organizations ("HMOs"), and pharmaceutical companies will acquire equipment at a minimal cost and will pay for utilizing such equipment, together with necessary disposable products -- on a per use basis. The Company intends to increase the demand for its treatment by educating patients about the benefits of its treatment via various means of media publicity, consistent with FDA regulation. The Company will pursue, for long-term growth, along two discrete development paths:

- It is anticipated that, in the near term - from two to four years, the Company's treatment revenues will come from an exploitation of its proprietary technology for BPH, and from its deep focused heat

technology for breast cancer and deep-seated tumors. The Company intends to generate initial sales through a combination of direct marketing and development of marketing alliances. The Company has begun discussions with a national HMO for the development of a long-term joint research and marketing alliance. The Company is currently considering other offers to establish a series of value-added marketing alliances with certain manufacturers that sell directly to the nation's hospital community.

- In the longer term - from four to six years, the Company intends to generate new revenue streams from its current development work with Duke University and Memorial Sloan Kettering in targeted drug delivery systems and gene therapy. The Company has first options to acquire Duke University patents covering heat sensitive liposome targeted drug delivery technology. It is anticipated that treatment revenues will come from pharmaceutical manufacturers, hospitals, and clinics employing these technologies to deliver drug regimens or change genes throughout the body. Duke has commenced development of this integrated, targeted drug delivery system employing the Company's focused heat technology. To market its liposome, heat sensitive drug delivery systems, the Company is currently seeking alliances with pharmaceutical companies, major hospitals, and HMOs. The Company's intended marketing strategy will be to place its microwave equipment at minimal cost, and to share revenues from drug delivery on a per transaction basis. It is anticipated that there will also be significant revenues from both the Company's targeted drug delivery and gene therapy delivery to major drug companies.

Assuming FDA approval, the Company plans to launch its BPH treatment system in late 1999 or earlier 2000. Pending FDA approvals, the Company's focused heat breast cancer and deep tumor treatment systems could reach the market in the years 2000 and 2001. Microwave liposome drug delivery treatments could reach the market as early as 2002.

#### Patents and Proprietary Rights

The Company owns no patents. Through the Company's license agreements with MIT, MMTC and Haim Bitcher Cancer Institute ("HBCI"), the Company has exclusive rights within defined fields of use to eight U.S. patents. Five of the patents relate to the cancer equipment and three relate to the BPH equipment. The patents expire at various times from May, 1999 to November, 2014. The Company, in conjunction with the patent holders, has filed or intends to file international applications for certain of the U.S. patents.

The Company also relies upon trade secrets and proprietary know-how, which it seeks to protect, in part, through proprietary information agreements with employees, consultants and others. There can be no assurance that proprietary information agreements will not be breached, that the Company would have adequate remedies for any such breach or that such agreements, even if fully enforced, would be adequate to prevent third party use of the Company's proprietary technology.

#### Third Party Reimbursement

The Company believes that third party reimbursement will be essential to commercial acceptance of the Deep Focused Heat Systems and Microfocus BPH System procedures, and that overall cost effectiveness and physician advocacy will be keys to obtaining such reimbursement. The Company believes that its procedures can be performed for substantially lower total cost than surgical treatments for BPH or cancer or continuous drug therapy. Consequently, the Company believes that third party payers seeking procedures that provide quality clinical outcomes at lower cost will help drive acceptance of the Company's products.

The Company's strategy for obtaining reimbursement in the United States is to obtain appropriate reimbursement codes and perform studies in conjunction with clinical studies to establish the efficacy and cost effectiveness of the procedures as compared to surgical and drug treatments for BPH and cancer. The Company plans to use this information when approaching health care payers to obtain reimbursement authorizations.



With the increasing use of managed care and capitation as a means to control health care costs in the United States, the Company believes that physicians may view the Company's products as a tool to treat efficaciously BPH and cancer patients at a lower total cost, thus providing them with a competitive advantage when negotiating managed care contracts. This is especially important in the United States, where a significant portion of the aging Medicare population is moving into a managed care system.

Subject to regulatory approval for the Deep Focused Heat Systems to treat cancer and the new Microfocus BPH System to treat BPH, it is anticipated that physicians will submit insurance claims for reimbursement for the procedure to third party payers, such as Medicare carriers, Medicaid carriers, HMOs, and private insurers. In the United States and in international markets, third party reimbursement is generally available for existing therapies used to treat cancer and BPH. The availability and level of reimbursement from such payors for the use of the Company's new Deep Focus Heat Systems and the new Microfocus BPH System will be a significant factor in the Company's ability to commercialize these systems.

The Company believes that new regulations regarding third party reimbursement for certain investigational devices in the United States will allow it to pursue early reimbursement from Medicare with individual clinical sites prior to receiving FDA approval. However, the Company believes that FDA approval will be necessary to obtain a national coverage determination from Medicare. The national coverage determination for third party reimbursement will depend on the determination of the United States Health Care Financing Administration ("HCFA"), which establishes national coverage policies for Medicare carriers, including the amount to be reimbursed, for coverage of claims submitted for reimbursement related to specific procedures. Private insurance companies and HMOs make their own determinations regarding coverage and reimbursement based upon "usual and customary" fees. Reimbursement experience with a particular third party payor does not reflect a formal reimbursement determination by the third party payor.

Internationally, reimbursement approvals for procedure utilizing the Company's new products will be sought on an individual country basis. Some countries currently have established reimbursement authorizations for transurethral microwave therapy. Clinical studies and physician advocacy will be used to support reimbursement requests in countries where there is currently no reimbursement for such procedures.

#### Commercial Design and Manufacturing

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The Company's existing BPH treatment devices were designed and manufactured by the Company. The Company believes it is best suited to conduct basic research and development, pursue a development idea through clinical testing and regulatory approval and market the final product. The Company intends to outsource the development of a commercial product from its development stage product and the actual manufacture of the commercial product. The Company has engaged Herbst Lazar Bell, Inc. to develop the commercial versions of its future products. See "Certain Transactions". It is intended that manufacture of future products will be contracted to manufacturers who are currently being solicited for interest and cost estimates.

#### Competition

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##### Thermotherapy For Cancer

The Company believes that there are at least six other domestic firms, as well as a number of foreign firms, producing, or designing and intending to produce, thermotherapy systems to treat cancer. Of those firms, at least four have obtained PMA for their machines and several have obtained IDE for their machines. Some, and possibly all of those firms, have greater resources than those which the Company now has or may reasonably be expected to have in the near future. Other firms not presently in competition with the Company may decide to produce thermotherapy systems which compete with those of the Company. At least some of those firms may reasonably be expected to have resources greater than those of the Company. As acceptance of thermotherapy as a cancer treatment increases, the Company expects that the competition will also increase.

The two major competitors of the Company are BSD Medical Corporation in Salt Lake City, Utah ("BSD"), and Labthermics Technology, Inc. in Champaign, Illinois ("Labthermics"), each of which manufactures thermotherapy machines competitive with the Company's current Microfocus 1000. The major factors in competition for sales of thermotherapy equipment are product performance, product service, and product cost. The product performance of the Company's Microfocus 1000 in PMA clinical trials has been superior to the performance of competing machines. The system manufactured by BSD uses microwave technology. Labthermics uses ultrasound technology to heat the cancer site.

BSD received its FDA approval in 1983 and was allowed to begin marketing its system at that time. To date, BSD has sold approximately 200 thermotherapy systems worldwide and has a much larger presence in the thermotherapy market than has the Company.

Service in the thermotherapy business includes maintenance of the thermotherapy machines to minimize downtime as well as training for personnel who will utilize the machines to render treatment to patients. The Company has warranty and service policies which are competitive within the industry. The Company's warranty for the Microfocus 1000 is for a period of 12 months and the Company offers a service policy following expiration of the warranty. These terms are substantially similar to the warranties and service policies offered by competitors. The Company provides three to four days of training for the personnel who will be operating each machine that the Company places at a treatment center. The Company also provides training programs at its facility in Maryland for doctors who desire to receive training on the Company's Microfocus 1000. Both training courses are helpful in marketing the Company's Microfocus 1000, because users who become familiar with one machine have a reluctance to switch to another machine which would require additional training. For this reason, the Company will seek to increase the frequency of its training sessions given at its facility in Maryland.

#### Thermotherapy For Prostatic Diseases

The Company believes there are as many as 10 companies in the USA and as many as 15 companies worldwide that are planning to enter or already active in this marketplace.

On May 7, 1996, the FDA for the first time approved a microwave-based BPH treatment device manufactured by EDAP Technomed, Inc. ("Technomed"), called "Prostatron." In addition, Urologix and Dornier recently received FDA approval on their BPH systems. These approvals should enhance market acceptance of microwave BPH treatment systems both in the United States and abroad but gives Technomed a competitive advantage of being first to the market in the United States. The Company's new BPH system has not been approved by the FDA for sale in the United States. However, the Company has an IDE approval from the FDA to conduct clinical trials which are currently being conducted at the Montefiore Medical Center.

Large global companies such as Dornier, Olympus, and Technomed will spend large amounts of resources to market and develop the BPH industry. In addition to the above companies, the following are companies offering BPH thermotherapy systems in the worldwide marketplace: BSD, Direx Medical, Technomatix (Primus), Lund Science, Quantum, GENEMED, Bruker, and Meditherm. There are several other companies which have not yet brought their products to the international marketplace. Presently, Technomed is considered the market leader with its Prostatron system. The Prostatron unit is a high cost system which sells for approximately U.S. \$300,000. Other companies are marketing their systems in the range of US \$100,000 to \$300,000. To date, it is believed there are over 600 installed BPH Systems worldwide of which Technomed and Direx have the largest share of approximately 30% combined. There are approximately 75 Microfocus BPH Systems installed worldwide.

#### Government Regulation

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##### United States Regulation

In the United States, the FDA regulates the sale and use of medical devices, which include the Company's thermotherapy systems for both cancer and

BPH. A company introducing a medical device in the United States must go through a two step process. The company must first obtain an Investigational Device Exemption ("IDE") permit from the FDA. An IDE is granted upon the manufacturer adequately demonstrating the safety of the device for patient use. Receipt of the IDE allows the use of the device on patients for the purpose of obtaining efficacy confirmation. A PMA is granted upon compilation of sufficient clinical data to establish efficacy for the indicated use of the device. This process is not only time consuming but is also expensive. Obtaining PMA is a significant barrier to entry into the thermotherapy market. Firms which lack PMA face significant impediments to the successful marketing of their thermotherapy equipment, because under applicable regulations customers can obtain reimbursement from Medicare, Medicaid and health insurers only for treatment with products that have PMA.

The Federal Communications Commission (the "FCC") regulates the frequencies of microwave and radio-frequency emissions from medical and other types of equipment to prevent interference with commercial and governmental communications networks. The frequency of 915 MHZ has been approved by the FCC for medical applications and machines utilizing that frequency do not require shielding to prevent interference with communications. The Microfocus 1000 and the Microfocus BPH System utilize the 915 MHZ frequency.

In December 1984, the Health Care Financing Administration ("HCFA") approved reimbursement under Medicare and Medicaid for thermotherapy treatment when used in conjunction with radiation therapy for the treatment of surface and subsurface tumors. At this time, most of the large medical insurance carriers in the United States have approved reimbursement for such thermotherapy treatment under their health policies. Thermotherapy treatment administered using equipment which has received PMA is eligible for such reimbursement.

The Company and its facilities are subject to inspection by the FDA at any time to insure compliance with FDA regulations in the production and sale of medical products. The Company believes that it is substantially in compliance with FDA regulations governing the manufacturing and marketing of medical devices. The Company has received a PMA from the FDA for its Microfocus 1000 cancer treatment equipment for surface and sub-surface tumors in conjunction with radiation. The Company is seeking a new indication of use to enable this equipment to be used for breast cancer ablation.

#### Foreign Regulation

Sales of medical devices outside of the United States are subject to United States export requirements and foreign regulatory requirements. Export sales of investigational devices that are subject to PMA requirements and have not received FDA marketing approval generally may be subject to FDA export permit requirements under the Federal Food, Drug and Cosmetic Act ("FDC Act") depending upon, among other things, the purpose of the export (investigational or commercial) and on whether the device has valid marketing authorization in a country listed in the FDA Export Reform and Enhancement Act of 1996. In order to obtain such a permit, when required, the Company must provide the FDA with documentation from the medical device regulatory authority of the country in which the purchaser is located, stating that the device has the approval of the country. In addition, the FDA must find that exportation of the device is not contrary to the public health and safety of the country in order for the Company to obtain the permit.

The Company has sold products in approximately twenty selected countries in Asia, Europe, and South America. Meeting the registration requirements within these countries is the sole responsibility of the distributors in each of these countries. Legal restrictions on the sale of imported medical devices vary from country to country. The time required to obtain approval by a foreign country may be longer or shorter than that required for FDA approval, and the requirements may differ. The Company expects to receive approvals for marketing in a number of countries outside the United States prior to the time that it will be able to market its products in the United States. The timing for such approvals is not known.

Product Liability and Insurance

The business of the Company entails the risk of product liability claims. Although the Company has not experienced any product liability claims to date, any such claims could have an adverse impact on the Company. In the past, the Company had not maintained product liability insurance. Recently, the Company has secured product liability insurance in the amount of \$5,000,000 and directors and officers insurance in the amount of \$3,000,000. There is no assurance, however, that claims will be covered by such insurance and will not exceed such insurance coverage limits.

Employees

As of September 30, 1998, the Company had six full-time employees. None of the Company's employees is represented by a collective bargaining organization. The Company considers its relations with its employees to be good.

ITEM 2. PROPERTIES

The Company's corporate headquarters consists of approximately 5,918 square feet of office, laboratory and production space at 10220-I Old Columbia Road, Columbia, Maryland 21046-1705. The Company leases the premises from an unaffiliated party on a three year lease which will terminate on May 31, 2000. Monthly rent is \$5,779.91.

ITEM 3. LEGAL PROCEEDINGS

The Company presently is not a party to any litigation, and the Company is not aware of any threat of litigation, except as follows:

The Company was named as a defendant in a lawsuit filed by Eastwell Management Services, Ltd. ("Eastwell") in the United States District Court for the District of Maryland claiming, inter alia, breach of contract. On December 19, 1998, the U.S. District Court of Maryland found in favor of the Company. In a related decision the U.S. District Court of Maryland also found in favor of the Company regarding its countersuit, concluding that the Company is entitled to \$100,000 from Eastwell, which breached the original contract between the two parties. The Company intends to pursue all legally possible avenues to collect the \$100,000 from Eastwell.

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

On April 27, 1998 the Company held its Annual Shareholders meeting. Listed below are the names of the seven directors elected at the meeting and their respective terms of office.

Name	Term Expires
Spencer J. Volk	2001
Augustine Y. Cheung	2001
Warren C. Stearns*	1999
Walter B. Herbst	2000
Mel D. Soule*	2000
Max E. Link	2001
John Mon	1999

\* Messrs. Stearns and Soule resigned from the Board of Directors of the Company in July 1998. Listed below is the vote count related to the other matters approved at the meeting:

Proposition -----	For ---	Against -----	Abstain -----
To approve an amendment to the Company's by-laws adopting a staggered board of directors.	28,531,934	171,083	142,050
To ratify the appointment of Stegman & Company as auditors to examine the Company's accounts for the fiscal year ending September 30, 1998.	32,186,822	5,425	152,768
To amend the Company's Articles of Incorporation to increase the number of authorized shares to 100,000,000 shares.	31,672,167	466,873	205,975
To amend the Company's Articles of Incorporation to change the Company's name to The Company Corporation or variations thereof approved by the Directors.	32,016,210	112,147	216,658
To approve an omnibus stock option plan.	27,626,867	357,943	418,451

PART II  
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ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the over-the-counter market. The quotations set forth below reflect inter-dealer prices, do not include retail markups, markdowns or commissions, and may not necessarily represent actual transactions. There were approximately 1,298 holders of record of the Common Stock as of December 8, 1998. The Company has never paid cash dividends on its stock and does not expect to pay any cash dividends in the foreseeable future.

Period -----	September 30 -----			
	1997 ----		1998 ----	
	High ----	Low ---	High ----	Low ---
1st Quarter (Oct. 1 to Dec. 31)	1.13	0.69	1.13	0.75
2nd Quarter (Jan. 1 to March 31)	0.81	0.56	1.03	0.69
3rd Quarter (April 1 to June 30)	0.94	0.48	0.90	0.36
4th Quarter (July 1 to Sept. 30)	1.31	0.63	0.52	0.21

Issuance of Shares Without Registration

During the fourth quarter of the fiscal year ended September 30, 1998, the Company issued the following securities without registration under the Securities Act of 1933, as amended (the "Securities Act"):

1. During the quarter, the Company issued 2,006,238 shares to 11 persons in satisfaction of previously outstanding debt and contractual obligations totaling \$650,271. The issuance was made to a limited number of accredited investors. Messrs. Spencer Volk, Augustine Cheung, and Herbst Lazar Bell, Inc. were three of the investors. No commissions were paid with respect to the conversions. The Company believes the issuance was exempt from registration under the Securities Act pursuant to Sections 4(2) or 4(6) of the Securities Act and Regulation D promulgated thereunder.
2. During the quarter, the Company issued 580,000 shares to 7 accredited investors for cash consideration totaling \$145,000. The issuance was made to a limited number of accredited investors. No commissions were paid with respect to the issuance, but finders fees of \$4,500 were paid to persons who introduced the Company to certain investors. The Company believes the issuance was exempt from registration under the Securities Act pursuant to Section 4(2) or 4(6) of the Securities Act and Regulation D promulgated thereunder.
3. During the quarter, the Company issued 73,866 shares to its current and certain past directors as directors fees and certain members on the Scientific Advisory Board for their services. Such shares were valued at a total of \$23,637. The issuance was made to a limited number of accredited investors. No commissions were paid with respect to the issuance. The Company believes the issuance was exempt from registration under the Securities Act pursuant to Sections 4(2) or 4(6) of the Securities Act.

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ITEM 6. SELECTED FINANCIAL DATA

The following table summarizes certain financial data for the Company for the years ended September 30, 1998, 1997, 1996, 1995, and 1994 and is qualified in its entirety by, and should be read in conjunction with the Financial Statements, the related Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this report.

	1994	1995	1996	1997	1998
	-----	-----	-----	-----	-----
Statement of Operations Data:					
Revenues:					
Product Sales (Net)	\$1,025,651	\$157,618	\$74,006	\$121,257	\$174,182
Research and development contracts	60,742	0	0	0	0
Total revenues	\$1,086,393	\$157,618	\$74,006	\$121,257	\$174,182
Cost of product sales	494,946	67,350	64,406	46,734	136,500
Gross profit on product sales	591,447	90,268	9,600	74,523	37,682
Other costs and expenses:					
Research and development	202,569	18,546	94,012	185,974	1,534,872
Selling, general and administrative	704,295	1,386,854	1,321,361	2,283,245	2,515,822
Total operating expenses	906,864	1,405,400	1,415,373	2,469,219	4,050,694
Profit(Loss) from operations	(315,417)	(1,315,132)	(1,405,773)	(2,394,696)	(4,013,012)
Other income (expense)	170,997	8,620	(442,192)	(471,631)	11,870
Interest income (expense)	(184,700)	(90,805)	(85,506)	(185,562)	(199,346)
Extraordinary Item - Gain on forgiveness of debt	591,728				
Net income (loss)	390,880	(1,397,317)	(1,933,471)	(3,051,889)	(4,200,488)
Net Income (loss) per share	\$ .02	(\$ .06)	(\$0.05)	(\$0.11)	(0.12)
Weighted average shares outstanding	16,712,978	23,466,070	39,499,650	28,386,145	34,867,001

	1994	1995	1996	1997	1998
	-----	-----	-----	-----	-----
Balance Sheet Data:					
Working Capital	(748,193)	(1,101,136)	(646,754)	(2,645,908)	(2,000,351)
Total Assets	955,456	9,710,742 (3)	9,321,600 (4)	823,209	330,738
Long-term debt, less current maturities	26,000	2,000	1,213,000	0	5,719
Redeemable Convertible Preferred Stock					
Accumulated deficit	(8,880,845)	(10,278,162)	(12,211,633)	(15,263,522)	(19,464,010)
Total stockholders' equity (deficit)	(666,542)	8,128,768	6,755,874 (3)	(2,460,646)	(1,851,077)

(1) Includes \$17,009 gain on disposition of investment in Ardex Equipment, L.L.C.

(2) Includes \$438,803 loss on write off of Ardex Notes Receivable.

(3) Includes the Company's equity interest in Aestar Fine Chemical Company valued at \$8,000,000 on the Company's September 30, 1995 balance sheet.

(4) On October 23, 1996, the Company, based on the provisions of an agreement reached on June 6, 1996, as amended, redeemed 16,000,000 shares of its Common Stock. The redemption provided for the Company to return its investment in Aestar Fine Chemical Company (valued at \$8,000,000 on the Company's September 30, 1996 balance sheet) and to relinquish its rights to the funds held under an investment contract (\$40,000 at September 30, 1996) in order to effect the transaction. This transaction has a significant impact on the financial position, current ratios and stockholder's equity of the Company. If the foregoing transaction had occurred on or before September 30, 1996, total assets would have been

reduced by \$8,040,000 and stockholder's equity would have reduced by \$8,040,000, resulting in a negative stockholder's equity of (\$1,284,126).

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

### Forward-Looking Statements

Statements regarding the Company's expectations as to the effectiveness of its technology, demand for its products and certain other information presented in this Form 10-K constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Although the Company believes that its expectations are based on reasonable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results will not differ materially from its expectations. Factors which could cause actual results to differ from expectations include, but are not limited to, the following:

1. **Decreasing Sales, Increasing Losses and Undercapitalization.** The Company's product sales have been substantially decreasing over the past three years as the Company pursued its new technologies. Because of the focus on research and development of its new technologies, the Company is not concentrating on sales of its original equipment at this time. Assuming approval of the new technologies by the appropriate government agencies, the Company expects revenue to increase. However, there is no assurance sales will increase with the application of new technologies being developed by the Company. The Company has had increasing losses which have resulted in an accumulated deficit of \$19,464,010 as of September 30, 1998. Losses will continue until current and future sales increase substantially. The Company lacks adequate capital to finance its research and development and marketing. Lack of adequate capital and governmental regulatory approvals will affect future sales.
2. **Acceptance of Products.** Thermotherapy has not been widely accepted by the medical community as an effective cancer treatment. The Company believes that this is primarily due to the inability to adequately focus heat prior to introduction of the Company's APA technology. The Company believes the APA technology allows microwave energy to be accurately targeted deep within the body, resulting in heating a well defined target area without damaging surrounding tissue. The medical community may not embrace the advantages of APA-focused thermotherapy without more extensive testing and clinical experience than the Company could afford to conduct. It is also possible that the technology will not be as effective in practice as theory and testing in animals have indicated. Similarly, the medical community has no experience with balloon catheter treatment for BPH.
3. **Limited Products.** The Company currently has a limited number of products. Failure to develop new products utilizing current products and newly acquired technology would affect the profitability of the Company. The development of new products and application of new technology to existing products is subject to uncertainty and delay.
4. **Lack of a Proven Marketing Plan.** The Company intends to market its new products by concentrating on per-use revenue. Such plan is dependant on market acceptance and adequate capitalization.

### General

Since inception, the Company has incurred substantial operating losses, principally from expenses associated with the Company's research and development programs, the clinical trials conducted in connection with the Company's thermotherapy system and PMA application for submission to the FDA. The Company



believes these expenditures are essential for the commercialization of its technologies. The Company has experienced significant operating losses and as of September 30, 1998 had an accumulated deficit of \$19,464,010. The Company expects such operating losses to continue and possibly increase in the near term and for the foreseeable future as it continues its product development efforts, expands its marketing and sales activities and scales up its manufacturing operations. The Company's ability to achieve profitability is dependent upon its ability to successfully obtain governmental approvals, manufacture, market and sell its new technology and integrate such technology into its thermotherapy systems. The Company has not been able to successfully market its current thermotherapy system because of its inability to provide heat treatment for other than surface and sub-surface tumors. There can be no assurance that the Company will be able to successfully commercialize its newly acquired technology and apply it to its current thermotherapy systems or that profitability will ever be achieved. The operating results of the Company have fluctuated significantly in the past on an annual and a quarterly basis. The Company expects that its operating results will fluctuate significantly from quarter to quarter in the future and will depend on a number of factors, many of which are outside the Company's control.

The major obstacles facing the Company over the last several years have been inadequate funding, a negative net worth, and the slow development of the thermotherapy market as a sizeable market due to technical shortcomings of the thermotherapy equipment available commercially.

The Company has refocused the Company's efforts on the enhancement of current products through the development of new technology and sale of the thermotherapy products as the Company's core business. The Company is currently focused on the enhancement of its thermotherapy equipment and obtaining governmental approvals. Towards this end the Company has licensed the APA technology and the MMTC technology.

The Company anticipates that its results of operations will be affected for the foreseeable future by a number of factors, including its ability to develop the new technology to enhance its current systems, regulatory matters, health care cost reimbursements, clinical studies and market acceptance.

#### Results of Operations

Comparison of Fiscal Year Ended September 30, 1998 to Fiscal Year Ended September 30, 1997

Product sales for the fiscal year ended September 30, 1998 ("fiscal 1998") were \$174,182. These sales occurred due to re-orders of the Company's original equipment. During the prior fiscal year, gross product sales, taking returns and allowances into consideration, were \$121,257. Increased revenues from products are not expected until products incorporating the new technologies are developed and approved by governmental regulatory agencies. Furthermore, with respect to the APA-focused thermotherapy equipment, the Company believes it must complete clinical studies to satisfy potential users.

Cost of sales increased to \$136,500 in fiscal 1998 from \$46,734 in fiscal 1997. The Company does not believe that fluctuations in gross margin are meaningful at the current low level of sales.

Research and development expense increased to \$1,534,872 in fiscal 1998 from \$185,974 in fiscal 1997. The Company expects to significantly increase its expenditures for research and development to fund the development or enhancement of products by incorporating the APA technology and the MMTC technology.

Selling, general and administrative expenses increased to \$2,515,822 in fiscal 1998 from \$2,283,245 in fiscal 1997. Increased administrative expenses reflect strengthening of the Company's management team and the resulting increased salary levels. These expenses also reflect the increased use of outside consultants and advisers to assist the Company in developing and implementing its plans to utilize and commercialize its new technologies. The Company expects selling and marketing expense to increase substantially as it expands its advertising and promotional activities and increases its marketing and sales force, principally for the commercialization of its thermotherapy systems.

Interest expense increased to \$199,346 in fiscal 1998 from \$185,562 in fiscal 1997. This primarily reflects the recognition of interest obligation in the amount of approximately \$130,000 incurred in the Company's past operations. See "Liquidity and Capital Resources" below.

Comparison of Fiscal Year Ended September 30, 1997 to Fiscal Year Ended September 30, 1996

Product sales for the fiscal year ended September 30, 1997 ("fiscal 1997") were \$121,257. During the prior fiscal year, gross product sales were \$134,006, but net product sales after returns and allowances were \$74,006. Increased sales of products are not expected until products incorporating the new technologies are developed and approved for sale by governmental regulatory agencies. Furthermore, with respect to the APA- focused hyperthermia machines, the Company believes it must complete clinical studies to satisfy potential users.

Cost of sales decreased to \$46,734 in fiscal 1997 from \$64,406 in fiscal 1996. This reflects the decrease in gross sales. The Company does not believe that fluctuations in gross margin are meaningful at the current low level of sales.

Research and development expense increased to \$185,974 in fiscal 1997 from \$94,012 in fiscal 1996. The Company expects to significantly increase its expenditures for research and development to fund the development or enhancement of products by incorporating the APA technology and the MMTc technology.

Selling, general and administrative expenses increased to \$2,283,245 in fiscal 1997 from \$1,321,361 in fiscal 1996. Increased administrative expenses reflect strengthening of the Company's management team and the resulting increased salary levels. These expenses also reflect the increased use of outside consultants and advisers to assist the Company in formulating its plans to utilize its new technologies. The Company expects selling and marketing expense to increase substantially as it expands its advertising and promotional activities and increases its marketing and sales force, principally for the commercialization of its thermotherapy systems.

During fiscal 1997, the Company wrote off as uncollectible the notes receivable related to Ardex Equipment, LLC. As part of the Gao settlement, the Company also lost the funds held under an investment contract. Together these two items resulted in \$478,803 of non-operating expense in fiscal 1997.

Interest expense increased to \$185,562 in fiscal 1997 from \$85,506 in fiscal 1996. This primarily reflects an increase in short term debt incurred to finance the Company's operations. See "Liquidity and Capital Resources" below.

#### Liquidity and Capital Resources

Since inception, the Company's expenses have significantly exceeded its revenues, resulting in an accumulated deficit of \$19,464,010 at September 30, 1998. The Company has funded its operations primarily through the sale of equity securities. As of September 30, 1998, the Company had cash, cash equivalents and short-term investments aggregating approximately \$ 54,920. Current liabilities on such date were \$2,176,086. Net cash used in the Company's operating activities was \$ 2,112,529 for fiscal 1998.

The Company does not have any bank financing arrangements. As of September 30, 1998, the Company's indebtedness consisted of a promissory note payable to Yu Shai Lai in the principal amount of \$36,041; a promissory note payable to Lake Shu Loon in the principal amount of \$10,000; a promissory note payable to Charles Shelton in the principal amount of \$50,000; a secured promissory note payable to George T. Horton Trust (the "Horton Note") in the principal amount of \$220,000, the payment of which is secured by certain equipment owned by the Company and was due by its terms on December 15, 1997; and a promissory note payable to Spencer Volk in the amount of \$50,000, which was subsequently converted into 200,000 shares of the Company's Common Stock and a Warrant to purchase 200,000 share of the Company's Common Stock (see "Certain Relationships and Related Transactions"). At September 30, 1998, the outstanding principal amount of the Horton Note was \$18,000; as of the date hereof, the outstanding principal amount of the Horton Note is \$13,000. The holder's remedies for non-payment include foreclosing on the collateral, increasing the

interest rate to 17% per annum or converting the balance into common stock having a market value of 200% of the note balance.

The Company has incurred 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, including seeking FDA approval for the domestic sale of the Company's products, expand its sales and marketing activities and scale up its manufacturing. The Company expects that its existing capital resources will not be adequate to fund the Company's operations through the next twelve months. The Company is dependent on raising additional capital to fund its development of technology and to implement a marketing plan. Such dependence will continue at least until the Company begins marketing its new technologies. The Company's future capital requirements and the adequacy of its financing depend upon numerous factors, including the successful commercialization of the thermotherapy systems progress in its product development efforts, the magnitude and scope of such efforts, progress with preclinical studies and clinical trials, the cost and timing of manufacturing scale-up, the development of effective sales and marketing activities, the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights, competing technological and market developments, and the development of strategic alliances for the marketing of its products. To the extent that funds generated from the Company's operations are insufficient to meet current or planned operating requirements, the Company will be required to obtain additional funds through equity or debt financing, strategic alliances with corporate partners and others, or through other sources. The Company does not have any committed sources of additional financing, and there can be no assurance that additional funding, if necessary, will be available on acceptable terms, if at all. If adequate funds are not available, the Company may be required to delay, scale-back or eliminate certain aspects of its operations or attempt to obtain funds through arrangements with collaborative partners or others that may require the Company to relinquish rights to certain of its technologies, product candidates, products or potential markets. If adequate funds are not available, the Company's business, financial condition and results of operations will be materially and adversely effected.

The Company intends to spend over \$3,500,000, subject to availability of funding, with various educational and research institutions for research and development in fiscal 1999. The Company is also required to do clinical trials to prepare for submission of products to the FDA. The amount required to perform such trials and to prosecute the applications is not currently known, but is expected to run in the millions of dollars. The Company does not currently have funds available to do such trials and clinical work. The Company is actively seeking these funds through the sales of securities and other alternatives. If the Company cannot fund such obligations, it will lose the data necessary to develop and commercialize its products or even the rights to certain licensing agreements. The Company may also lose any benefit it has previously received from association with well known research institutions. The Company has committed to pay advisors and officers pursuant to contractual arrangements set forth in "Directors and Executive Officers of the Registrant" and "Certain Relationships and Related Transactions." The Company will be dependent on additional capital to be raised to fulfill all of the above agreements and obligations.

#### Risk Factors

##### Unfunded Research Obligations

The Company engages third party research institutions and hospitals to perform research and clinical trials for the Company. As of September 30, 1998, the Company entered into agreements to fund a minimum of \$900,000 of research and clinical trials through March 30, 1999. The Company does not have the capital to fund such obligations, nor does it have commitments for such capital. The Company has recently engaged the investment banking firm of Josephberg Grosz & Co., Inc. and certain other financial advisors to assist in raising capital. Josephberg Grosz & Co., Inc. replaced Stearns Management Company, the Company's former financial adviser. Mr. Warren C. Stearns, President of Stearns Management Company, also resigned as a member of the Board of Directors of the Company. There is no assurance that these funds will be raised and if they are not raised, the clinical trials will likely be delayed or not completed. If the Company cannot fund such obligations, it will lose the data necessary to develop and commercialize its products. The Company may also lose any benefit it has previously received from association with well known research institutions.

Additional research and development spending of \$5.0 to \$6.0 million is planned for 1999 to complete breast cancer and BPH clinical trials. It will be necessary to raise capital to conduct these trials and there is no assurance that this will occur as revenues are not expected to begin until late 1999 at the earliest, with early year 2000 being more likely. If the Company does not obtain sufficient capital to fund its proposed research and trial schedule, the Company may become in breach of its license agreements with MMTC and MIT and its sponsored research agreements with Duke University. The Company's business plan incorporating the planned 1998 and 1999 expenditures for research and development, and clinical trials have been updated to include latest developments. Phase I of the BPH clinical trials is currently being conducted at the Montefiore Medical Center under the direction of Dr. Arnold Melman. The Company has submitted an IDE application to the FDA to start the Phase I clinical trials to use its new breast cancer treatment system to ablate breast cancer tumors through heat alone. Subject to FDA approval, Phase I clinical trials of such breast cancer treatment system will be conducted at the Massachusetts General Hospital. All of the above research is dependent on the raising of additional capital and there is no assurance that this will be achieved.

In March 1998, the Company entered into two sponsored research agreements with Duke University pursuant to which the Company agreed to pay Duke University for all direct and indirect costs incurred in the performance of the research contemplated under such agreements not to exceed \$625,062 and Duke University agreed to grant to the Company an option (the "Option") to acquire an exclusive, worldwide, royalty bearing license of Duke University's rights to any invention, development, or discovery resulting from the subject research. As of the date hereof, the Company has paid \$75,000 of a total of \$625,062 of the required payments set forth in the research agreements. The Company and Duke University have agreed, however, that Duke University shall suspend its research until the Company is able to raise additional capital, the amount currently payable by the Company to Duke University is approximately \$110,000 based upon Duke University's actual costs to date and that Duke University will not consider the Company in default if such payment is made by January 31, 1999.

History of Losses; Accumulated Deficit; No Assurance of Revenue or Operating Profit

Since inception, the Company's expenses have significantly exceeded its revenues, resulting in an accumulated deficit of \$19,464,010 and a shareholders' deficit of \$1,851,067 at September 30, 1998, including losses for the quarter ended September 30, 1998 of \$678,662. The Company anticipates reporting similar losses for the quarter ended December 30, 1998. The Company has funded its operations primarily through the sale of Company securities. Losses are expected to continue until the product enhancements have been completed and approved by the FDA or until the Company can implement its marketing plan. The Company has experienced diminishing revenue from product sales in recent years. The Company currently has limited revenue from product sales, and there can be no assurance that it will be able to develop such revenue sources or that its operations will become profitable, even if it is able to commercialize any products. The Company will be required to conduct significant research, development, testing and regulatory compliance activities which, together with projected general and administrative expenses, are expected to result in substantial operating losses in the future.

Early Stage of Product Development; Continuing Uncertainty of Technology

The Company's current commercialized products have not produced any significant profit to date and the Company believes that without the enhancement of its newly acquired technology, it is likely they will not produce profits in the future. Progress with any of the Company's potential products will require significant further research, development, testing and regulatory clearances and will be subject to the risks of failure inherent in the development of products based on innovative technologies. These risks include the possibility that the technologies used by the Company may be found to be ineffective or impractical; that the products, if safe and effective, could fail to receive necessary regulatory clearances or be difficult to market; that the proprietary rights of third parties may preclude the Company from marketing the products; or that third parties may market superior or equivalent products. There can be no assurance that the Company's research and development activities will result in any commercially viable products.

The field of hyperthermia is rapidly evolving, and it is expected to continue to undergo significant and rapid technological changes. Rapid technological development could result in actual and proposed products, services, or processes becoming obsolete before the Company recovers a significant portion of its related research, development and capital expenses. Although to date the Company has engaged in substantial research and development efforts, the Company does not expect to be able to commercialize any products utilizing the new technology for a number of years, if at all. The Company is unable to predict precisely when a product might be commercialized due to uncertainties as to the time that will be required for, and the nature of, additional research and development, human clinical trials to assess each potential product and satisfying government regulatory requirements.

#### Need for Substantial Additional Funds

It is anticipated that additional financing of approximately \$10,000,000 will be needed for 1999. In addition, the Company's cash requirements may vary materially from those now planned because of results of research and development, results of pre-clinical testing, relationships with collaborators, changes in the focus and direction of the Company's research and development programs, competitive and technological advances, the FDA's regulatory process, and other factors. The Company has recently engaged the investment banking firm of Josephberg Grosz & Co., Inc. and certain other financial advisors to assist in raising capital. The Company is dependent on raising new capital to fund operations to commercialize its products and to satisfy the commitments made by the Company for 1998 and 1999 as revenues are not expected to begin until late 1999 at the earliest, with early year 2000 being more likely. Failure to meet commitments may result in a loss of licensed technology. There is no assurance that adequate funds for these purposes, whether obtained through the financial markets, collaborative or other arrangements with corporate partners, or from other sources, will be available when needed or on terms acceptable to the Company. Insufficient funds may cause the loss of licenses on new technology and may require the Company to delay, scale back, or eliminate certain of its research and product development programs or to license third parties to commercialize products or technologies that the Company would otherwise seek to develop or commercialize itself.

#### Dependence upon Key Personnel and Collaborators

The Company's success depends (i) on the continued contributions of its executive officers, scientific and technical personnel, and consultants and (ii) on the Company's ability to attract new personnel as the Company seeks to implement its business strategy. During the Company's limited operating history, many key responsibilities within the Company have been assigned to a relatively small number of individuals. The competition for qualified personnel is intense, and the loss of services of certain key personnel could adversely affect the business of the Company. There are no employment agreements with any of current management other than Mr. Spencer J. Volk, the Company's Chief Executive Officer and President.

#### Competition

There are many companies and institutions that are conducting research and development activities on thermotherapy technologies for both oncology and prostate products that are similar to the efforts of the Company. The Company believes that the interest in investigating the potential of thermotherapy technologies will continue and may accelerate. Competitors engaged in all areas of cancer and prostate treatment in the United States and other countries are numerous and include, among others, major pharmaceutical and chemical companies, specialized technology companies, universities, and other research institutions. There can be no assurance that the Company's competitors will not succeed in developing products or other technologies that are more effective than any which have been or are being developed by the Company or which would render the Company's technology and products obsolete and non-competitive.

Many of the Company's competitors have substantially greater financial, technical, human, and other resources. In addition, many of these competitors have significantly greater experience than the Company in undertaking preclinical testing and human clinical trials of new products and obtaining FDA and other regulatory approvals. Accordingly, certain of the Company's

competitors may succeed in obtaining FDA approval for products more rapidly than the Company. Furthermore, if the Company is permitted to commence commercial sales of products, it will also be competing with respect to manufacturing efficiency and marketing with companies having greater resources and experience in these areas. The Company currently has limited experience in these areas.

#### Uncertain Ability to Protect Proprietary Technology

The Company's success will depend, in part, on its ability to maintain license agreements on patented technology. No assurance can be given that any patents issued to or licensed by the Company will not be successfully challenged or circumvented by others, or that the rights granted will provide adequate protection to the Company. The Company is aware of patent applications and issued patents belonging to competitors and it is uncertain whether any of these, or patent applications filed of which the Company may not have any knowledge, will require the Company to alter its potential products or processes, pay licensing fees, or cease certain activities. Litigation, which could result in substantial cost to the Company, may also be necessary to enforce any patents issued to or licensed by the Company or determine the scope and validity of others' claimed proprietary rights. The Company also relies on trade secrets and confidential information that it seeks to protect, in part, by confidentiality agreements with its corporate partners, collaborators, employees, and consultants. There can be no assurance that these agreements will not be breached, that the Company would have adequate remedies for any such breach, or that the Company's trade secrets will not otherwise become known or be independently discovered by competitors.

#### Technological Change

Various modalities for the treatment of cancer are the subject of extensive research and development. Many possible treatments which are being researched may not be amenable to enhancement with the Company's technology, or may not require thermotherapy for an effective cure. The development and acceptance of any such treatment could make the Company's technology obsolete.

#### No Assurance of FDA Approval; Government Regulation

The FDA and comparable agencies in foreign countries impose substantial requirements upon the introduction of medical products through lengthy and detailed laboratory and clinical testing procedures, sampling activities and other costly and time-consuming procedures. Satisfaction of these requirements typically takes several years or more and varies substantially based upon the type, complexity, and novelty of the product.

The effect of government regulation may be to delay marketing of new products for a considerable period of time, to impose costly procedures upon the Company's activities, and to furnish a competitive advantage to larger companies that compete with the Company. There can be no assurance that FDA or other regulatory approval for any products developed by the Company will be granted on a timely basis or at all. Any such delay in obtaining, or failure to obtain, such approvals would adversely affect the marketing of any contemplated products and the ability to earn product revenue. Further, regulation of manufacturing facilities by state, local, and other authorities is subject to change. Any additional regulation could result in limitations or restrictions on the Company's ability to utilize any of its technologies, thereby adversely affecting the Company's operations.

#### License Agreements for Patented Technology

The Company has entered into exclusive license agreements with Massachusetts Institute of Technology (the "MIT Agreement") and MMTC, Inc. (the "MMTC Agreement") for the use of certain patented technologies. The MIT Agreement and the MMTC Agreement each contain license fee and royalty requirements and other performance requirements which the Company must meet by certain deadlines with respect to the use of the patented technologies. If the Company were to breach the MIT Agreement or the MMTC Agreement, the Company would lose its rights to the respective licensed technology and would not receive compensation for its efforts in developing or exploiting the technology.

In March 1998, the Company entered into two sponsored research agreements with Duke University pursuant to which the Company has agreed to pay Duke University for all direct and indirect costs incurred in the performance of the research contemplated under such agreements not to exceed \$625,062 and Duke University has agreed to grant to the Company an option (the "Option") to acquire an exclusive, worldwide, royalty bearing license of Duke University's rights to any invention, development, or discovery resulting from the subject research. As of the date hereof, the Company has paid \$75,000 of a total of \$625,062 of the required payments set forth in the research agreements. The Company and Duke University have agreed, however, that Duke University shall suspend its research until the Company is able to raise additional capital, the amount currently payable by the Company to Duke University is approximately \$110,000 based upon Duke University's actual costs to date and that Duke University will not consider the Company in default if such payment is made by January 31, 1999.

#### Uncertain Availability of Health Care Reimbursement

The Company's ability to commercialize thermotherapy products successfully will depend in part on the extent to which reimbursement for the costs of such products and related treatments will be available from government health administration authorities, private health insurers and other third-party payors. Significant uncertainty exists as to the reimbursement status of newly-approved medical products. There can be no assurance that adequate third-party insurance coverage will be available for the Company to establish and maintain price levels sufficient for realization of an appropriate return on its investment in developing new therapies. Government, private health insurers, and other third-party payors are increasingly attempting to contain health care costs by limiting both coverage and the level of reimbursement for new therapeutic products approved for marketing by the FDA. If adequate coverage and reimbursement levels are not provided by government, private health insurers, and third-party payors for uses of the Company's products, the market acceptance of these products would be adversely affected.

#### Uncertainty Related to Health Care Reform Measures

There have been a number of federal and state proposals during the last few years to subject the pricing of health care goods and services to government control and to make other changes to the health care system of the United States. It is uncertain what legislative proposals will be adopted or what actions federal, state, or private payors for health care goods and services may take in response to any health care reform proposals or legislation. The Company cannot predict the effect health care reforms may have on its business, and no assurance can be given that any such reforms will not have a material adverse effect on the Company.

#### Applicability and Adequacy of Product Liability Insurance Coverage

The Company's business exposes it to potential product liability risks which are inherent in the testing, manufacturing, and marketing of human therapeutic products. Recently, the Company has secured product liability insurance in the amount of \$5,000,000 and directors and officers insurance in the amount of \$3,000,000. There is no assurance, however, that claims will be covered by such insurance and will not exceed such insurance coverage limits.

#### Limited Manufacturing Experience

The Company has only limited experience in producing its current products (approximately 84 BPH systems and 31 cancer systems worldwide) and has not produced any products utilizing the new technology. The Company's facilities comply with FDA's Good Manufacturing Practices ("GMP"). The facilities of certain of its contract manufacturers will need to comply with applicable regulations including the GMP regulation and other regulations. Failure to comply with applicable requirements and regulations by the Company's contract manufacturers could delay or prohibit manufacturing of the new products system, which could have a material adverse effect on the Company's business, financial condition and results of operations. Any increase in production rates in response to demand for the Company's products could adversely impact the ability of the Company or its contract manufacturers to comply with such requirements.

## Contract Manufacturing; Dependence Upon Key Suppliers

The Company purchases components used in its products from various suppliers. Delays would be caused if the supply of such components were interrupted. These delays could be extended if substituted components require a product redesign or regulatory approval. The current products are assembled by contract manufacturers and it is anticipated that the new products will be assembled primarily by a contract manufacturer. If for any reason the contract manufacturer is unable or unwilling to manufacture the current and new products for the Company in the future, the Company could incur significant delays in obtaining a substitute contract manufacturer. The Company expects to be dependent upon such manufacturers and subcontractors for the foreseeable future. Therefore, failure to obtain components from such sources or delays associated with any future components shortages, particularly as the Company makes the transition to commercial production, could have a material adverse effect on the Company's business, financial condition and results of operations.

## Possible Volatility of Share Price

Market prices for securities of medical and high technology companies have been volatile. Factors such as announcements of technological innovations or new products by the Company or its competitors, government regulatory action, litigation, patent or proprietary rights developments, and market conditions for medical and high technology stocks in general could have a significant impact on any future market for the Common Stock. The volatility of the Company's stock may also be affected by the lack of stock analyst coverage of the Company and the factors described at "-- NASDAQ Listing Requirements; Risks of Low-Priced Stocks" below.

## NASDAQ Listing Requirements; Risks of Low-Priced Stocks

The Company's Common Stock is currently traded in the over-the-counter market.

The Company intends to have its Common Stock listed on NASDAQ or some other national exchange upon meeting the applicable listing requirements. There can be no assurance that the Company will meet the NASDAQ listing requirements or the requirements of any other exchange. If the Company is unable to satisfy NASDAQ's initial listing criteria in the future, its securities will continue to be traded in the over-the-counter market in the so-called "pink sheets" or the "Electronic Bulletin Board" of the National Association of Securities Dealers, Inc. ("NASD"). As a consequence, an investor could find it more difficult to dispose of, or to obtain accurate quotations as to the price of the Company's securities.

The Securities Enforcement and Penny Stock Reform Act of 1990 requires additional disclosure in connection with trades in any stock defined as a penny stock. Regulations generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. Such exceptions include any equity security listed on NASDAQ and any equity security issued by an issuer that has (i) net tangible assets of at least \$2,000,000, if such issuer has been in continuous operation for three years, (ii) net tangible assets of at least \$5,000,000, if such issuer has been in continuous operation for less than three years, or (iii) average annual revenue of at least \$6,000,000, if such issuer has been in continuous operation for less than three years.

If the Company's securities are not quoted on NASDAQ, or the Company does not have \$2,000,000 in net tangible assets, trading in the Company's securities will continue to be covered by Rules 15g-1 through 15g-6 promulgated under the Exchange Act for non-NASDAQ and non-exchange listed securities. Under such rules, broker-dealers who recommend such securities to persons (other than established customers and accredited investors) must make a special written suitability determination that the penny stock is a suitable investment for the purchaser and must receive other information from the purchaser.



## Market Overhang from Warrants and Outstanding Options; Registration Rights

As of September 30, 1998, the Company had outstanding commitments to issue shares to management, and options and warrants to purchase, an aggregate amount of approximately 13,053,983 shares of Common Stock, a significant portion of which are exercisable at exercise prices substantially below the current market price. In addition, this number does not reflect additional shares that may be issued pursuant to anti-dilution provisions. To the extent that such shares are issued, or such warrants or options are exercised, dilution to the interests of the Company's stockholders may occur. In the event that the market value of the Common Stock decreases significantly, the offering price in the Company's private placements or public offerings may be similarly affected. If this occurs, the number of shares issuable on exercise of certain options or warrants may significantly increase, thereby increasing the dilutive effect on other shareholders. Exercise of these options or warrants or even the potential of their exercise may have an adverse effect on the trading price and market for the Company's Common Stock. The holders of the options or warrants are likely to exercise them at times when the market price of the shares of Common Stock exceeds the exercise price of the options or warrants. Accordingly, the issuance of shares of Common Stock upon exercise of the options or warrants may result in dilution of the equity represented by the then-outstanding shares of Common Stock held by other stockholders. Holders of the options or warrants can be expected to exercise them at a time when the Company would in all likelihood be able to obtain any needed capital on terms which are more favorable to the Company than the exercise terms provided by such options or warrants.

Common Stock issued or to be issued pursuant to a substantial number of the warrants and options have demand and/or piggyback registration rights. Pursuant thereto, the Company was required to use good faith efforts to effect the registration of such securities on or before July 10, 1998, although such registration has not yet been effected. If such registration rights are exercised on a substantial portion of the Common Stock, the trading price and market for the Company's registered Common Stock may be adversely affected.

## Year 2000 Compliance

As the year 2000 (Y2K) approaches, an issue has emerged regarding how existing application software programs and operating systems can accommodate this date value. Failure to adequately address this issue could have potentially serious repercussions. The Company believes that all of its current systems are year 2000 compliant. In addition, the Company's older systems have been tested and are expected to function normally beginning January 1, 2000 for several reasons. First, the older systems' software, operations, and control systems are not date driven; and second, the older systems are "stand alone" systems and, therefore, are not connected to any other computer systems. The treatment record and storage archives used by such systems are, however, date driven and the Company is currently testing the data programs to determine the most efficient method or upgrade to retrieve and store data. Finally, the Company is dependent on various vendors and subcontractors and is in the process working with these vendors and subcontractors to prepare for the year 2000. Although the Company does not anticipate that the year 2000 issue will have a material impact on the Company's ability to operate at current levels, there can be no assurance that steps taken in preparation for the year 2000 will be sufficient to avoid any adverse impact on the Company.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements, supplementary data and report of independent public accountants are filed as part of this report on pages F-1 through F-15.

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

No change of accountants and/or disagreements on any matter of accounting principles or financial statement disclosures have occurred within the last two years.

## PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth the names and ages of the members of the Company's Board of Directors and its executive officers, and sets forth the position with the Company held by each:

Name ----	Age ---	Position -----
Augustine Y. Cheung+	51	Chairman of the Board of Directors, Chief Scientific Officer
Spencer J. Volk+	64	President, Chief Executive Officer and Director
John Mon*	46	Secretary, Treasurer/General Manager and Director
Max E. Link+	57	Director
Walter B. Herbst**	60	Director
Peter Gombrich ** (1)	59	Director

\* Term as director expires in 1999

\*\* Term as director expires in 2000

+ Term as director expires in 2001

(1) Mr. Gombrich resigned as a member of the Board of Directors of the Company on December 8, 1998.

The Board of Directors presently maintains an Audit Committee, a Compensation Committee, and a Research and Development Oversight Committee. Messrs. Warren C. Stearns and Mel D. Soule comprised the Audit Committee prior to their resignation as a members of the Board of Directors of the Company in July 1998. Mr. Peter Gombrich was appointed as a member of the Board of Directors to replace Mr. Soule. The vacancies in the Board of Directors of the Company created by Messrs. Stearns' and Gombrich's resignations has not been filled as of the date of this report. The Audit Committee held no meetings during fiscal year 1997 and three meetings to date in the fiscal year ended September 30, 1998 ("fiscal year 1998"). Messrs. Volk and Herbst comprise the current Compensation Committee. The Compensation Committee held two meetings during fiscal year 1997 and four meetings in fiscal year 1998. Messrs. Cheung and Herbst comprise the Research and Development Oversight Committee. The Research and Development Oversight Committee was created in January 1998 and held a number of informal meetings during fiscal year 1998.

Augustine Y. Cheung. Dr. Cheung has served as the Chairman of the Board of Directors of the Company since 1982. Dr. Cheung was the founder of the Company, was President of the Company from 1982 to 1986 and Chief Executive Officer from 1982 to 1996. From 1982 to 1985, Dr. Cheung was a Research Associate Professor of the Department of Electrical Engineering and Computer Science at George Washington University and from 1975 to 1981 was a Research Associate Professor and Assistant Professor at the Institute for Physical Science and Technology and the Department of Radiation Therapy at the University of Maryland. Dr. Cheung holds a Ph.D. and Masters degree from the University of Maryland. Dr. Cheung is the brother-in-law of John Mon.

Spencer J. Volk. Mr. Volk has been a director, President, and Chief Executive Officer of the Company since May 22, 1997. From 1994 to 1996, Mr. Volk was President and Chief Operating Officer of Sunbeam International. From 1991 to 1993, Mr. Volk was the President and Chief Executive Officer of the Liggett Group, Inc. From 1989 to 1991, he was the President and Chief Operating Officer of Church and Dwight (Arm and Hammer), and from 1984 to 1986, he was the President and Chief Executive Officer of Tropicana Products, Inc. Prior to that,

he spent thirteen years at Pepsico, ultimately as Senior Vice President for the Western Hemisphere. Mr. Volk holds an Honors BA in Economics and Math from Queens University in Ontario, Canada and a BA in Economics from Royal Military College in Ontario, Canada.

John Mon. Mr. Mon has served as Treasurer/General Manager of the Company since 1989, and Secretary and a director since June 1997. From 1986 to 1988, Mr. Mon was responsible for the FDA regulatory approval for the Microfocus 1000. From 1983 to 1986, he was an economist with the U.S. Department of Commerce in charge of forecasting business sales, inventory and prices for all business sectors in the estimation of Gross National Product. Mr. Mon holds a B.S. degree from the University of Maryland. Mr. Mon is the brother-in-law of Dr. Cheung.

Walter B. Herbst. Mr. Herbst has been a director of the Company since May 28, 1997. Mr. Herbst has been and currently is the Chairman of Herbst Lazar Bell, Inc. ("HLB"), the engineering firm he founded in 1962. Mr. Herbst also serves as a faculty fellow in industrial design at the Northwestern University McCormick School of Engineering and Applied Sciences teaching materials and process. Additionally, he serves on the faculty at Northwestern University's Kellogg Graduate School teaching a course in product development. Mr. Herbst holds a BFA in Industrial Design from the University of Illinois and a Master of Management from the Kellogg Graduate School of Northwestern University.

Max E. Link. Dr. Link has been a director of the Company since September 23, 1997. Dr. Link currently provides consulting and advisory services to a number of pharmaceutical and biotechnology companies. From 1993 to 1994, Dr. Link served as Chief Executive Officer of Corange, Ltd., a medical diagnostics company acquired by Hoffman-LaRoche. From 1971 to 1993, Dr. Link served in numerous positions with Sandoz Pharma AG culminating in his appointment as Chairman of the Board of Directors in 1992. Dr. Link serves on the Board of Directors of the following publicly held companies: Human Genome Sciences; Alexion Pharmaceuticals; Cell Therapeutics; Access Pharmaceuticals; Protein Design Laboratories; Osiris Therapeutics; Procept, Inc.; Discovery Laboratories Inc. and Cytrx Corp. Dr. Link holds a Ph.D. in economics from the University of St. Gallen (Switzerland).

Peter Gombrich. Mr. Gombrich has been a director of the Company since September 14, 1998. Mr. Gombrich was the founder of InPath, LLC and has over 30 years experience in the healthcare industry. In 1994, Mr. Gombrich founded AccuMed International, Inc, and served as Chairman, President and Chief Executive Officer until 1998. He was also the founder and Chief Executive Officer of Clinicom, a bedside clinical information system company. In 1976, Mr. Gombrich co-founded St. Jude Medical, Inc., a world renowned life support medical device company. He was also the Senior Vice President of Medtronic, Inc. Mr. Gombrich has a B.S. in Electrical Engineering from the University of Colorado and an M.B.A. from the University of Denver. Mr. Gombrich resigned as a member of the Board of Directors of the Company on December 8, 1998.

The Board of Directors conducted 9 meetings during the year ended September 30, 1998. All members, except Mr. Gombrich, attended at least 75% of the Board of Directors meetings held during their tenure in 1998. Mr. Gombrich attended one of the two meetings of the Board of Directors held during his tenure. Additional actions were taken by unanimous consent resolutions.

#### Scientific Advisory Board

The Company currently has a scientific advisory board ("SAB") comprised of individuals listed below. The purpose of the SAB is to assist management of the Company in identifying and developing technology trends and business opportunities within the Company's industry. The SAB members operate as consultants and not as officers or directors of the Company. The following persons serve on the SAB:

Robert Barnett, M.D. Dr. Barnett currently the Surveyor for the American College of Surgeons and is the former President of the Maryland chapter of the American Cancer Society. Dr. Barnett consults with the Company on issues relating to oncological surgeons.

Donald Beard. Mr. Beard is a retired businessman and is the former senior program manager for the United States Department of Energy. Mr. Beard consults with the Company in connection with technology and business development matters.

Augustine Cheung, PhD. Dr. Cheung serves as the chairman of the SAB and as the Company's Chief Scientific Officer. Dr. Cheung's background is set forth above.

Michael Davidson, M.D. Dr. Davidson currently practices medicine and is the Chief Executive Officer of The Chicago Center for Clinical Trials. Dr. Davidson specializes in designing and implementing clinical trials. Dr. Davidson consults with the Company in connection with establishing clinical trials and on FDA regulatory matters.

Mark Dewhirst, PhD. Dr. Dewhirst currently serves as a Professor of Radiology and Oncology and the Director of the Tumor Microcirculation Laboratories in the Department of Radiation & Oncology at Duke University. Dr. Dewhirst consults with the Company in connection with research on temperature sensitive liposomes.

Donald Kapp, M.D., Ph.D. Dr. Kapp currently serves as Professor of Radiation Oncology at Stanford University. Dr. Kapp consults with the Company in connection with conducting clinical studies.

Gloria Li, PhD. Dr. Li currently serves as the Director of the Radiation Biology Laboratory at Memorial Sloan-Kettering Hospital. Dr. Li consults with the Company on heat shock and gene therapy.

Arnold Melman, M.D. Dr. Melman currently serves as the Chairman of the Department of Urology at Albert Einstein College of Medicine. Dr. Melman consults with the Company on clinical studies in urology and is the Company's primary investigator on BPH.

David Needham, PhD. Dr. Needham currently serves as the Director of Cell and Micro-carrier Research and an Associate Professor in the Duke University Department of Mechanical Engineering and Materials Science. Dr. Needham consults with the Company in connection with research on temperature sensitive liposomes.

Thomas Ripley, PhD. Dr. Ripley currently serves as Director of Operations, Grace Biomedical at W.R. Grace & Co. Dr. Ripley consults with the Company on technology and business development.

Mel Soule. Mr. Soule serves as Co-Chairman of the SAB. From 1994 through 1997, Mr. Soule was the president and chief executive officer of Grace Biomedical Division, a subsidiary of the W.R. Grace & Co. From 1993 through 1994, Mr. Soule was the director of commercial planning for the Washington Research Center of W.R. Grace & Co. From 1992 to 1993, Mr. Soule was a senior development manager for W.R. Grace & Co. Mr. Soule is currently a consultant to several biomedical companies.

Mays Swicord, PhD. Dr. Swicord currently serves as Director of Research at Motorola Corporation. Dr. Swicord consults with the Company on the biological effects of microwave technology.

Claude Tihon, PhD. Dr. Tihon currently serves as the Chief Executive Officer of Conti-Med, Inc. Dr. Tihon consults with the Company in connection with urological devices and regulation.

All members of the SAB serve at the discretion of the Board of Directors. Each member of the SAB, other than Mr. Swicord, received an option to purchase 5,000 shares of the Common Stock of the Company at the time they were appointed. The options are exercisable for a five year term at \$.50 per share. In addition, each member of the SAB will receive an option to purchase 3,000 shares of the Common Stock of the Company for each 12 months served by such member on the SAB, exercisable at the market price of the Common Stock of the Company's on the date of grant. Such options will be exercisable for a five year term. During fiscal year 1998, each member of the SAB, other than Messrs. Cheung

and Swicord, received an option to purchase 3,000 shares of the Common Stock of the Company at \$1.25 per share. In addition, members of the SAB are compensated at the rate of \$125 per hour or a total of \$1,000 per day, together with expenses, on consulting matters undertaken by the SAB.

Compliance with Section 16(a) of the Exchange Act

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission and the National Association of Securities Dealers. Officers, directors, and greater than ten-percent shareholders are required by Securities and Exchange Commission regulations to furnish the Company with copies of all Section 16(a) forms they file. Based solely on a review of the copies of such forms furnished to the Company between October 1, 1997, and September 30, 1998, and on representations that no other reports were required, the Company has determined that during the last fiscal year all applicable 16(a) filing requirements were met except as follows:

Spencer J. Volk is the Chief Executive Officer and a director of the Company. Mr. Volk acquired 167,114 shares of Common Stock of the Company on September 23, 1998 and 2,000 shares of Common Stock of the Company on September 30, 1998. Mr. Volk filed a Form 4 on or about October 29, 1998. The Form 4 should have been filed on or before October 10, 1998.

Walter B. Herbst is a director of the Company. Herbst Lazar, Bell, Inc., of which Mr Herbst is the Chairman and Chief Executive Officer, acquired 833,334 shares of Common Stock of the Company on September 23, 1998. Mr. Herbst filed a Form 4 on or about October 28, 1998. The Form 4 should have been filed on or before October 10, 1998.

Mr. Peter Gombrich was appointed to be a director of the Company as of September 14, 1997, and thereby became subject to Section 16(a) reporting requirements. Mr. Gombrich filed a Form 3 on or about December 7, 1998. The Form 3 should have been filed on or before September 24, 1998.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth the aggregate cash compensation paid for services rendered to the Company in all capacities during the last three fiscal years to the Company's Chief Executive Officer and to each of the Company's other executive officers where annual salary and bonus for the most recent fiscal year exceeded \$100,000.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation Awards		All Other Compensation (\$)
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Restricted Stock Awards (\$)	Stock Options (#)	
Augustine Y. Cheung, Chairman of the Board of Directors	1998	\$125,000 (1)			\$640 (2)		
	1997	\$125,000			\$2,120 (2)		
	1996	\$125,000			\$2,120 (2)	400,000 (3)	

Spencer J. Volk, President and Chief Executive Officer	1998	\$240,000 (4)	\$700,640 (2)(5)	
	1997	\$96,923 (6)	\$281,995 (2)(5)	
Verle D. Blaha, Former President and Chief Executive Officer	1997	\$177,100 (7)	\$1,182 (2)	
	1996	\$81,000	\$2,120 (2)	400,000 (8)
Warren C. Stearns, Acting Chief Financial Officer	1998	\$195,297 (9)	\$961 (2)	
	1997	\$266,666 (9)	\$1,461 (2)	
	1996	\$66,753		(9)

- (1) Dr. Cheung's annual salary is \$125,000. Of the amount, approximately \$84,134 was paid in fiscal year 1998.
- (2) In each of fiscal years 1996, 1997 and 1998, Dr. Cheung received 2,000 shares of the Common Stock of the Company for his services as a member of the Board of Directors of the Company. Mr. Blaha received 2,000 shares of the Common Stock of the Company for his service as a member of the Board of Directors of the Company in fiscal year 1996 and 1,112 shares for his services as a member of the Board of Directors of the Company in fiscal year 1997. Mr. Volk received 701 shares of the Common Stock of the Company for his service as a member of the Board of Directors of the Company in fiscal year 1997 and received 2,000 shares of the Common Stock of the Company for his service as a member of the Board of Directors of the Company in fiscal year 1998. Mr. Stearns received 1,375 shares for his service as a member of the Board of Directors of the Company in fiscal year 1997 and received 3,003 shares of the Common Stock of the Company for his service as a member of the Board of Directors of the Company in fiscal year 1998.
- (3) In fiscal year 1996, Dr. Cheung received an option to purchase 400,000 shares of the Common Stock of the Company at \$0.35 per share as adjusted, exercisable on or before May 16, 2001.
- (4) Mr. Volk's annual salary is \$240,000. Of that amount, approximately \$87,692 was paid in fiscal year 1998.
- (5) Mr. Volk received 500,000 shares of Common Stock of the Company in fiscal year 1997 pursuant to his employment agreement and has the right to receive up to 1,400,000 additional shares of the Common Stock of the Company if the Company meets certain financing goals during his tenure and if he is employed by the Company after one year. As of September 30, 1998, Mr. Volk received 1,000,000 shares of such amount.
- (6) Mr. Volk became President and Chief Executive Officer of the Company on May 22, 1997.
- (7) Mr. Blaha resigned as the President and Chief Executive Officer of the Company on April 23, 1997.
- (8) The Company granted an option to purchase 400,000 shares of the Common Stock of the Company, with an exercise price of \$.41 per share as adjusted, to New Opportunities, Ltd., a company affiliated with Mr. Blaha.
- (9) Amounts listed as annual compensation in fiscal year 1996 and fiscal year 1997 for Mr. Stearns consist of fees paid to Stearns Management Company ("SMC"). In fiscal year 1998, SMC was paid approximately \$95,297 in fees and for reimbursement

expenses. In May 1997, Mr. Stearns resigned as the Acting Chief Financial Officer of the Company. In July 1998, Mr. Stearns resigned as a member of the Company's Board of Directors. The Company and SMC have agreed that the remaining fees and reimbursement for expenses the Company still owes to SMC is \$100,000. During fiscal year 1996, assignees of SMC also received warrants with anti-dilution rights to purchase 4.6875% of the Common Stock of the Company.

During fiscal year 1998, there were no profit sharing plans for the benefit of the Company's officers, directors, or employees. In fiscal year 1997, the Company established a SARSEP pension plan for its employees. The Company does not contribute any funds to the plan. In addition, the Company provides health insurance coverage for its employees. At the annual meeting held on April 27, 1998, the stockholders approved an omnibus option plan. The Board of Directors may recommend and adopt additional programs in the future for the benefit of officers, directors, and employees.

#### Option Grants in Fiscal 1998 / Director Compensation

During fiscal 1998, no options were granted to the named executive officers listed in the Summary Compensation Table. Each non-employee director and each employee director receives a grant of 12,000 shares and 2,000 shares of Common Stock of the Company respectively for the full year served or the pro rata portion if less than one year. In addition, Mr. Herbst received an option to purchase 50,000 shares of Common Stock of the Company at \$0.50 per share commencing October 1, 1998 through September 30, 2003 for his service on the Board of Directors for the full fiscal 1998 year. Mr. Gombrich received an option to purchase 50,000 shares of Common Stock of the Company at \$0.50 per share commencing October 1, 1998 through September 30, 2003 for becoming a member of the Board of Directors. Mr. Link will receive an option to purchase 50,000 shares of Common Stock of the Company at \$0.75 per share commencing December 31, 1998 through December 30, 2003 for his service on the Board of Directors for the full fiscal 1998 year.

#### Aggregated Option Exercises and Year-End Option Values in 1998

The following table summarizes for each of the named executive officers of the Company the number of stock options, if any, exercised during 1998, the aggregate dollar value realized upon exercise, the total number of unexercised options held at September 30, 1998 and the aggregate dollar value of in-the-money unexercised options, if any, held at September 30, 1998. Value realized upon exercise is the difference between the fair market value of the underlying stock on the exercise date and the exercise price of the option. The value of unexercised, in-the-money options at September 30, 1998 is the difference between its exercise price and the fair market value of the underlying stock on September 30, 1998, which was \$0.32 per share based on the closing price of the Common Stock of the Company on September 30, 1998. The underlying options have not been and may never be exercised; and actual gains, if any, on exercise will depend on the value of the Common Stock of the Company on the actual date of exercise. There can be no assurance that these values will be realized.

#### Aggregated Option Exercises in Fiscal 1998 and Year-End Option Values

Name	Shares Acquired on Exercise	Value Realized (\$)	Number of Unexercised Options at 9/30/98 -----		Value of Unexercised In-the-Money Options at 9/30/98 -----	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Augustine Y. Cheung	0	\$0	400,000	0	\$28,000	\$0
Spencer J. Volk	0	\$0	0	0	\$0	\$0
John Mon	0	\$0	600,000	0	\$42,000	\$0
Warren C. Stearns	0	\$0	2,499,630	0	\$249,630	\$0

#### Long-Term Incentive Plan Awards in Fiscal Year 1998

At the annual meeting held on April 27, 1998, the stockholders approved an omnibus stock option plan. See "Stock Option Plans".

#### Future Benefits or Pension Plan Disclosure in Fiscal Year 1998

The Company provides a SAR-SEP saving plan to which eligible employees may make pretax payroll contribution up to 15 % of compensation. The Company does not make contributions to the plan. At the annual meeting held on April 27, 1998, the stockholders approved an omnibus stock option plan. See "Stock Option Plans". The Board of Directors may recommend and adopt additional programs in the future for the benefit of officers, directors, and employees.

#### Employment Contracts and Termination of Employment and Change-In-Control Arrangements

On May 22, 1997, Spencer J. Volk became the President and Chief Executive Officer of the Company. The Company and Mr. Volk have entered into an employment agreement, dated May 11, 1997, with an initial annual salary of \$240,000, which will increase to \$360,000 per annum upon the successful raising of \$5,000,000 through public or private offerings. In addition, Mr. Volk was awarded 500,000 shares of Common Stock of the Company upon execution of the employment agreement and may earn up to an additional 1,400,000 shares based on the Company's ability to raise additional capital and Mr. Volk's continued employment. Mr. Volk, as of September 30, 1998, received 1,000,000 of such shares.

Additionally, Mr. Warren C. Stearns, a former officer and director of the Company, received compensation through Stearns Management Company, which had an exclusive advisory services arrangement with the Company.

Other than as set forth above, there are no employment contracts, termination of employment or change in control arrangements.

#### Stock Option Plans

At the annual meeting held on April 27, 1998, the stockholders approved an omnibus stock option plan. The plan commits up to 2,000,000 shares for option grants to directors, employees and consultants. 280,000 of such shares have been granted at the direction of Spencer J. Volk. The Company has committed to allow Mr. Volk to nominate the recipients of options for 1,720,000 shares under the plan.

#### Report of the Compensation Committee on Executive Compensation

The Company formed a Compensation Committee in June 1997, consisting of Spencer J. Volk, an employee director, and Walter Herbst, a non-employee director. The Committee is responsible for establishing and administering the compensation policies applicable to the Company's officers and key personnel. The committee's responsibilities include, establishing general compensation policy and, except as prohibited by applicable law, taking any and all action that the Board could take relating to the compensation of employees, directors and other parties. The Committee also evaluates the performance of and makes compensation recommendations for senior management.

#### Executive Compensation Philosophy

-----

The Company attempts to design executive compensation to achieve two principal objectives. First, the program is intended to be fully competitive so that the Company may attract, motivate and retain talented executives. Second, the program is intended to create an alignment of interests between the Company's executives and stockholders such that a significant portion of each executive's compensation varies with business performance.



The Committee's philosophy is to pay competitive annual salaries, coupled with an incentive system that pays more than competitive total compensation for superior performance reflected in increases in the Company's stock price. The incentive system consists of annual compensation and stock compensation.

Based on assessments by the Board and the Committee, the Committee believes that the Company's compensation program for the Named Executive Officers has the following characteristics that serve to align executive interests with long-term stockholder interests:

- a. Emphasizes "at risk" pay such as options and grants of restricted stock;
- b. Emphasizes long-term compensation such as options restricted stock awards; and
- c. Rewards financial results and promotion of Company objectives rather than individual performance against individual objectives.

#### Annual Salaries -----

Salary ranges and increases for executives, including the Chief Executive Officer and the other named executive officers, are established annually (unless subject to longer term contracts) based on competitive data. Within those ranges, individual salaries vary based upon the individual's work experience, performance, level of responsibility, impact on the business, tenure and potential for advancement within the organization. Annual salaries for newly-hired executives are determined at time of hire taking into account the above factors other than tenure.

#### Long-Term Incentives -----

The grant of restricted stock or options to key employees encourages equity ownership and closely aligns management interests with the interests of stockholders. The amount and nature of any option or restricted stock award is determined by the Committee on a case by case basis, depending upon the individual's perceived future benefit to the Company and the perceived need to provide additional incentive to align performance with the objectives of the shareholders.

#### Company Performance and Chief Executive Officer Compensation -----

The compensation of Spencer Volk was established prior to organization of the Compensation Committee. The Committee believes that Spencer Volk's compensation package aligns his interests with those of the stockholders.

#### Stockholder Return Performance Graph

Federal regulation requires that inclusion of a line graph comparing cumulative total shareholder return on Common Stock with the cumulative total return of (1) NASDAQ Combined Index and (2) a published industry or line-of-business index. The performance comparison appears below. The Board of Directors recognizes that the market price of stock is influenced by many factors, only one of which is Company performance. The stock performance shown on the graph is not necessarily indicative of future price performance.

[GRAPHIC OMITTED]

Total Return Analysis

9/30/94            9/29/95            9/30/96            9/30/97            9/30/98

-----  
The Company            \$ 100            \$ 473            \$ 300            \$ 309            \$ 93

-----  
Nasdaq Health            \$ 100            \$ 106            \$ 139            \$ 139            \$ 94

-----  
Nasdaq Composite (US)    \$ 100            \$ 137            \$ 161            \$ 221            \$ 222

-----  
Source: Carl Thompson Associates [www.ctaonline.com](http://www.ctaonline.com) (800) 959-9677. Data from Bloomberg Financial Markets

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND  
MANAGEMENT

The following table sets forth information regarding shares of voting securities of the Company beneficially owned as of September 30, 1998 by: (i) each person known by the Company to beneficially own 5% or more of the outstanding voting securities; (ii) by each director, (iii) by each current executive officer and (iv) by all current directors and executive officers as a group. As of September 30, 1998, there were 39,945,826 shares of Common Stock outstanding.

Name and Addresses of Officers, Directors and Principal Shareholders	Amount of Common Shares	Percentage of Voting Securities(1)
Augustine Y. Cheung (2)(3) 10220-I Old Columbia Road Columbia, MD 21046-1705	6,673,408	16.3%
Spencer J. Volk (2)(4) 10220-I Old Columbia Road Columbia, MD 21046-1705	1,913,717	4.7%
John Mon (2)(5) 10220-I Old Columbia Road Columbia, MD 21046-1705	769,212	1.9%
Walter B. Herbst (2)(6) 355 North Canal Street Chicago, IL 60606	1,135,586	2.8%
Max E. Link (2)(7) Tobelhofstr. 30 8044 Zurich Switzerland	62,038	**
Peter Gombrich (2)(8) 920 N. Franklin Street Suite 304 Chicago, IL 60610	50,493	**
Bei-Lan Tan Ning Yeung Terrace 78 Bonham Rd., Mid Level Hong Kong, China	3,340,000	8.2%
Executive Officers and Directors as a group (6 individuals)	10,604,454	26.2%

\* Assumes exercise of all options held by listed security holders which can be exercised within 60 days from September 30, 1998.

\*\* Less than 1%.

(1) Except as noted, the above table does not give effect to an aggregate of approximately 13,030,822 shares of Common Stock underlying outstanding stock options and warrants, obligations to issue shares or warrants that are contingent on future offerings. Outstanding warrants and options entitle the holders thereof to no voting rights.

(2) Director or Executive Officer. Mr. Gombrich resigned as a member of the Board of Directors of the Company on December 8, 1998.

- (3) Includes 400,000 shares underlying an option exercisable commencing May 16, 1995 through May 16, 2001 at \$0.35 per share as adjusted.
- (4) Includes 1,000,000 shares earned by Mr. Volk pursuant to his employment agreement subsequent to the end of fiscal year 1997. Does not include an additional 400,000 shares of Common Stock that have been committed to and may be earned by Mr. Volk pursuant to his employment agreement upon the occurrence of certain events.
- (5) Includes 400,000 shares of Common Stock underlying an option to Mr. Mon exercisable commencing May 16, 1996 through May 16, 2001 at \$0.35 per share as adjusted and 200,000 shares of Common Stock underlying an option exercisable commencing April 1, 1997 through March 31, 2002 at \$0.41 per share as adjusted.
- (6) Includes 35,000 shares of Common Stock underlying options exercisable beginning June 16, 1997 and ending June 16, 2002 at a price of \$.41 per share, 15,000 shares of Common Stock underlying an option exercisable commencing June 1, 1998 through August 31, 2003 at \$.50 per share, and 50,000 shares of Common Stock underlying an option exercisable commencing October 1, 1998 through September 30, 2003 at \$.50 per share. Includes 20,000 shares of Common Stock underlying options to HLB exercisable beginning October 31, 1997 and ending October 30, 2002 at a price of \$1.00 per share and 875,198 shares of Common Stock owned by HLB. Mr. Herbst disclaims beneficial ownership of the stock option and shares of Common Stock owned by HLB.
- (7) Does not include 150,000 shares of Common Stock underlying an option exercisable at \$.75 per share which vest as to 50,000 shares of Common Stock on December 31 of 1998, 1999 and 2000.
- (8) Includes 50,000 shares of Common Stock underlying an option exercisable commencing October 1, 1998 through September 30, 2003 at \$.50 per share.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

##### SMC Contract

On May 28, 1996, the Company entered into a consulting agreement with Stearns Management Company ("SMC"). Warren C. Stearns, former Acting Chief Financial Officer and a former member of the Board of Directors, is President of SMC. Additionally, the George T. Horton Trust, which is a secured creditor of the Company, is an equity owner of SMC. Pursuant to the Agreement, SMC had an exclusive arrangement to render advisory services involving solicitation of outside capital, restructuring the Company, business plans, marketing, selection of advisory personnel, adding additional directors, and sale of stock by insiders.

In exchange for such services, during the fiscal year 1997, SMC was paid approximately \$266,666 in fees and \$38,824 for reimbursement of expenses. In fiscal year 1996, the Company granted to assignees of SMC a warrant to purchase, in the aggregate, a 4.6875% interest in the equity of the Company as of the next registered public offering of Common Stock of the Company. The warrants, all of which are exercisable at \$0.41 per share as adjusted, contain anti-dilution provisions and are exercisable for five years and renewable for an additional five years. Mr. Stearns was paid a per diem expense of \$1,500 per day or \$190 per hour and reimbursement for expenses at cost plus 20%. During fiscal year 1998, SMC was paid approximately \$95,297 in fees and for reimbursement expenses, the Company and SMC have agreed that the remaining fees and reimbursement for expenses that the Company still owes to SMC is \$100,000.

Mr. Stearns resigned as the Company's Acting Chief Financial Officer in May 1998 and as a member of the Board of Directors in July 1998. The Company terminated its consulting agreement with Stearns Management Company effective July 19, 1998 and engaged the investment banking firm of Josephberg Grosz & Co., Inc. to assist in raising capital.

#### George T. Horton Trust Loan

The Company is obligated under a secured note to the George T. Horton Trust in the original principal amount of \$220,000, which bears interest at 1% per month, and was payable December 15, 1997, and is secured by equipment and software for APA technology. George T. Horton Trust is an equity owner of SMC, the President of which, Warren C. Stearns, was also an officer and director of the Company until his recent resignation. As of the date of this report, the Company has paid \$107,000 of the principal of this note and the note holder has converted \$100,000 of principal into Common Stock of the Company. The remaining principal is \$13,000 as of the date of this report. The remaining principal accrues interest at the rate of 17% per annum or may be converted into Common Stock of the Company at the rate of 200% of the loan balance.

#### Herbst Lazar Bell, Inc.

The Company has retained the engineering firm of Herbst LaZar Bell, Inc., of Chicago to assist in the development of the commercial versions of its future deep focused heat systems and BPH treatment system. Walter Herbst, a director of the Company, is the founder and chief executive officer of HLB. HLB, with a team of engineers specializing in systems engineering and industrial design, will serve as the primary engineering resource for the Company. In fiscal year 1998, HLB billed the Company \$561,238 for the engineering and design work it performed, HLB was paid \$106,500 in cash and converted \$250,000 owed to it by the Company into 833,334 shares of the Common Stock of the Company.

#### Townhouse Lease

The Company leased from Augustine Cheung, Chairman of the Board, and John Mon, an officer and director, on a month to month basis a townhouse near its corporate offices in Columbia, Maryland for \$900 per month, plus utilities. The housing was used for visiting executives. The lease has been terminated as of the date hereof.

#### Promissory Notes

From 1987 through 1998, the Company borrowed money from related parties. The Company formalized such borrowing by executing promissory notes to the following related parties:

An unsecured term note dated January 26, 1987 payable to Dr. Augustine Cheung, accruing interest at the rate of twelve percent (12%) per annum, in the principal amount of \$78,750 due December 31, 1998.

An unsecured term note dated June 30, 1994 payable to Dr. Augustine Cheung, accruing interest at the rate of ten percent (10%) per annum, in the principal amount of \$42,669 due December 31, 1998.

An unsecured term note dated June 23, 1998 payable to Spencer J. Volk, accruing interest at the rate of eight percent (8%) per annum, in the principal amount of \$50,000 due September 30, 1998. Mr. Volk has extended the maturity date of the unsecured term note dated June 23, 1998 issued by the Company to him in the principal amount of \$50,000.00 from September 30, 1998 to December 31, 1998. As of September 30, 1998, the outstanding principal balance of such note is \$50,000 .

A secured term note dated September 9, 1994 payable to Charles C. Shelton, accruing interest at the rate of ten percent (10%) per annum, in the principal amount of \$50,000 payable as follows: beginning October 1, 1994 and ending December 31, 1995 - interest only; beginning January 1, 1996 and for 25 months thereafter - principal at the rate of \$2,000 per month, together with the monthly payment on interest on the

unpaid balance of the note until paid in full; provided, however, that such interest shall not be payable in the event that the principal amount of the note is repaid by the Company on or before September 30, 1999. The outstanding principal balance of such note as of the date of this report is approximately \$50,000.

On September 23, 1998, Dr. Cheung converted (i) the unpaid principal and accrued interest on the unsecured term note dated June 30, 1994 issued by the Company to him in the principal amount of \$42,669.00 into 5,800 shares of the Common Stock at \$0.30 per share and (ii) the unpaid principal and accrued interest on the unsecured term note dated January 26, 1987 issued by the Company to him in the principal amount of \$78,750.00 into 254,200 shares of the Common Stock at \$0.30 per share.

On December 10, 1998, Mr. Volk converted the principal of the unsecured term note dated June 23, 1998 issued by the Company to him in the principal amount of \$50,000 into 200,000 shares of Common Stock of the Company, a warrant to purchase 100,000 shares of the Company's Common Stock at \$0.50 per shares, and a warrant to purchase 100,000 shares of the Company's Common Stock at \$1.00 per shares.

In addition, on September 23, 1998, Mr. Volk converted \$50,134 of unpaid expense reimbursements owed to him by the Company into 167,114 shares of the Common Stock at \$0.30 per share.

#### Redemption Agreement

On February 16, 1995, Gao Yu Wen executed a subscription agreement with the Company to purchase 20,000,000 shares of Common Stock at \$0.50 per share or \$10,000,000. The price was paid by paying \$2,000,000 cash and property, and transferring to the Company 9.5% of the outstanding equity of Aestar Fine Chemical Company ("Aestar"). On June 6, 1996 the Company and Gao entered into a Redemption Agreement wherein the Company renounced any interest in Aestar and Gao agreed that upon delivery by the Company of \$2,200,000 to Gao, he would return the 20,000,000 shares of the Company. The promise to pay \$2,200,000 by November 30, 1996, was secured by all 20,000,000 shares. On October 23, 1996, the Company and Mr. Gao executed an Amendment by which the terms of the Redemption Agreement were modified. Under the terms of the First Amendment, Mr. Gao agreed to immediately convey to the Company certificates representing 16 million shares of Common Stock. The \$2,200,000 payment was reduced to \$2,160,000 and the timing was extended until December 31, 1996, with an additional three months period at a penalty of 3/4% per month. On October 23, 1996, Mr. Gao conveyed the 16 million shares to the Company. Such shares were subsequently canceled. The Company had the right and might have had the obligation to repurchase the remaining 4,000,000 shares of the Company for \$2,160,000 on or before November 30, 1997.

In a related transaction, on April 26, 1995, the Company entered into an Investment Agreement with Gao whereby the Company transferred \$700,000 to Gao to invest as agent of the Company at the rate of no less than 17% per annum. Gao repaid \$190,000 by September 30, 1996. The remaining amount has been forgiven as part of the Rescission Agreement.

#### Rescission of Ardex Acquisition

On or about March 31, 1995, the Company invested \$400,000 in Ardex Equipment, LLC ("Ardex"), and paid \$50,000 to Charles C. Shelton and Joseph Colino, who were then directors of the Company, in exchange for a 19.25% interest in Ardex. In 1996, the Company received \$50,000 distribution from Ardex. On August 2, 1996, the Company and Ardex entered into a Letter of Intent rescinding the Company's investment in Ardex (the "Rescission"). Pursuant to the Rescission, the Company was to receive a 5-year negotiable promissory note for \$350,000 bearing interest at 8% per annum. Interest only was to be paid until the principal became due. Principal was due upon the first of the following events to occur: (i) completion of public or private offerings by Ardex in the aggregate of \$1,500,000 or more; (ii) 90 days following the year end in which sales have been or exceed \$3,000,000; (iii) Ardex having a cash balance of \$800,000 or more from operations; or (iv) five years from the date of the note. The note was to be secured by a limited guarantee of Charles C. Shelton, Joseph Colino and John Kohlman only to the extent of their interest in Ardex and their options in the Company. In addition, Mr. Shelton was to execute a promissory

note for \$15,000; Mr. Colino was to execute a note for \$22,500; and Mr. Kohlman was to execute a note for \$12,000. These notes were to be secured by the same security as the Ardex note. Under the terms of the Rescission, all of the previously mentioned notes and ancillary documents were to have been executed on or before August 31, 1996, but none have been delivered to the Company as of the date hereof. The Company is no longer continuing with its efforts to obtain the documents contemplated by the Rescission.

On September 30, 1998, the Company and Mr. Charles Shelton entered into a settlement agreement pursuant to which Mr. Shelton waived his alleged option to purchase 420,000 share of the Common Stock of the Company and his alleged right to receive approximately \$110,000 from the Company in exchange for 50,000 shares of Common Stock of the Company.

#### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K

##### (a)(1) Index to Financial Statements and Supplemental Schedules

Title of Documents - - - - -	Page No. - - - - -
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Balance Sheet	F-2
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CELSION CORPORATION

REPORT ON AUDITS OF  
FINANCIAL STATEMENTS

FOR THE YEARS ENDED  
SEPTEMBER 30, 1998, 1997 AND 1996



INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders  
Celsion Corporation  
Columbia, Maryland

We have audited the accompanying balance sheets of Celsion Corporation as of September 30, 1998 and 1997, and the related statements of operations, changes in stockholders' deficit, and cash flows for each of the three years in the period ended September 30, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Celsion Corporation as of September 30, 1998 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 1998 in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 of the financial statements, the Company has suffered recurring losses from operations, which raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Stegman & Co.

Baltimore, Maryland  
November 18, 1998

CELSION CORPORATION  
BALANCE SHEETS  
SEPTEMBER 30, 1998 AND 1997

ASSETS

	1998	1997
	-----	-----
CURRENT ASSETS:		
Cash	\$ 54,920	\$267,353
Accounts receivable	1,812	5,891
Inventories	42,059	329,741
Prepaid expenses	76,944	8,207
Other current assets	--	26,755
	-----	-----
Total current assets	175,735	637,947
	-----	-----
PROPERTY AND EQUIPMENT - at cost:		
Furniture and office equipment	195,794	180,348
Laboratory and shop equipment	47,048	92,228
	-----	-----
	242,842	272,576
Less accumulated depreciation	212,029	213,885
	-----	-----
Net value of property and equipment	30,813	58,691
	-----	-----
OTHER ASSETS:		
Patent licenses (net of accumulated amortization of \$ 65,760 and \$53,379 in 1998 and 1997, respectively)	124,190	126,571
	-----	-----
TOTAL ASSETS	\$330,738	\$823,209
	=====	=====

See accompanying notes.

LIABILITIES AND STOCKHOLDERS' DEFICIT

	1998	1997
	-----	-----
CURRENT LIABILITIES:		
Accounts payable - trade	\$ 1,034,767	\$ 614,173
Notes payable - other	132,778	1,481,831
Notes payable - related parties	146,041	221,943
Accrued interest payable - related parties	150,020	245,784
Accrued interest payable - other	127,538	116,604
Accrued compensation	470,220	331,715
Accrued professional fees	100,000	256,301
Other accrued liabilities	13,639	15,504
Capital lease - current	1,083	--
	-----	-----
Total current liabilities	2,176,086	3,283,855
LONG-TERM LIABILITIES:		
Capital lease - long-term	5,719	--
	-----	-----
Total liabilities	2,181,805	3,283,855
	-----	-----
STOCKHOLDERS' DEFICIT:		
Capital stock - \$.01 par value; 51,000,000 shares authorized, 39,945,826 and 29,095,333 issued and outstanding for 1998 and 1997, respectively	399,458	290,953
Additional paid-in capital	17,213,485	12,511,923
Accumulated deficit	(19,464,010)	(15,263,522)
	-----	-----
Total stockholders' deficit	(1,851,067)	(2,460,646)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 330,738	\$ 823,209
	=====	=====

CELSION CORPORATION

STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED SEPTEMBER 30, 1998, 1997 AND 1996

	1998	1997	1996
	-----	-----	-----
REVENUES:			
Equipment sales and parts	\$ 174,182	\$ 121,257	\$ 134,006
Returns and allowances	--	--	(60,000)
	-----	-----	-----
Total revenues	174,182	121,257	74,006
COST OF SALES	136,500	46,734	64,406
	-----	-----	-----
GROSS PROFIT	37,682	74,523	9,600
	-----	-----	-----
OPERATING EXPENSES:			
Selling, general and administrative	2,515,822	2,283,245	1,321,361
Research and development	1,534,872	185,974	94,012
	-----	-----	-----
Total operating expenses	4,050,694	2,469,219	1,415,373
	-----	-----	-----
LOSS FROM OPERATIONS	(4,013,012)	(2,394,696)	(1,405,773)
LOSS ON COSMETICS DIVISION	--	--	(471,000)
LOSS ON FUNDS HELD IN INVESTMENT CONTRACT	--	(40,000)	--
LOSS ON WRITE-OFF OF ARDEX EQUIPMENT, L.L.C. NOTES RECEIVABLE AND RELATED ACCRUED INTEREST RECEIVABLE	--	(438,803)	--
OTHER INCOME	11,870	7,172	28,808
INTEREST EXPENSE	(199,346)	(185,562)	(85,506)
	-----	-----	-----
LOSS BEFORE INCOME TAXES	(4,200,488)	(3,051,889)	(1,933,471)
INCOME TAXES	--	--	--
	-----	-----	-----
NET LOSS	\$ (4,200,488)	\$ (3,051,889)	\$ (1,933,471)
	=====	=====	=====
BASIC AND DILUTED NET LOSS PER COMMON SHARE	\$ (.12)	\$ (.11)	\$ (.05)
	=====	=====	=====
BASIC AND DILUTED WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	34,867,001	28,386,145	39,499,650
	=====	=====	=====

See accompanying notes.

CELSION CORPORATION

STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIT  
FOR THE YEARS ENDED SEPTEMBER 30, 1998, 1997 AND 1996

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deficit	Total
	-----	-----	-----	-----	-----
Balances at October 1, 1995	39,207,664	\$ 392,076	\$ 18,014,854	\$(10,278,162)	\$ 8,128,768
Sale of common stock	1,299,711	12,997	406,513	--	419,510
Issuance of 698,985 shares of common stock as payment of indebtedness and expenses	698,985	6,990	134,077	--	141,067
Net loss	--	--	--	(1,933,471)	(1,933,471)
	-----	-----	-----	-----	-----
Balances at September 30, 1996	41,206,360	412,063	18,555,444	(12,211,633)	6,755,874
Sale of common stock	1,409,902	14,099	668,901	--	683,000
Issuance of 2,479,071 shares of common stock as payment of indebtedness and expenses	2,479,071	24,791	1,127,578	--	1,152,369
Retirement of shares	(16,000,000)	(160,000)	(7,840,000)	--	(8,000,000)
Net loss	--	--	--	(3,051,889)	(3,051,889)
	-----	-----	-----	-----	-----
Balances at September 30, 1997	29,095,333	290,953	12,511,923	(15,263,522)	(2,460,646)
Sale of common stock	4,315,000	43,150	1,981,850	--	2,025,000
Issuance of 6,535,493 shares of common stock as payment of indebtedness and expenses	6,535,493	65,355	2,719,712	--	2,785,067
Net loss	--	--	--	(4,200,488)	(4,200,488)
	-----	-----	-----	-----	-----
Balance at September 30, 1998	<u>39,945,826</u>	<u>\$ 399,458</u>	<u>\$ 17,213,485</u>	<u>\$(19,464,010)</u>	<u>\$ (1,851,067)</u>

See accompanying notes.

CELSION CORPORATION

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED SEPTEMBER 30, 1998, 1997 AND 1996

	1998	1997	1996
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net loss	\$(4,200,488)	\$(3,051,889)	\$(1,933,471)
Noncash items included in net loss:			
Funds held under investment contract used for cosmetic division expenses	--	40,000	471,000
Depreciation and amortization	24,291	24,169	18,545
Bad debt expense	--	120,865	51,397
Loss on disposal of property and equipment	45,180	--	--
Gain on disposition of investment in Ardex Equipment, L.L.C	--	--	(17,009)
Write-off of obsolete inventory	287,682	--	--
Write-off of Ardex Equipment - note receivable and accrued interest	--	438,803	--
Common stock issued for operating expenses	796,745	297,542	9,000
Net changes in:			
Accounts receivable	4,079	(2,421)	(68,631)
Inventories	--	(58,789)	45,327
Accrued interest receivable - related parties	--	(33,470)	(5,333)
Prepaid expenses	5,430	(6,538)	6,000
Other current assets	10,085	--	(1,204)
Accounts payable and accrued interest payable	903,900	837,172	25,445
Accrued compensation	168,732	145,256	(166,039)
Accrued professional fees	(156,300)	179,950	74,852
Other accrued liabilities	(1,865)	(85,401)	27,533
 Net cash used in operating activities	 (2,112,529)	 (1,154,751)	 (1,462,588)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Rescission of investment in Ardex Equipment, L.L.C	--	--	100,000
Purchases of patent licenses	(10,000)	--	(100,000)
Purchase of property and equipment	(21,935)	(3,807)	(10,256)
Funds returned - investment contract	--	--	139,000
 Net cash (used) provided by investing activities	 (31,935)	 (3,807)	 128,744
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from notes payable	50,000	615,000	1,205,000
Payment on notes payable - related parties	(63,240)	(24,020)	(48,973)
Payment on notes payable - other	(79,254)	(95,000)	(2,000)
Payment on capital lease obligation	(475)	--	--
Proceeds of stock issuances	2,025,000	683,000	419,510
 Net cash provided by financing activities	 1,932,031	 1,178,980	 1,573,537
 NET (DECREASE) INCREASE IN CASH	 (212,433)	 20,422	 239,693
 CASH AT BEGINNING OF YEAR	 267,353	 246,931	 7,238
 CASH AT END OF YEAR	 \$ 54,920	 \$ 267,353	 \$ 246,931

Celsion Corporation

Statements of Cash Flows (Continued)  
For the Years Ended September 30, 1998, 1997 and 1996

	1998	1997	1996
	-----	-----	-----
Schedule of noncash investing and financing transactions:			
Acquisition and rescission of a 9.5% interest in the Aestar Fine Chemical Company in exchange for 16,000,000 shares of common stock	\$ -- =====	\$ (8,000,000) =====	\$ -- =====
Conversion of accounts payable, debt and accrued interest payable through issuance of common stock	\$ 1,988,322 =====	\$ 854,826 =====	\$ 132,067 =====
Equipment repossessed for internal use	\$ -- =====	\$ 30,000 =====	\$ -- =====
Acquisition of equipment:			
Cost of equipment	\$ 7,277	\$ --	\$ --
Capital lease payable	(7,277) -----	-- -----	-- -----
Cash down payment for equipment	\$ -- =====	\$ -- =====	\$ -- =====
Payment on notes payable:			
Decrease in notes payable	\$ 16,670	\$ --	\$ 25,223
Offset of accounts receivable	(16,670) -----	-- -----	(25,223) -----
Net cash paid	\$ -- =====	\$ -- =====	\$ -- =====
Rescission of investment in Ardex Equipment, L.L.C. in exchange for notes receivable	\$ -- =====	\$ -- =====	\$ 400,000 =====
Cash paid during the year for:			
Interest	\$ 103,470 =====	\$ -- =====	\$ 45,000 =====
Income taxes	\$ -- =====	\$ -- =====	\$ -- =====

See accompanying notes.

CELSION CORPORATION

NOTES TO FINANCIAL STATEMENTS  
FOR THE YEARS ENDED SEPTEMBER 30, 1998, 1997 AND 1996

1. DESCRIPTION OF BUSINESS

Celsion Corporation (the "Company") is in the business of developing thermotherapy products for medical applications.

2. GOING CONCERN UNCERTAINTY

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, which contemplates continuation of the Company as a going concern. However, the Company has sustained substantial operating losses in recent years and has used substantial amounts of working capital in its operations. Further, at September 30, 1998, current liabilities exceed current assets by \$2,000,351. The continued operation of the Company is dependent upon its ability to obtain funding necessary to complete clinical trials of its products. Management continues to attempt to obtain funding through both private and public offerings. The realization of the majority of the Company's assets is dependent upon the success of these offerings.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents  
-----

The Company classifies highly liquid investments with original maturities of 90 days or less to be cash equivalents. Cash equivalents are stated at cost, which approximates market value.

Inventories  
-----

Inventories are stated at the lower of cost or market. Cost is determined using the average cost method.

Property and Equipment  
-----

Property and equipment is stated at cost. Depreciation is provided over the estimated useful lives of the related assets of five years. Major renewals and betterments are capitalized at cost and ordinary repairs and maintenance are charged against operations as incurred.

Patent Licenses  
-----

The Company has purchased several licenses to use the rights to patented technologies. Patent licenses are amortized straight-line over the remaining patent life.



#### Revenue Recognition

-----

Revenue is recognized when systems, products or components are shipped and when consulting services are rendered. Deferred revenue is recorded for customer deposits received on contingent sale agreements.

#### Research and Development

-----

Research and development costs are expensed as incurred. Equipment and facilities acquired for research and development activities which have alternative future uses are capitalized and charged to expense over their estimated useful lives.

#### Net Loss Per Common Share

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Basic and diluted net loss per common share was computed by dividing net loss by the weighted average number of shares of common stock outstanding during each period. The impact of common stock equivalents has been excluded from the computation of weighted average common shares outstanding, as the effect would be antidilutive.

#### Use of Estimates

-----

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

#### Financial Institutions

-----

For most financial instruments, including cash, accounts payable and accruals, management believes that the carrying amount approximates fair value, as the majority of these instruments are short-term in nature.

#### New Accounting Pronouncements

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In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation (SFAS No. 123), which was effective for the Company's year ended September 30, 1997. SFAS No. 123 allows companies either to continue to account for stock-based employee compensation plans under existing accounting standards or to adopt a fair value based method of accounting as defined in the new standard. The Company will follow the existing accounting standards for these plans, and has provided pro forma disclosure of net income and earnings per share as if the expense provisions of SFAS No. 123 had been adopted. Implementation of SFAS No. 123 did not have a material impact on results of operations or financial condition.

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, Earnings per Share (SFAS No. 128), which establishes new standards for computing and presenting earnings per share. SFAS No. 128 is effective for the Company's September 30, 1998 financial statements, including restatement of interim periods; earlier application was not permitted. The effect of the new standard did not have a material impact on previously reported earnings per share.

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS No. 130), which establishes standards for reporting and displaying comprehensive income and its components. SFAS No. 130 requires comprehensive income and its components, as recognized under the accounting standards, to be displayed in a financial statement with the same prominence as other financial statements. The Company has adopted the standard, as required, in the fiscal year ended September 30, 1998. The Company had no items of comprehensive income for the three years ended September 30, 1998.

Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS No. 131), also issued in June 1997, establishes new standards for reporting information about operating segments in annual and interim financial statements. The standard also requires descriptive information about the way the operating segments are determined, the products and services provided by the segments, and the nature of differences between reportable segment measurements and those used for the consolidated enterprise. This standard is effective for years beginning after December 15, 1997. Adoption in interim financial statements is not required until the year after initial adoption, however, comparative prior period information is required. The Company is evaluating the standard and plans adoption as required in 1999; adoption of this disclosure requirement will not have a material impact on the Company's results of operations or financial position.

#### 4. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	1998	1997
	-----	-----
Trade receivables	\$1,812	\$4,431
Related party receivables:		
Microfocus	--	1,460
	-----	-----
	\$1,812	\$5,891
	=====	=====

#### 5. INVENTORIES

Inventories are comprised of the following at September 30:

	1998	1997
	-----	-----
Materials	\$ 5,059	\$235,748
Work-in-process	--	16,990
Finished products	37,000	77,003
	-----	-----
	\$ 42,059	\$329,741
	=====	=====

During the year ended September 30, 1998, management completed a thorough review of all its components inventory. Based on this review, management wrote off as obsolete a substantial portion of its inventory. This write off, totaling \$287,682, is included in operating expenses for the year ended September 30, 1998.

6. RELATED PARTY TRANSACTIONS

Notes Payable - Related Parties

Notes payable to related parties as of September 30 are comprised of the following:

	1998	1997
	-----	-----
Term note payable to an officer and stockholder of the Company, accruing interest at 10% per annum	\$ --	\$ 28,650
Term notes payable to an officer and stockholder of the Company, accruing interest at 12% per annum	--	68,750
Demand note payable to relative of an officer and stockholder of the Company, accruing interest at 12% per annum	36,041	36,041
Demand note payable to related party of remainder of funds borrowed for discontinued project, note bears interest at 12% per annum	--	28,502
Term notes payable to interested parties of the Company accruing interest at 12% per annum	10,000	10,000
Term note payable to an officer and stockholder of the Company accruing interest at 8% per annum	50,000	--
Term note payable to stockholder of the Company accruing interest at 10% per annum payable in monthly payments of \$2,000 for 25 months. The note is secured by all accounts receivable and general intangibles of the Company	50,000	50,000
	-----	-----
Less current portion	146,041	221,943
	-----	-----
Long-term portion - due in 1998	\$ --	\$ --
	=====	=====

Accrued interest payable on these notes amounted to \$150,020 and \$245,784 at September 30, 1998 and 1997, respectively.

Stock Based Compensation Plan

As part of the Company's employment agreement with the current

chief executive officer (CEO), the Company has granted to the CEO 1,900,000 shares of the Company's capital stock which vests in certain milestones throughout the term of employment. Ultimately all shares become fully vested, provided that the CEO remains with the Company through the term of the contract. The total amount charged to compensation expense for 1998 and 1997 under this plan was \$699,375 and \$280,000, respectively.

7. NOTES PAYABLE - OTHER

Notes payable - other consist of the following as of September 30:

	1998 -----	1997 -----
Senior secured convertible notes, resulting from private placement offerings in July 1996 and June 1997, accruing interest at 8% per annum. The notes are secured by the Company's common stock held by an executive officer. The notes matured December 31, 1997.	\$ -	\$1,169,800
Term note with interest accruing at 24% per annum, compounded monthly. The note matured April 30, 1996.	114,778	112,031
Term note with accrued interest payable each month at 12% per annum. The note is secured by inventory and property. The note matured December 18, 1997.	18,000 -----	200,000 -----
	\$132,778 =====	\$1,481,831 =====

Accrued interest payable on these notes amounted to \$127,538 and \$116,604 at September 30, 1998 and 1997, respectively.

8. RETIREMENT PLAN

The Company provides a SAR-SEP savings plan to which eligible employees may make pretax payroll contributions up to 15% of compensation. The Company does not make contributions to the plan.

9. INVESTMENT IN AESTAR FINE CHEMICAL COMPANY - AT COST

During 1995, the Company acquired a 9.5% equity interest in Aestar Fine Chemical Company (Aestar) in exchange for 16,000,000 shares of its common stock. The investment was carried at cost, as measured by the \$.50 per share fair market value of the 16,000,000 shares of the Company's common stock. The Company has subsequently rescinded this investment during the year ended September 30, 1997.

10. INVESTMENT IN ARDEX EQUIPMENT, L.L.C. - AT EQUITY

The Company purchased a 19.25% equity interest in Ardex Equipment, L.L.C. (Ardex) in 1995. The investment was carried at cost, adjusted for the Company's proportionate share of Ardex's loss from the purchase date through September 30, 1995. During 1996, the Company rescinded its investment in Ardex, the effects of which are reflected in these financial statements.

11. LOSS ON COSMETICS DIVISION

During 1995, the Company issued 20,000,000 shares of common stock to an investor which enabled the investor to obtain a majority interest in the Company by recapitalizing the Company through this investment of \$2,000,000 in cash and an \$8,000,000 interest in a foreign corporation. In connection with this recapitalization, the Company agreed to the initiation of the development of a cosmetics division and to the investment of excess funds in an investment contract. During the year ended September 30, 1996, this agreement was rescission and the Company recognized a loss on the cosmetics division in the amount of \$471,000. Additionally as a result of the rescission agreement, the balance of the investment contract of \$40,000 was written-off in the year ended September 30, 1997.

12. INCOME TAXES

A reconciliation of the Company's statutory tax rate to the effective rate for the years ended September 30 is as follows:

	1998	1997	1996
	-----	-----	-----
Federal statutory rate	34.0%	34.0%	34.0%
State taxes, net of federal tax benefit	4.6	4.6	4.6
Valuation allowance	(38.6)	(38.6)	(38.6)
	-----	-----	-----
	.0%	.0%	.0%
	=====	=====	=====

As of September 30, 1998, the Company had net operating loss carryforwards of approximately \$18,000,000 for federal income tax purposes that are available to offset future taxable income through the year 2018.

The components of the Company's deferred tax asset for the years ended September 30 is as follows:

	1998	1997
	-----	-----
Net operating loss carryforwards	\$6,952,000	\$5,330,000
Valuation allowance	(6,952,000)	(5,330,000)
	-----	-----
	\$ -	\$ -
	=====	=====

The evaluation of the realizability of such deferred tax assets in future periods is made based upon a variety of factors for generating future taxable income, such as intent and ability to sell assets and historical and projected operating performance. At this time, the Company has established a valuation reserve for all of its deferred tax assets. Such tax assets are available to be recognized and benefit future periods.

13. COMMON STOCK

During the year ended September 30, 1998, the Company issued 4,315,000 shares of common stock for \$2,025,000, 5,274,961 shares were issued to extinguish debt, and 1,260,532 shares were issued as payment for various operating expenses.

During the year ended September 30, 1997, the Company issued 1,409,902 shares of common stock for \$683,000, 1,317,143 shares were issued to extinguish debt, and 1,161,828 shares were issued as payment for various operating expenses. Additionally, the Company retired 16,000,000 shares of common stock in connection with the rescission in its investment in Aestar.

During the year ended September 30, 1996, the Company issued 1,299,711 shares of common stock for \$419,510, 689,985 shares were issued to extinguish debt, and 9,000 shares were issued as payments for various operating expenses.

14. STOCK OPTIONS AND WARRANTS

The Company has issued stock options to employees, directors, vendors and debt holders. Options are granted at market value at the date of the grant and are immediately exercisable.

A summary of the Company's stock option activity and related information for the years ended September 30, 1998 and 1997 is as follows:

	1998		1997	
	Common Stock Options	Weighted Average Exercise Price	Common Stock Options	Weighted Average Exercise Price
Outstanding at beginning of year	3,565,000	\$.38	3,050,000	\$.34
Granted	-	.00	515,000	.61
Exercised	(125,000)	.45	-	.00
Expired/canceled	(695,000)	.25	-	.00
Outstanding at end of year	<u>2,745,000</u>	<u>\$.41</u>	<u>3,565,000</u>	<u>\$.38</u>

Additionally, the Company has issued warrants to purchase the Company's stock as follows:

	1998		1997	
	Common Stock Warrants	Weighted Average Exercise Price	Common Stock Warrants	Weighted Average Exercise Price
Outstanding at beginning of year	3,276,818	\$.35	2,218,035	\$.29
Issued	4,582,165	.52	1,058,783	.48
Outstanding at end of year	<u>7,858,983</u>	<u>\$.45</u>	<u>3,276,818</u>	<u>\$.35</u>

The following summarizes information about options and warrants at September 30, 1998:

Range of Exercise Prices	Options/Warrants Outstanding			Options/ Warrants Exercisable	
	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
\$0.22 - \$3.00	10,603,982	3.77 years	\$ .44	7,060,731	\$ .41

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), but applies Accounting Principles Board Opinion No. 25 and related interpretations. No compensation expense related to the granting of stock options was recorded during the three years ended September 30, 1998. The fair value of these equity awards was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 1998 and 1997: risk-free interest rate of 5.75% and 6.5% for 1998 and 1997, respectively; expected volatility of 50%; expected option life of 3 to 5 years from vesting and an expected dividend yield of 0.0%. If the Company had elected to recognize cost based on the fair value at the grant dates consistent with the method of prescribed by SFAS No. 123, net loss and loss per share would have been changed to the pro forma amounts as follows:

	1998	1997	1996
Net loss	\$(5,272,699)	\$(3,476,159)	\$(2,708,362)
Net loss per common share - basic	(.12)	(.12)	(.07)

#### 15. COMMITMENTS AND CONTINGENCIES

##### Potential Liability and Insurance

In the normal course of business, the Company may be subject to warranty and product liability claims on its hyperthermia equipment. Currently, the Company does not have a product liability insurance policy in effect although management does anticipate obtaining such coverage when adequate financial resources are available. The assertion of any product liability claim against the Company, therefore, may have an adverse effect on its financial condition. As of September 30, 1998, no product, warranty claims or other liabilities against the Company have been asserted.

##### Warranty Reserve

The Company warrants its hyperthermia units to be free from defects in material and workmanship under normal use and service for the period of one year from the date of shipment. Claims have been confined to basic repairs. Given the one year limitation of the warranty, management has elected to not set up a warranty reserve but, instead, to expense repairs as costs are incurred.

#### 16. OTHER BUSINESS VENTURES - TERMINATION OF PURCHASE OPTION

On April 26, 1995, the Company entered into an agreement to purchase a 50% interest in the United Aerosol and Home Products Company, LTD ("Unisol"), located in Zhongshan, China. Unisol is a specialty chemical and fine chemical aerosol packaging and bottle/can filling business. The purchase price was to be 20% of the appraised value of Unisol equipment, payable in the Company's common stock at the close of business on April 26, 1996. This agreement was terminated during the year ended September 30, 1997.

17. LEASE OBLIGATIONS

During the year ended September 30, 1997, the Company has entered into a 3-year lease for their facilities in Columbia, Maryland. Future minimum lease obligations are as follows:

1999	\$ 69,131
2000	55,877
	-----
	\$125,008
	=====

Total amounts charged to rent expense for 1998, 1997 and 1996 were \$75,018, \$64,594 and \$55,982, respectively.



(a)(2) No schedules are provided because of the absence of conditions under which they are required.

(b) Reports on Form 8-K.

The Company filed no reports on Form 8-K during the fourth quarter of its fiscal year ended September 30, 1998.

(c) Exhibits.

The following documents are included as exhibits to this report:

Exhibit Number	Description
3.1	Articles of Incorporation of the Company as filed on May 19, 1982 with the State of Maryland Department of Assignments and Taxation, incorporated herein by reference to the exhibits to the Company's Registration Statement on Form S-1, as amended, originally filed with the Securities and Exchange Commission on October 17, 1984, Registration No. 2- 93826-W.
3.1.1	Articles of Amendment and Restatement to the Articles of Incorporation of the Company as filed on June 21, 1984 with the State of Maryland Department of Assignments and Taxation, incorporated herein by reference to Exhibit 3.1.1 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
3.1.2	Articles of Amendment to the Articles of Incorporation of the Company as filed on December 14, 1994 with the State of Maryland Department of Assignments and Taxation, incorporated herein by reference to Exhibit 3.1.2 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
3.1.3	Certificate of Amendment to Certificate of Incorporation as filed on May 1, 1998 with the State of Maryland Department of Assignment and Taxation, incorporated herein by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q of the Company for the quarter ended March 30, 1998.
3.2	By-laws, incorporated herein by reference to Exhibit 3.2 to the Annual Report on Form 10- K of the Company for the year ended September 30, 1996.
3.2.1	Amendment to the By-laws of the Company adopted December 9, 1994, incorporated herein by reference to Exhibit 3.2.1 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
3.2.2	Amendment to the By-laws of the Company adopted April 27, 1998, incorporated herein by reference to Exhibit 3.2 to the Quarterly Report on Form 10-Q of the Company for the quarter ended March 30, 1998.
10.1	Patent License Agreement between the Company and Massachusetts Institute of Technology dated June 1, 1996, incorporated herein by reference to Exhibit 10.1 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996 (Confidential Treatment Requested).
10.2	License Agreement between the Company and MMTC, Inc. dated August 23, 1996, incorporated herein by reference to Exhibit 10.2 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996 (Confidential Treatment Requested).
10.3	Letter Agreement between the Company and H.B.C.I., Inc., dated September 17, 1996, incorporated herein by reference to Exhibit 10.3 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
10.4	Letter Agreement between the Company and Herbst, Lazar, Bell, Inc. dated October 4, 1996, incorporated herein by reference to Exhibit 10.4 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
10.5	Sponsored Research Agreement dated March 26, 1998 between the Company and Duke University*
10.6	Engagement Letter dated August 6, 1998 between the Company and Josephberg Grosz & Co., Inc.*

- 
- 10.7 Omnibus Stock Option Plan, incorporated herein by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q of the Company for the quarter ended March 30, 1998.
- 
- 10.8 Letter of Intent between the Company and Mr. Sun Shou Yi, representative of Mr. Gao Yu Wen, dated May 27, 1996 and Redemption Agreement between the Company and Mr. Sun Shou Yi., representative of Mr. Gao Yu Wen, dated June 6, 1996, incorporated herein by reference to Exhibit 10.8 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
- 
- 10.9 Amendment among the Company, Sun Shou Yi, Ou Yang An, Gao Yu Wen, dated October 23, 1996, incorporated herein by reference to Exhibit 10.9 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
- 
- 10.10 Unsecured Promissory Note, dated June 23, 1998, in the amount of \$50,000 and bearing interest at the rate of eight percent, payable to Spencer J. Volk\*
- 
- 10.11 Form of Series 200 Warrant issued to certain employees, directors, and consultants to Purchase Common Stock of the Company\*
- 
- 10.12 Form of Series 250 Warrant Issued to DunnHughes Holding, Inc. to Purchase Common Stock of the Company\*
- 
- 10.13 Form of Series 300 Warrant Issued to Nace Resources, Inc. and George T. Horton Trust to Purchase Common Stock of the Company\*
- 
- 10.14 Form of Series 400 Warrant Issued to Stearns Management Company Assignees to Purchase Common Stock of the Company\*
- 
- 10.15 Form of Series 500 Warrant to Purchase Common Stock of the Company pursuant to the Private Placement Memorandum of the Company dated January 6, 1997, as amended\*
- 
- 10.16 Form of Series 550 Warrant to Purchase Common Stock of the Company pursuant to the Private Placement Memorandum of the Company dated January 6, 1997, as amended\*
- 
- 10.17 Form of Series 600 Warrant Issued to Certain Employees and Directors on May 16, 1996 to Purchase Common Stock of the Company\*
- 
- 10.18 Form of Series 700 Warrant to Purchase Common Stock of the Company pursuant to the Private Placement Memorandum of the Company dated September 10, 1998, as amended\*
- 
- 10.19 Form of Registration Rights Agreement pursuant to the Private Placement Memorandum of the Company dated January 6, 1997, as amended \*
- 
- 10.20 Form of Registration Rights Agreement pursuant to the Private Placement Memorandum of the Company dated September 10, 1998, as amended\*
- 
- 21.1 Subsidiaries of the Registrant, incorporated herein by reference to Exhibit 21.1 to the Annual Report on Form 10-K of the Company for the year ended September 30, 1996.
- 
- 23.1 Consent of Stegman & Company, independent public accountants of the Company\*
- 
- 27.1 Financial Data Schedule\*
- 

\* Filed herewith

SIGNATURES

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

CELSION CORPORATION

January 12, 1999

By: /s/ Spencer J. Volk

-----  
Spencer J. Volk  
President

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

Signature -----	Title -----	Date -----
/s/Spencer. J. Volk ----- Spencer J. Volk	Chief Executive Officer, President and Director	January 12, 1998
/s/John Mon ----- John Mon	General Manager, Treasurer Director	January 12, 1998
/s/Augustine Y. Cheung ----- Dr. Augustine Y. Cheung	Chairman, Director	January 12, 1998
----- Walter Herbst	Director	January __, 1998
----- Max Link	Director	January __, 1998

SPONSORED RESEARCH AGREEMENT (NON-CLINICAL)

This Agreement ("Agreement") is between Duke University ("Duke"), a North Carolina non-profit corporation, located in Durham, North Carolina and Cheung Laboratories, Inc. ("Sponsor"), a Maryland corporation having offices at 10220-I Old Columbia Road, Columbia, Maryland 21046.

WHEREAS, the research program contemplated by this Agreement is of mutual interest and benefit to Duke and Sponsor, and will further the instructional and research objectives of Duke in a manner consistent with its status as a non-profit educational institution.

NOW, THEREFORE, the parties agree as follows:

ARTICLE 1  
STATEMENT OF WORK

Duke agrees to use its best effort to perform the research program described in the "Statement of Work" ("Statement"), a copy of which is attached to this Agreement as Exhibit "A".

ARTICLE 2  
INDEPENDENT CONTRACTOR

Duke's relationship to Sponsor under this Agreement will be of an independent contractor and not an agent, joint venturer or partner of Sponsor.

ARTICLE 3  
PRINCIPAL INVESTIGATOR

The research will be supervised by David Needham, PhD ("Investigator") at Duke. If, for any reason Investigator is unable to continue to serve as Principal Investigator and a successor acceptable to both Duke and Sponsor is not available, the Agreement will be terminated in accordance with Article 7 below.

ARTICLE 4  
CONSIDERATION

In consideration of the foregoing, and as more specifically provided in the budget included as Exhibit B, Sponsor will pay Duke for all direct and indirect costs incurred in the performance of the research as set forth in the Statement, a total not to exceed \$184,336. Payment will be made to Duke by Sponsor in advance, on the schedule set forth in Exhibit B.

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ARTICLE 5  
PERIOD OF PERFORMANCE

The research will be conducted during a 1 year period commencing on \_\_\_\_\_, 19\_\_ and concluding on or before \_\_\_\_\_. This agreement will be renewable for additional periods upon the mutual consent of the parties by a new agreement or by amendment hereto expressed in writing. Either party may terminate this Agreement on any anniversary date of this Agreement after the first anniversary date by giving the other party at least sixty (60) days prior written notice of such termination. In the case of such termination, Duke will proceed in an orderly fashion to terminate any outstanding commitments and to stop the work as soon as it is practicable to do so. All reasonable costs to Duke associated with termination will be considered reimbursable costs, including costs incurred prior to the notice of termination but which have not yet been reimbursed, and commitments existing at the time the notice of termination is received which cannot be cancelled.

ARTICLE 6  
RESEARCH REPORTS

Duke will provide Sponsor with periodic progress reports on the research. In addition, Duke will provide Sponsor with a final report on such research within sixty (60) days of termination of this Agreement.

ARTICLE 7  
TERMINATION

In the event that either party commits a breach or default in any of the terms or conditions of this Agreement and that party fails to remedy that default or breach within thirty (30) days after receipt of written notice of that breach from the other party, the party giving notice may, at its option and in addition to any other remedies it may have in law or in equity; terminate this Agreement by sending written notice of termination to stop the work as soon as it is practicable to do so. All costs to Duke associated with termination will be considered reimbursable costs, including costs incurred prior to the notice of termination but which have not yet been reimbursed, and commitments existing at the time the notice of termination is received which cannot be cancelled. This shall include all noncancellable contracts and fellowships or postdoctoral associate appointments incurred prior to the effective date of termination. After termination, any obligation of Sponsor for fellowships or postdoctoral associates shall end no later than the first to occur of (i) the end of Duke's academic year following termination. or (ii) the next anniversary date on which Sponsor could have terminated this Agreement pursuant to Article 5. In no case will reimbursement under this Agreement exceed the total estimated project costs specified in Exhibit B.



ARTICLE 8  
CONFIDENTIAL INFORMATION

"Confidential Information" ("Information") shall mean all information provided by one party to the other and clearly identified as confidential by the transmitting party at the time of disclosure. Specifically excepted from this definition is all information: (a) known by the receiving party at the time of disclosure; (b) publicly disclosed except by breach of this Agreement; (c) rightfully received by the receiving party from a third party without an express obligation of confidence; and (d) independently developed by the employees or agents of either party without any knowledge of the confidential information provided by the other party. The party receiving the Information agrees to hold that Information in trust and confidence for the transmitting party, using the same care and discretion that the receiving party uses with similar Information which it considers confidential. The receiving party will not use Information other than for the benefit of the two parties and relating to the Agreement and except as may be provided for in Article 9 regarding publication herein, neither party will disclose such information without authorization from the other party. This provision shall remain in effect during the term of this Agreement and for three (3) years thereafter.

ARTICLE 9  
PUBLICATION AND OTHER USE

Duke shall be free to use the results of the subject research for its own teaching, research, educational, clinical and publication purposes without the payment of royalties or other fees. Duke agrees to submit to Sponsor for its review, a copy of any proposed publication resulting from the subject research at least sixty (60) days prior to the estimated date of publication, and if no response is received within thirty (30) days of the date submitted to Sponsor, it will be conclusively presumed that the publication may proceed without delay. If Sponsor determines that the proposed publication contains patentable subject matters which require protection, Sponsor may require the delay of the publication for a period of time not to exceed sixty (60) days for the purpose of allowing the pursuit of such protection.

ARTICLE 10  
INVENTIONS

Any new invention, development, or discovery resulting from the subject research ("Invention") shall be promptly disclosed in writing to Sponsor. Sponsor is hereby granted, without option fee other than the consideration of the research sponsored herein and the reimbursement of Duke for all patent expenses incurred to the date of disclosure related to the Invention, an option to acquire an exclusive, worldwide, royalty bearing license of Duke's rights to any Invention, which option shall extend for ninety (90) days after Sponsor's receipt of an Invention disclosure. If Sponsor notifies Duke in writing of its exercise of the option within the option period, then the parties will proceed

in good faith to negotiate a license agreement on commercially reasonable terms within ninety (90) days after notification of exercise, and if Sponsor does not exercise this option, or notifies Duke that it will not exercise this option, or the parties fail to sign a license agreement within said ninety (90) day period, then Sponsor shall no longer own any rights in the subject Invention.

ARTICLE 11  
INDEMNITY AND INSURANCE

Sponsor agrees to indemnify, hold harmless and defend Duke, its officers, employees, and agents against any and all claims, suits, losses, damages, costs, fees, and expenses asserted by third parties, both government and non-government, resulting from or arising out of this agreement; provided, however, that Sponsor shall not be responsible for Duke's negligence or willful misconduct. Sponsor shall maintain in force at its sole cost and expense, with reputable insurance companies, insurance of a type and in an amount reasonably sufficient to protect against liability hereunder. Duke shall have the right to request the appropriate certificates of insurance from Sponsor for the purpose of ascertaining the sufficiency of such coverage.

ARTICLE 12  
USE OF A PARTY'S NAME

Neither party will, without the prior written consent of the other party: (a) use in advertising, publicity or otherwise, the name of any employee or agent, any trade-name, trademark, trade device, service mark, symbol, or any abbreviation, contraction or simulation thereof owned by the other party, or (b) represent, either directly or indirectly, that any product or service of the other party is a product or service of the representing party or that it is made in accordance with or utilizes the information or documents of the other party. Notwithstanding the above, Sponsor shall have the right to state that it has entered into this Agreement with Duke and to state or summarize the terms hereof in its filings with the Securities and Exchange Commission and related shareholder communications; provided that Sponsor shall submit the text of such statements to Duke at least 48 hours prior to publication.

ARTICLE 13  
NOTICE

Any notice or other communication required or permitted under this Agreement will be in writing and will be deemed given as of the date it is: (a) delivered by hand, or (b) mailed, postage prepaid, first class, certified mail, return receipt requested, to the party at the address listed below or subsequently specified in writing, or (c) sent, shipping prepaid, return receipt requested, by national courier service, to the party at the address listed below or subsequently specified in writing:



As to Duke: Office of Grants and Contracts  
107 Seeley G. Mudd Building  
Duke University Medical Center - Box 3001  
Durham, North Carolina 27710

cc: University Counsel  
Duke University - 011 Allen Building  
Durham, North Carolina 27708

As to Sponsor: Cheung Laboratories, Inc.  
10220-I Old Columbia Road  
Columbia, Maryland 21046

Attn: Augustine Cheung

This Agreement is for professional research services. Neither party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the other party.

ARTICLE 14  
ENTIRE AGREEMENT

This Agreement and all attached Exhibits contain the entire agreement and understanding between the parties as to its subject matter. It merges all prior discussions between the parties and neither party will be bound by conditions, definitions, warranties, understandings, or representations concerning such subject matter except as provided in this Agreement or as specified on or subsequent to the effective date of this Agreement in a writing signed by properly authorized representatives of the parties. This Agreement can only be modified by written agreement duly signed by persons authorized to sign agreements on behalf of both Sponsor and Duke.

ARTICLE 15  
WAIVER

The failure of a party in any instance to insist upon the strict performance of the terms of this Agreement will not be construed to be a waiver or relinquishment of any of the terms of this Agreement, either at the time of the party's failure to insist upon strict performance or at any time in the future, and such terms will continue in full force and effect.

ARTICLE 16  
SEVERANCE

Each clause of this Agreement is a distinct and severable clause and if any clause is deemed illegal, void or unenforceable, the validity, legality or enforceability of any other clause or portion of this Agreement will not be affected thereby.

ARTICLE 17  
GOVERNING LAW

The construction and performance of this Agreement will be governed by the laws of the State of North Carolina.

ARTICLE 18  
TITLES

All titles and articles headings contained in this Agreement are inserted only as a matter of convenience and reference. They do not define, limit extend or describe the scope of this Agreement or the intent of any of its provisions.

IN WITNESS WHEREOF, the parties hereunto set their hands and seals.

DUKE UNIVERSITY

By: /s/ Ralph Hyderman

-----

Name:  
Title:

Date Executed: \_\_\_\_\_

Principal Investigator:

SPONSOR:

CHEUNG LABORATORIES, INC.

By: /s/Augustine Y. Cheung

-----

Name:  
Title:Chairman

Date Executed: March 17, 1998

Exhibit "B"

Payment Schedule

Payment Due Date	Amount
January __, 1998	\$25,000
April __, 1998	\$53,112
July __, 1998	\$53,112
October __, 1998	\$53,112
Total	\$184,336

483203.001(B&F)

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01/11/99

SPONSORED RESEARCH AGREEMENT (NON-CLINICAL)

This Agreement ("Agreement") is between Duke University ("Duke"), a North Carolina non-profit corporation, located in Durham, North Carolina and Cheung Laboratories, Inc. ("Sponsor"), a Maryland corporation having offices at 10220-I Old Columbia Road, Columbia, Maryland 21046.

WHEREAS, the research program contemplated by this Agreement is of mutual interest and benefit to Duke and Sponsor, and will further the instructional and research objectives of Duke in a manner consistent with its status as a non-profit educational institution.

NOW, THEREFORE, the parties agree as follows:

ARTICLE 4  
STATEMENT OF WORK

Duke agrees to use its best effort to perform the research program described in the "Statement of Work" ("Statement"), a copy of which is attached to this Agreement as Exhibit "A".

ARTICLE 5  
INDEPENDENT CONTRACTOR

Duke's relationship to Sponsor under this Agreement will be of an independent contractor and not an agent, joint venturer or partner of Sponsor.

ARTICLE 6  
PRINCIPAL INVESTIGATOR

The research will be supervised by Mark W. Dewhirst, DVM, PhD ("Investigator") at Duke. If, for any reason Investigator is unable to continue to serve as Principal Investigator and a successor acceptable to both Duke and Sponsor is not available, the Agreement will be terminated in accordance with Article 7 below.

ARTICLE 4  
CONSIDERATION

In consideration of the foregoing, and as more specifically provided in the budget included as Exhibit B, Sponsor will pay Duke for all direct and

indirect costs incurred in the performance of the research as set forth in the Statement, a total not to exceed \$440,726. Payment will be made to Duke by Sponsor in advance, on the schedule set forth in Exhibit B.

ARTICLE 5  
PERIOD OF PERFORMANCE

The research will be conducted during a 1 year period commencing on February 1, 1998 and concluding on or before January 31, 1999. This agreement will be renewable for additional periods upon the mutual consent of the parties by a new agreement or by amendment hereto expressed in writing. Either party may terminate this Agreement on any anniversary date of this Agreement after the first anniversary date by giving the other party at least sixty (60) days prior written notice of such termination. In the case of such termination, Duke will proceed in an orderly fashion to terminate any outstanding commitments and to stop the work as soon as it is practicable to do so. All reasonable costs to Duke associated with termination will be considered reimbursable costs, including costs incurred prior to the notice of termination but which have not yet been reimbursed, and commitments existing at the time the notice of termination is received which cannot be cancelled.

ARTICLE 6  
RESEARCH REPORTS

Duke will provide Sponsor with periodic progress reports on the research. In addition, Duke will provide Sponsor with a final report on such research within sixty (60) days of termination of this Agreement.

ARTICLE 7  
TERMINATION

In the event that either party commits a breach or default in any of the terms or conditions of this Agreement and that party fails to remedy that default or breach within thirty (30) days after receipt of written notice of that breach from the other party, the party giving notice may, at its option and in addition to any other remedies it may have in law or in equity; terminate this Agreement by sending written notice of termination to stop the work as soon as it is practicable to do so. All costs to Duke associated with termination will be considered reimbursable costs, including costs incurred prior to the notice of termination but which have not yet been reimbursed, and commitments existing at the time the notice of termination is received which cannot be cancelled. This shall include all noncancellable contracts and fellowships or postdoctoral associate appointments incurred prior to the effective date of termination. After termination, any obligation of Sponsor for fellowships or postdoctoral associates shall end no later than the first to occur of (i) the end of Duke's academic year following termination. or (ii) the next anniversary date on which Sponsor could have terminated this Agreement pursuant to Article

5. In no case will reimbursement under this Agreement exceed the total estimated project costs specified in Exhibit B.

ARTICLE 8  
CONFIDENTIAL INFORMATION

"Confidential Information" ("Information") shall mean all information provided by one party to the other and clearly identified as confidential by the transmitting party at the time of disclosure. Specifically excepted from this definition is all information: (a) known by the receiving party at the time of disclosure; (b) publicly disclosed except by breach of this Agreement; (c) rightfully received by the receiving party from a third party without an express obligation of confidence; and (d) independently developed by the employees or agents of either party without any knowledge of the confidential information provided by the other party. The party receiving the Information agrees to hold that Information in trust and confidence for the transmitting party, using the same care and discretion that the receiving party uses with similar Information which it considers confidential. The receiving party will not use Information other than for the benefit of the two parties and relating to the Agreement and except as may be provided for in Article 9 regarding publication herein, neither party will disclose such information without authorization from the other party. This provision shall remain in effect during the term of this Agreement and for three (3) years thereafter.

ARTICLE 9  
PUBLICATION AND OTHER USE

Duke shall be free to use the results of the subject research for its own teaching, research, educational, clinical and publication purposes without the payment of royalties or other fees. Duke agrees to submit to Sponsor for its review, a copy of any proposed publication resulting from the subject research at least sixty (60) days prior to the estimated date of publication, and if no response is received within thirty (30) days of the date submitted to Sponsor, it will be conclusively presumed that the publication may proceed without delay. If Sponsor determines that the proposed publication contains patentable subject matters which require protection, Sponsor may require the delay of the publication for a period of time not to exceed sixty (60) days for the purpose of allowing the pursuit of such protection.

ARTICLE 10  
INVENTIONS

Any new invention, development, or discovery resulting from the subject research ("Invention") shall be promptly disclosed in writing to Sponsor. Sponsor is hereby granted, without option fee other than the consideration of the research sponsored herein and the reimbursement of Duke for all patent expenses incurred to the date of disclosure related to the Invention, an option

to acquire an exclusive, worldwide, royalty bearing license of Duke's rights to any Invention, which option shall extend for ninety (90) days after Sponsor's receipt of an Invention disclosure. If Sponsor notifies Duke in writing of its exercise of the option within the option period, then the parties will proceed in good faith to negotiate a license agreement on commercially reasonable terms within ninety (90) days after notification of exercise, and if Sponsor does not exercise this option, or notifies Duke that it will not exercise this option, or the parties fail to sign a license agreement within said ninety (90) day period, then Sponsor shall no longer own any rights in the subject Invention.

ARTICLE 11  
INDEMNITY AND INSURANCE

Sponsor agrees to indemnify, hold harmless and defend Duke, its officers, employees, and agents against any and all claims, suits, losses, damages, costs, fees, and expenses asserted by third parties, both government and non-government, resulting from or arising out of this agreement; provided, however, that Sponsor shall not be responsible for Duke's negligence or willful misconduct. Sponsor shall maintain in force at its sole cost and expense, with reputable insurance companies, insurance of a type and in an amount reasonably sufficient to protect against liability hereunder. Duke shall have the right to request the appropriate certificates of insurance from Sponsor for the purpose of ascertaining the sufficiency of such coverage.

ARTICLE 12  
USE OF A PARTY'S NAME

Neither party will, without the prior written consent of the other party: (a) use in advertising, publicity or otherwise, the name of any employee or agent, any trade-name, trademark, trade device, service mark, symbol, or any abbreviation, contraction or simulation thereof owned by the other party, or (b) represent, either directly or indirectly, that any product or service of the other party is a product or service of the representing party or that it is made in accordance with or utilizes the information or documents of the other party. Notwithstanding the above, Sponsor shall have the right to state that it has entered into this Agreement with Duke and to state or summarize the terms hereof in its filings with the Securities and Exchange Commission and related shareholder communications; provided that Sponsor shall submit the text of such statements to Duke at least 48 hours prior to publication.

ARTICLE 13  
NOTICE

Any notice or other communication required or permitted under this Agreement will be in writing and will be deemed given as of the date it is: (a) delivered by hand, or (b) mailed, postage prepaid, first class, certified mail, return receipt requested, to the party at the address listed below or

subsequently specified in writing, or (c) sent, shipping prepaid, return receipt requested, by national courier service, to the party at the address listed below or subsequently specified in writing:

As to Duke: Office of Grants and Contracts  
107 Seeley G. Mudd Building  
Duke University Medical Center - Box 3001  
Durham, North Carolina 27710

cc: University Counsel  
Duke University - 011 Allen Building  
Durham, North Carolina 27708

As to Sponsor: Cheung Laboratories, Inc.  
10220-I Old Columbia Road  
Columbia, Maryland 21046

Attn: Augustine Cheung

This Agreement is for professional research services. Neither party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the other party.

ARTICLE 14  
ENTIRE AGREEMENT

This Agreement and all attached Exhibits contain the entire agreement and understanding between the parties as to its subject matter. It merges all prior discussions between the parties and neither party will be bound by conditions, definitions, warranties, understandings, or representations concerning such subject matter except as provided in this Agreement or as specified on or subsequent to the effective date of this Agreement in a writing signed by properly authorized representatives of the parties. This Agreement can only be modified by written agreement duly signed by persons authorized to sign agreements on behalf of both Sponsor and Duke.

ARTICLE 15  
WAIVER

The failure of a party in any instance to insist upon the strict performance of the terms of this Agreement will not be construed to be a waiver or relinquishment of any of the terms of this Agreement, either at the time of the party's failure to insist upon strict performance or at any time in the future, and such terms will continue in full force and effect.



ARTICLE 16  
SEVERANCE

Each clause of this Agreement is a distinct and severable clause and if any clause is deemed illegal, void or unenforceable, the validity, legality or enforceability of any other clause or portion of this Agreement will not be affected thereby.

ARTICLE 17  
GOVERNING LAW

The construction and performance of this Agreement will be governed by the laws of the State of North Carolina.

ARTICLE 18  
TITLES

All titles and articles headings contained in this Agreement are inserted only as a matter of convenience and reference. They do not define, limit extend or describe the scope of this Agreement or the intent of any of its provisions.

IN WITNESS WHEREOF, the parties hereunto set their hands and seals.

DUKE UNIVERSITY

By: /s/Ralph Hyderman

-----

Name:  
Title:

Date Executed: \_\_\_\_\_

Principal Investigator:

SPONSOR:

CHEUNG LABORATORIES, INC.

By: /s/Augustine Y. Cheung

-----

Name:  
Title: Chairman

Date Executed: March 17, 1998

Exhibit "B"

Payment Schedule

Payment Due Date	Amount
February __, 1998	\$110,181
May __, 1998	\$110,181
August __, 1998	\$110,181
November __, 1998	\$110,183
Total	\$440,726

483203.001(B&F)

14

01/11/99

Josephberg Grosz & Co. Inc.  
Investment Bankers  
810 Seventh Avenue \* New York, NY 10019  
(212) 974-9926 Fax (212) 397-5832  
Dir: (212) 333-0825 e-mail: Gaelynberg@aol.com

July 31, 1998

Dr. Augustine Cheung, Chairman  
Mr. Spencer Volk President, CEO  
Celsion Corporation  
10220-1 Old Columbia Road  
Columbia MD 21046-1705

Gentleman:

I. The purpose of this letter is to set forth the terms of our agreement (the "Agreement") with respect to the compensation which Josephberg Grosz & Co., Inc. or their designees ("JGC") are to receive for assisting and advising Celsion Corporation or related entities, direct or indirect (the "Company"), in obtaining a capital infusion of equity, debt, bridge financing, merger and acquisitions, letter or line of credit, lease financing or other types of financing transactions. (the "Financing") Financing does not include business the Company is doing in the ordinary course of business such as but not limited to obtaining licenses from institutions and marketing arrangements with potential users of the Company's products or technology.

Financing does not include any transactions done with the following parties or their contacts with whom the Company is or has been dealing:

1. Ryan, Lee & Company or another retail lead syndicator
2. K. Greenberg
3. LBC Capital Corporation
4. Sucsy, Fischer and Company
5. Gilford Securities

Our focus will be on providing Financing to the Company as follows: \$1,000,000 in the months of August and September and \$8,000,000-\$10,000,000 over the next twelve months.

II. To assist the Company in obtaining Financing, the Company agrees to engage JGC as its nonexclusive agent with respect to all Financing sources, direct or indirect, (except as exempted from the definition) (the "Investor"). When such Financing from any Investor (other than a Financing in the nature of one described in paragraphs III & IV below) is provided, JGC will be compensated by the Company, in full, at the closing of the Financing, by receiving a total fee of 10% (8% cash; 2% stock).

Dr. Augustine Cheung  
July 31, 1999  
Page Two

The total gross dollar value received or to be received (including any form of equity, bridge, stock, convertible securities or subordinated debt Financing) by the Company pursuant to such financing up to \$5,000,000 (i.e. \$5,000,000 Financing provided; JG Capital, Inc. receives a cash fee of 8%, to be \$400,000 and a fee of 2% in the form of common stock of the Company to JG Partners, L.P. at the same valuation and price as the Investor). On any dollar amount in excess of the first \$5,000,000 provided, JGC will receive a total fee of 8% (6% cash, 2% stock). In addition, JGC will have the right to invest in the Company by receiving, at the closing of the Financing, a five year warrant. Such warrant shall give JGC or its designees the right, at anytime over a five year period, to purchase securities on a cashless basis in the Company equal to 10% of the total shares issued to the Investor at the same price, the same type securities and the same rights as the Investor (i.e. \$5,000,000 Financing provided, JGC's designees receive warrants to purchase shares of the same type securities and at the same price and valuation as the Investor at the time of Financing at anytime over a five year period). Any and all securities and/or warrants and securities underlying such warrants to be received by JGC and its designees shall have appropriate piggy-back and registration rights and in any case become free trading under rule 144 holding period. For any Financing (except as exempted from the definition) not introduced directly or indirectly by JGC to the Company, JGC will receive from the Company, a total fee of 3% (1-1/2% cash; 1-1/2% stock) at the closing of the Financing. Notwithstanding the previous sentence. JGC shall receive the 3% fee on any Investors that invest through LBC Capital Corporation with JGC Investor.

III. For senior debt, credit facilities, guarantees; lease financing and letter or line of credit Financing, JGC's cash fee, if such is provided by an Investor introduced by JGC, directly or indirectly, shall be 3.0% of the total dollar value received or made available to the Company.

IV. In the event the Company enters into a merger, acquisition or joint venture with an Investor or entity introduced by JGC or entities or Investors negotiated with on behalf of the Company by JGC, directly or indirectly, JGC will be compensated by the Company, in full, at the closing thereof in accordance with the 5/4/3 Formula, (i.e. by receiving a cash fee of 5% of the first \$1,000,000 of Value received by the Company or the Investor, whichever is

applicable, 4% of the second \$1,000,000, and 3% of all Value received in excess of \$3,000,000). While not all inclusive, Value shall include total cash, notes, debt, stock, consulting, non-compete, earn-out, sales and royalty agreements.

V. The fees in paragraphs II, III and IV above are totally independent of one another and are based upon the type or types of transactions JGC arranges.

VI. In addition, upon obtaining such Financing (i.e., the fees in paragraphs 11), JGC shall receive, at closing, a non-accountable 1% cash expense reimbursement, (i.e., \$5,000,000 total ]Financing provided or made available, JGC receives 1% to be \$50,000). In addition, JGC shall be reimbursed for all reasonable out-of-pocket travel expenses from the date of the execution of this Agreement until its termination which have been approved by the Company in advance.

Dr. Augustine Cheung  
July 31, 1998  
Page Three

VII. Upon the execution of this Agreement, the Company agrees to pay JG Capital, Inc. \$8,000 in cash and 57,000 shares of stock to JG Partners.. L.P. in the form of common stock of the Company.

VIII. This Agreement may be terminated or amended by the Company in its sole discretion on two days notice on September 21, 1998 or anytime thereafter with ten days prior written notice, Termination of this Agreement shall not release the Company of its obligation to compensate JGC or its designees for its services rendered if any Investor enters into a transaction with or provides Financing to the Company as long as the transaction (transactions) or Financing (Financings) was provided by such Investor within two years after termination of this Agreement.

IX. It is understood and agreed that you shall have the right to accept or reject in your judgement the terms of any Financing or transaction proposed by any Financing Sources, Investors, strategic partners and/or corporations presented to you. If such Financing is provided by the Investor to the Company and accepted, the Company agrees to represent to the Investor prior to the closing of the transaction or Financing that the fees due and payable to JGC as they apply to this Agreement will be paid to JGC at the closing of the transaction and/or Financing.

X. This Agreement shall be governed and construed in accordance with the laws of the State of New York. In the event of any dispute between us regarding the subject matter of this Agreement, such dispute shall be submitted to arbitration before a single arbitrator in New York City in accordance with the rules of the American Arbitration Association. Any decision or award shall be final and binding upon the parties hereto. All legal fees and expenses shall be paid to the prevailing party by the losing party.

XI. JGC represents that to its knowledge it is in full compliance with all regulatory laws that govern its business and agrees to indemnify the Company against any liabilities against the Company that arise out of a breach of this representation.

Sincerely,  
Josephberg Grosz & Co, Inc.

By: /s/ Richard A. Josephberg 8/5/98

-----  
Richard A. Josephberg                      Date  
Chairman

AGREED AND ACCEPTED:  
Celsion Corporation

By: /s/ Spencer J. Volk

8/6/98

-----  
Name: Spencer J. Volk  
Title: President & CEO

-----  
Date

Maryland

Columbia,

June 23, 1998

PROMISSORY NOTE

FOR VALUE RECEIVED, Celsion Corporation, a Maryland corporation. (the "Company") hereby promises to pay Spencer J. Volk, or registered assigns, (the "Holder") the principal amount of Fifty Thousand Dollars (\$50,000.00) (the Principal Amount) on or before September 30, 1998, with accrued interest. Interest (computed on the basis of a 360-day year of twelve 30-day months) on the unpaid Principal Amount shall accrue at the rate of 8% per annum from the date hereof.

Signed this 23rd day of June, 1998.

For the Company:

/s/John Mon

-----  
John Mon, General Manager

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED OR ANY STATE SECURITIES LAWS AND NEITHER THE SECURITIES NOR ANY INTEREST THEREIN MAY BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR SUCH LAWS OR AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT AND SUCH LAWS WHICH, IN THE OPINION OF COUNSEL FOR THE HOLDER, WHICH COUNSEL AND OPINION ARE REASONABLY SATISFACTORY TO COUNSEL FOR THIS CORPORATION, IS AVAILABLE.

Warrant Certificate No.: \_\_\_\_\_

Date of Issue:

Void after 5:00 p.m, Eastern Time on \_\_\_\_\_.

WARRANT TO PURCHASE

\_\_\_\_\_ SHARES OF COMMON STOCK

CELSION CORPORATION

This is to certify that, for value received,

\_\_\_\_\_ or registered assigns ("Holder"), is entitled to purchase, subject to the provisions of this Warrant, from Celsion Corporation, a Maryland corporation ("Company"), at any time after \_\_\_\_\_ and not later than 5:00 p.m., Eastern Time, on \_\_\_\_\_, \_\_\_\_\_ shares of common stock, \$0.01 par value, of the Company ("Common Stock"), at the purchase price per share of \$\_\_\_\_\_. The number of shares of Common Stock to be received upon the exercise of this Warrant and the price to be paid for a share of Common Stock may be adjusted from time to time as hereinafter set forth. The shares of Common Stock deliverable upon such exercise, and as adjusted from time to time, are hereinafter sometimes referred to as "Warrant Stock" and the exercise price of a share of Common Stock in effect at any time and as adjusted from time to time is hereinafter sometimes referred to as the "Exercise Price."

(a) Exercise of Warrant. This Warrant may be exercised in whole or in part at any time or from time to time on or after the date hereof, but not later than 5:00 p.m., Eastern Time, on the date set forth above. If such date is a day on which banking institutions are authorized by law to close, then the expiration date shall be on the next succeeding day which shall not be such a day. This Warrant may be exercised by presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, with written notice duly executed and accompanied by payment in cash or cash equivalent of the Exercise Price for the number of shares specified in such notice, together with all federal and state taxes applicable upon such exercise. If this Warrant should be exercised in part only, the Company shall, upon surrender of this Warrant for cancellation, execute and deliver a new Warrant evidencing the right of the holder to purchase the balance of the shares purchasable hereunder. Upon receipt by the Company of this Warrant at the office or agency of the Company, in proper form for exercise, the Holder shall be deemed to be the holder of record of the shares of Common Stock issuable upon such exercise, notwithstanding that the stock transfer books of the Company shall then be closed or that certificates representing such shares of Common Stock shall not then be actually delivered to the Holder. The Form of Subscription Agreement, attached hereto, has been executed by Holder and shall be confirmed as correct at the time of exercise, or amended to reflect changes, and all other documents reasonably requested.

(b) Reservation of Shares. The Company hereby agrees that at all times there shall be reserved for issuance and/or delivery upon exercise of this Warrant such number of shares of its Common Stock as shall be required for issuance or delivery upon exercise of this Warrant.

(c) Fractional Shares. No fractional shares or script representing fractional shares shall be issued upon the exercise of this Warrant. With respect to any fraction of a share called for upon any exercise hereof, the Company shall pay to the Holder an amount in cash equal to such fraction multiplied by the current market value of such fractional share, determined as follows:

(1) If the Common Stock is listed on a national securities exchange, admitted to unlisted trading privileges on such exchange or quoted on the Nasdaq National Market System or other interdealer trading systems providing last sale information, the current value shall be the last reported sale price of the Common Stock on such exchange, Nasdaq/NMS or trading system on the last business day prior to the date of exercise of this Warrant or if no such sale is made on such day, the average closing bid and asked prices for such day on such exchange, Nasdaq/NMS or trading system; or

(2) If the Common Stock is not so listed or admitted to unlisted trading privileges, the current value shall be the mean of the last reported bid and asked prices reported by an interdealer quotation system deemed reliable by the Company on the last business day prior to the date of the exercise of this Warrant; provided that if the Common Stock is quoted on more than one such system, the Company shall utilize, in order of priority, Nasdaq, the NASD OTC Bulletin

Board or the National Quotation Bureau, Inc.; or

(3) If the Common Stock is not so listed or admitted to unlisted trading privileges and bid and asked prices are not so reported, the current value shall be an amount, not less than book value, determined in such reasonable manner as may be prescribed by the Board of Directors of the Company, such determination to be final and binding on the Holder.

(d) Restrictions on Transfer. The securities represented hereby and the shares to be issued on exercise have not been registered under federal or state securities laws. They may not be sold or offered for sale in the absence of effective registration under such securities laws, or an opinion of counsel satisfactory to the Company that such registration is not required.

(e) Exchange, Assignment or Loss of Warrant. This Warrant is exchangeable, without expense, at the option of the Holder, upon presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, for other Warrants of different denominations entitling the holder thereof to purchase in the aggregate the same number of shares of Common Stock purchasable hereunder. Subject to compliance with paragraph (d), this Warrant is assignable. Any such assignment shall be made by surrender of this Warrant to the Company or at the office of its stock transfer agent, if any, with written notice of assignment duly executed and funds sufficient to pay any transfer tax; whereupon the Company shall, without charge, execute and deliver a new Warrant in the name of the assignee named in such instrument of assignment and this Warrant shall promptly be cancelled. This Warrant may be divided or combined with other Warrants which carry the same rights upon presentation hereof at the office of the Company or at the office of its stock transfer agent, if any, together with a written notice specifying the names and denominations in which new Warrants are to be issued and signed by the Holder hereof. The term "Warrant" as used herein includes any Warrant issued in substitution for or replacement of this Warrant, or into which this Warrant may be divided or exchanged and the term "original issue date hereof" shall refer to the date that the Company first issued a Warrant which was subsequently transferred or exchanged for another. Upon receipt by the Company of evidence satisfactory to it of the loss, theft, destruction or mutilation of this Warrant, and (in the case of loss, theft or destruction) of reasonably satisfactory indemnification, and upon surrender and cancellation of this Warrant, if mutilated, the Company will execute and deliver a new Warrant of like tenor and date. Any such new Warrant executed and delivered shall constitute an additional contractual obligation on the part of the Company whether or not this Warrant so lost, stolen, destroyed, or mutilated shall be at any time enforceable by anyone.

(f) Rights of the Holder. The Holder shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company either at law or equity, and the rights of the Holder are limited to those expressed in the Warrant and are not enforceable against the Company except to the extent set forth herein.



(g) Anti-Dilution Provisions.

(1) Adjustment of Number of Shares. Anything in this Section (g) to the contrary notwithstanding, in case the Company shall at any time issue Common Stock or convertible securities by way of dividend or other distribution on any stock of the Company or subdivide or combine the outstanding shares of Common Stock, the Exercise Price shall be proportionately decreased in the case of such issuance (on the day following the date fixed for determining shareholders entitled to receive such dividend or other distribution) or decreased in the case of such subdivision or increased in the case of such combination (on the date that such subdivision or combination shall become effective).

(2) No Adjustment for Small Amounts. Anything in this Section (g) to the contrary notwithstanding, the Company shall not be required to give effect to any adjustment in the Exercise Price unless and until the net effect of one or more adjustments, determined as above provided, shall have required a change of the Exercise Price by at least one cent, but when the cumulative net effect of more than one adjustment so determined shall be to change the actual Exercise Price by at least one cent, such change in the Exercise Price shall thereupon be given effect.

(3) Number of Shares Adjusted. Upon any adjustment of the Exercise Price other than pursuant to Section (g)(1), the holder of this Warrant shall thereafter (until another such adjustment) be entitled to purchase, at the new Exercise Price, the number of shares, calculated to the nearest full share, obtained by multiplying the number of shares of Common Stock initially issuable upon exercise of this Warrant by the Exercise Price in effect on the date hereof and dividing the product so obtained by the new Exercise Price.

(4) Common Stock Defined. Whenever reference is made in this Section (g) to the issue or sale of shares of Common Stock, the term "Common Stock" shall mean the common shares of the Company of the class authorized as of the date hereof and any other class of stock ranking on a parity with such Common Stock. However, subject to the provisions of Section (j) hereof, shares issuable upon exercise hereof shall include only shares of the class designated as Common Stock of the Company as of the date hereof.

(h) Officer's Certificate. Whenever the Exercise Price shall be adjusted as required by the provisions of Section (g) hereof, the Company shall forthwith file in the custody of its Secretary or an Assistant Secretary at its principal office, and with its stock transfer agent, if any, an officer's certificate showing the adjusted Exercise Price determined as herein provided and setting forth in reasonable detail the facts requiring such adjustment. Each such officer's certificate shall be made available at all reasonable times for inspection by the Holder and the Company shall, forthwith after each such adjustment, deliver a copy of such certificate to the Holder. Such certificate shall be conclusive as to the correctness of such adjustment.

(I) Notice to Warrant Holders. So long as this Warrant shall be outstanding and unexercised (I) if the Company shall pay any dividend or make

any distribution upon the Common Stock or (ii) if the Company shall offer to the holders of Common Stock for subscription or purchase by them any shares of stock of any class or any other rights or (iii) if any capital reorganization of the Company, reclassification of the capital stock of the Company, consolidation or merger of the Company with or into another corporation, sale, lease or transfer of all or substantially all of the property and assets of the Company to another corporation, or voluntary or involuntary dissolution, liquidation or winding up of the Company shall be effected, then, in any such case, the Company shall cause to be delivered to the Holder, at least ten (10) days prior to the date specified in (x) or (y) below, as the case may be, a notice containing a brief description of the proposed action and stating the date on which (x) a record is to be taken for the purpose of such dividend, distribution or rights, or (y) such reclassification, reorganization, consolidation, merger, conveyance, lease, dissolution, liquidation or winding up is to take place and the date, if any, is to be fixed, as of which the holders of Common Stock of record shall be entitled to exchange their shares of Common Stock for securities or other property deliverable upon such reclassification, reorganization, consolidation, merger, conveyance, dissolution, liquidation or winding up.

(j) Reclassification, Reorganization or Merger. In case of any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the Company (other than a change in par value, or from par value to no par value or from no par value to par value, or as a result of an issuance of Common Stock by way of dividend or other distribution or of a subdivision or combination), or in case of any consolidation or merger of the Company with or into another corporation (other than a merger in which the Company is the continuing corporation and which does not result in any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the class issuable upon exercise of this Warrant) or in case of any sale or conveyance to another corporation of the property of the Company as an entirety or substantially as an entirety, the Company shall cause effective provision to be made so that the holder shall have the right thereafter, by exercising this Warrant, to purchase the kind and amount of shares of stock and other securities and property receivable upon such reclassification, capital reorganization or other change, consolidation, merger, sale or conveyance. Any such provision shall include provisions for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Warrant. The foregoing provisions of this Section (j) shall similarly apply to successive reclassifications, capital reorganizations and changes of shares of Common Stock and to successive consolidations, mergers, sale or conveyances. In the event that in any such capital reorganization or reclassification, consolidation, merger, sale or conveyance, additional shares of Common Stock shall be issued in exchange, conversion, substitution or payment, in whole or in part, for or of a security of the Company other than Common Stock, any such issue shall be treated as an issue of common stock covered by the provisions of subsection (g)(1) hereof with the amount of the consideration received upon the issue thereof being determined by the Board of Directors of the Company, such determination to be final and binding on the holder.

(k) Applicable Law. This Warrant shall be governed by, and construed in accordance with, the laws of the State of Maryland.

(l) Optional Waiver. Holder may waive by signed writing any rights of Holder contained herein.

(m) IN ADDITION TO THE RESTRICTIONS ON TRANSFERABILITY DESCRIBED HEREIN, THE SECURITIES ISSUABLE ON EXERCISE OF THIS WARRANT SHALL NOT BE SOLD, PLEDGED, TRANSFERRED, HYPOTHECATED OR ASSIGNED WITHIN 7 DAYS BEFORE OR 180 DAYS AFTER THE DATE OF EFFECTIVENESS OF A REGISTRATION STATEMENT FILED BY THE COMPANY WITH THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH A PUBLIC OFFERING OF THE COMPANY'S SECURITIES. THIS RESTRICTION IS IN ADDITION TO AND NOT IN LIEU OF THE RESTRICTIONS CONTAINED HEREIN AND AS SUCH, THIS 180 DAY PERIOD MAY EXPIRE PRIOR TO OR BEYOND THE RESTRICTIONS IMPOSED HEREIN. THIS RESTRICTION SHALL OBLIGATE ALL SUCCESSORS IN INTEREST TO THE SHARES ISSUED ON EXERCISE. CERTIFICATES REPRESENTING THE WARRANT STOCK SHALL BEAR A LEGEND EVIDENCING THIS RESTRICTION.

THIS WARRANT CERTIFICATE, NUMBER \_\_\_\_\_, is granted and sold as of the date first above written.

CELSION CORPORATION

By: \_\_\_\_\_

Attest:

- - - - -  
Secretary

PURCHASE FORM

Dated: \_\_\_\_\_

Celsion Corporation  
10220-I Old Columbia Road  
Columbia, MD 21046-1705

Attention: Mr. John Mon, General Manager

Attached herewith is Celsion Corporation's Common Stock Purchase Warrant, Serial Number: \_\_\_\_\_, giving the Holder the right to purchase \_\_\_\_\_ shares.

I/We hereby notify you that I/we are exercising my/our right to purchase \_\_\_\_\_ shares and have enclosed herewith my/our check in the amount of \$\_\_\_\_\_, representing the aggregate exercise price of said shares. If transfer taxes (federal or state) are applicable to this transaction, I/we understand that you will be billing me/us for said taxes, which I/we agree will be promptly remitted to you within ten (10) days of my/our receipt of notification.

I/We hereby state that the shares being purchased are to be held by me/us for investment purposes and not with a view to sale, except pursuant to an effective registration statement or an exemption therefrom.

Please cancel the enclosed warrant and, if applicable, send me/us a Warrant, in partial substitution on identical terms, for the remaining shares not being purchased pursuant to this notification.

Yours very truly,

Holder of Warrant, Serial Number \_\_\_\_\_

- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_

THE SECURITIES REPRESENTED BY THIS CERTIFICATE MAY NOT BE OFFERED FOR SALE, SOLD OR OTHERWISE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT MADE UNDER THE SECURITIES ACT OF 1933 (THE "ACT"), OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE ACT.

Warrant Certificate No.: \_\_\_\_\_  
Date of Issue: \_\_\_\_\_

Void after 5:00 p.m, Columbia, Maryland Time on \_\_\_\_\_

Warrant to Purchase  
\_\_\_\_\_ Common Shares

WARRANT TO PURCHASE COMMON SHARES

CHEUNG LABORATORIES, INC.

This is to certify that, for value received,

DunnHughes Holdings, Inc.  
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or registered assigns ("Holder"), is entitled to purchase subject to the provisions of this Warrant, from Cheung Laboratories, Inc., a Maryland corporation ("Company"), at any time after \_\_\_\_\_ and not later than 5:00 p.m., Columbia, Maryland Time, on \_\_\_\_\_, shares, \$0.01 par value, of the Company Common Stock ("Common Stock"), at the purchase price per share of \$\_\_\_\_. The number of shares of Common Stock to be received upon the exercise of this Warrant and the price to be paid for a share of Common Stock may be adjusted from time to time as hereinafter set forth. The shares of Common Stock deliverable upon such exercise, and as adjusted from time to time, are hereinafter sometimes referred to as "Warrant Stock" and the exercise price of a share of Common Stock in effect at any time and as adjusted from time to time is hereinafter sometimes referred to as the "Exercise Price."

(a) Exercise of Warrant. This Warrant may be exercised in whole or in part at any time or from time to time on or after the date hereof, but not later than 5:00 p.m., Columbia, Maryland Time, on the date set forth above. If such date is a day on which banking institutions are authorized by law to close, then the expiration date shall be on the next succeeding day which shall not be such a day. This Warrant may be exercised by presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, with written notice duly executed and accompanied by payment in cash or cash equivalent of the Exercise Price for the number of shares specified in such notice, together with all federal and state taxes applicable upon such exercise. If this Warrant should be exercised in part only, the Company shall, upon surrender of this Warrant for cancellation, execute and deliver a new Warrant evidencing the right of the holder to purchase the balance of the shares purchasable hereunder. Upon receipt by the Company of this Warrant at the office or agency of the Company, in proper form for exercise, the Holder shall be deemed to be the holder of record of the shares of Common Stock issuable upon such exercise, notwithstanding that the stock transfer books of the Company shall then be closed or that certificates representing such shares of Common Stock shall not then be actually delivered to the Holder. The Form of Subscription Agreement, attached hereto, shall be submitted at the time of exercise and all other documents reasonably requested.

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(b) Reservation of Shares. The Company hereby agrees that at all times there shall be reserved for issuance and/or delivery upon exercise of this Warrant such number of shares of its Common Stock as shall be required for issuance or delivery upon exercise of this Warrant.

(c) Restrictions on Transfer. The securities represented hereby and the shares to be issued on exercise have not been registered under federal or state securities laws. They may not be sold or offered for sale in the absence of effective registration under such securities laws, or an opinion of counsel satisfactory to the Company that such registration is not required.

(d) Exchange, Assignment or Loss of Warrant. This Warrant is exchangeable, without expense, at the option of the Holder, upon presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, for other Warrants of different denominations entitling the holder thereof to purchase in the aggregate the same number of shares of Common Stock purchasable hereunder. Subject to compliance with paragraph (d), this Warrant is assignable. Any such assignment shall be made by surrender of this Warrant to the Company or at the office of its stock transfer agent, if any, with written notice of assignment duly executed and funds sufficient to pay any transfer tax; whereupon the Company shall, without charge, execute and deliver a new Warrant in the name of the assignee named in such instrument of assignment and this Warrant shall promptly be canceled. This Warrant may be divided or combined with other Warrants which carry the same rights upon presentation hereof at the office of the Company or at the office of its stock transfer agent, if any, together with a written notice specifying the names and denominations in which new Warrants are to be issued and signed by the Holder hereof. The term "Warrant" as used herein includes any Warrant issued in substitution for or replacement of this Warrant, or into which this Warrant may be divided or exchanged and the term "original issue date hereof" shall refer to the date that the Company first issued a Warrant which was subsequently transferred or exchanged for another. Upon receipt by the Company of evidence satisfactory to it of the loss, theft, destruction or mutilation of this

Warrant, and (in the case of loss, theft or destruction) of reasonably satisfactory indemnification, and upon surrender and cancellation of this Warrant, if mutilated, the Company will execute and deliver a new Warrant of like tenor and date. Any such new Warrant executed and delivered shall constitute an additional contractual obligation on the part of the Company whether or not this Warrant so lost, stolen, destroyed, or mutilated shall be at any time enforceable by anyone.

(e) Rights of the Holder. The Holder shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company either at law or equity, and the rights of the Holder are limited to those expressed in the Warrant and are not enforceable against the Company except to the extent set forth herein.

(f) Split or Combination of Stock and Stock Dividend: In case the Company shall at any time subdivide its outstanding shares of Stock into a greater number of shares or declare a dividend upon its Stock payable solely in shares of Stock, the Stock Purchase Price in effect immediately prior to such subdivision or declaration shall be proportionally reduced, and the number of shares issuable upon exercise of the Option shall be proportionately increased. Conversely, in case the outstanding shares of Stock of the Company shall be combined into a smaller number of shares, the Stock Purchase Price in effect immediately prior to such combination shall be proportionately increased, and the number of shares issuable upon exercise of the Option shall be proportionately reduced.

(g) Officer's Certificate. Whenever the Exercise Price shall be adjusted as required by the provisions of Section (f) hereof, the Company shall forthwith file in the custody of its Secretary or an Assistant Secretary at its principal office, and with its stock transfer agent, if any, an officer's

certificate showing the adjusted Exercise Price determined as herein provided and setting forth in reasonable detail the facts requiring such adjustment. Each such officer's certificate shall be made available at all reasonable times for inspection by the Holder and the Company shall, forthwith after each such adjustment, deliver a copy of such certificate to the Holder. Such certificate shall be conclusive as to the correctness of such adjustment.

(h) Notice to Warrant Holders. So long as this Warrant shall be outstanding and unexercised (i) if the Company shall pay any dividend or make any distribution upon the Common Stock or (ii) if the Company shall offer to the holders of Common Stock for subscription or purchase by them any shares of stock of any class or any other rights or (iii) if any capital reorganization of the Company, reclassification of the capital stock of the Company, consolidation or merger of the Company with or into another corporation, sale, lease or transfer of all or substantially all of the property and assets of the Company to another corporation, or voluntary or involuntary dissolution, liquidation or winding up of the Company shall be effected, then, in any such case, the Company shall cause to be delivered to the Holder, at least ten (10) days prior to the date specified in (x) or (y) below, as the case may be, a notice containing a brief description of the proposed action and stating the date on which (x) a record is to be taken for the purpose of such dividend, distribution or rights, or (y) such reclassification, reorganization, consolidation, merger, conveyance, lease, dissolution, liquidation or winding up is to take place and the date, if any, is to be fixed, as of which the holders of Common Stock of record shall be entitled to exchange their shares of Common Stock for securities or other property deliverable upon such reclassification, reorganization, consolidation, merger, conveyance, dissolution, liquidation or winding up.

(i) Reclassification, Reorganization or Merger. In case of any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the Company (other than a change in par value, or from par value to no par value or from no par value to par value, or as a result of an issuance of Common Stock by way of dividend or other distribution or of a subdivision or combination), or in case of any consolidation or merger of the Company with or into another corporation (other than a merger in which the Company is the continuing corporation and which does not result in any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the class issuable upon exercise of this Warrant) or in case of any sale or conveyance to another corporation of the property of the Company as an entirety or substantially as an entirety, the Company shall cause effective provision to be made so that the holder shall have the right thereafter, by exercising this Warrant, to purchase the kind and amount of shares of stock and other securities and property receivable upon such reclassification, capital reorganization or other change, consolidation, merger, sale or conveyance. Any such provision shall include provisions for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Warrant.

(j) Piggy-back/Incidental Registration If at any time the Company subsequent to the next public offering of registered Common Shares of the Company, shall propose the filing of a Registration Statement on an appropriate form under the Securities Act for the registration of any securities of the Company, other than a registration statement on Form S-4 or S-8 or any equivalent form of registration statement then in effect, then the Company shall give the Holder(s) notice of such proposed registration and shall include in any Registration Statement relating to such securities all or a portion of the Warrant Stock then owned or to be owned by such Holder(s), which such Holder(s) shall request (such Holder(s) to be considered "Selling Shareholder(s)"), by notice given by such Selling Shareholder(s) to the Company within 15 business days after the giving of such notice by the Company, within 15 business days after the giving of such notice by the Company, to be so included. In the event

of the inclusion of Warrant Stock pursuant to this paragraph k, the Company shall bear the Costs and Expenses of such registration; provided, however that the Selling Shareholder(s) shall pay the fees and disbursements of their own counsel and, pro-rata based upon the number of shares of Warrant Stock included therein as these relate to the total number of Common Shares to be offered or sold, the Securities Act registration fees and underwriters discounts and compensation attributable to the inclusion of such Warrant Stock. Nothing in this paragraph k shall require the registration of Warrant Stock in a Registration Statement relating solely to (a) securities to be issued by the Company in connection with the acquisition of the stock or the assets of another corporation, or the merger or consolidation of any other corporation by or with the Company or any of its subsidiaries, or an exchange offer with any corporation, (b) securities to be offered to the then existing security holders of the Company, or (c) securities to be offered to employees of the Company. In the event the distribution of securities of the Company covered by a Registration Statement referred to in this paragraph k is to be underwritten, then the Company's obligation to include Warrant Stock in such a Registration Statement shall be subject, at the option of the Company, to the following further conditions:

(1) The distribution for the account of the Selling Shareholders shall be underwritten by the same underwriters who are underwriting the distribution of the securities for the account of the Company and/or any other persons whose securities are covered by such Registration Statement and the Selling Shareholder(s) shall enter into an agreement with such underwriters containing customary provisions.

(2) If the Selling Shareholders are included in the Registration Statement and if the underwriting agreement entered into with the aforesaid underwriters contains restrictions upon the sale of securities of the Company, other than the securities which are to be included in the proposed distribution, for a period not exceeding 90 days from the effective date of the Registration Statement, then such restrictions shall be binding upon the Selling Shareholder(s) with respect to any Warrant Stock not covered by the Registration Statement and, if requested by the underwriter, the Selling Shareholder(s) shall enter into a written agreement to that effect.

(3) If the underwriters shall state in writing that they are unwilling to include any or all of the Selling Shareholder(s) Warrant Stock in the proposed underwriting because such inclusion would materially interfere with the orderly sale and distribution of the securities being offered by the Company, then the number of the Selling Shareholder(s)' shares of Warrant Stock to be included shall be reduced pro rata on the basis of the number of shares of Warrant Stock originally requested to be included by such Selling Shareholder(s), or there shall be no inclusion of the shares of the Selling Shareholder(s) in the Registration Statement not proposed distribution, in accordance with such statement by the underwriters.

(k) Applicable Law. This Warrant shall be governed by, and construed in accordance with, the laws of the State of Maryland.



(l) Optional Waiver. Holder may waive by signed writing any rights of Holder contained herein.

(m) IN ADDITION TO THE RESTRICTIONS ON TRANSFERABILITY DESCRIBED HEREIN, THE SECURITIES ISSUABLE ON EXERCISE OF THIS WARRANT SHALL NOT BE SOLD, PLEDGED, TRANSFERRED, HYPOTHECATED OR ASSIGNED WITHIN 7 DAYS BEFORE OR 180 DAYS AFTER THE DATE OF EFFECTIVENESS OF A REGISTRATION STATEMENT FILED BY THE COMPANY WITH THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH A PUBLIC OFFERING OF THE COMPANY'S SECURITIES. THIS RESTRICTION IS IN ADDITION TO AND NOT IN LIEU OF THE RESTRICTIONS CONTAINED HEREIN AND AS SUCH, THIS 180 DAY PERIOD MAY EXPIRE PRIOR TO OR BEYOND THE RESTRICTIONS IMPOSED HEREIN. THIS RESTRICTION SHALL OBLIGATE ALL SUCCESSORS IN INTEREST TO THE SHARES ISSUED ON EXERCISE. CERTIFICATES REPRESENTING THE WARRANT STOCK SHALL BEAR A LEGEND EVIDENCING THIS RESTRICTION.

Executed as of the date first above written.

CHEUNG LABORATORIES, INC.

By: \_\_\_\_\_  
Augustine Cheung, Chairman

Attest:

- \_\_\_\_\_  
Secretary

EXERCISE FORM

To be executed by the Holder  
in Order to Exercise Warrants

The undersigned Holder hereby irrevocably elects to exercise \_\_\_\_\_ Warrants represented by this Warrant Agreement, and to purchase the securities issuable upon the exercise of such Warrants, and requests that certificates for such securities shall be issued in the Holder's name and be delivered to

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[please print or type address]

and if such number of Warrants shall not be all the Warrants evidenced by this Warrant Agreement, that a new Warrant Agreement for the balance of such Warrants be registered in the name of, and delivered to, the Holder at the address stated above.

The undersigned acknowledges that the Warrant Shares issued on exercise will be "restricted securities" and will bear appropriate restrictive legends.

Dated: \_\_\_\_\_  
Signature of Holder

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-----  
Taxpayer ID Number

-----  
Signature Guaranteed  
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Serial Number \_\_\_\_\_

Void after 5:00 p.m., Chicago Time, on \_\_\_\_\_ (unless extended as provided below)

Warrant to Purchase certain  
Shares of Common Stock,  
dated \_\_\_\_\_

CERTIFICATE OF  
WARRANT TO PURCHASE COMMON STOCK  
OF  
CHEUNG LABORATORIES, INC.

This Is To Certify That, FOR CASH AND OTHER VALUE RECEIVED,

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its nominees, or assigns (hereinafter, the "Holder(s)") are entitled to purchase, subject to the provisions of this Warrant (its successors, divisions or additions), from Cheung Laboratories, Inc., a corporation duly organized, in good standing within its domicile, and whose offices as of the date hereof are at 10220-1 Old Columbia Road, Columbia, MD 21046 (hereinafter, the "Company"), restricted and legended shares of common stock of the Company ("Common Stock") at a purchase price equal to Forty One Cents (\$00.41 U.S.) per share in such amounts and at such times as are provided herein.

The number of shares of Common Stock to be received upon the exercise of this Warrant and the price to be paid for a share of Common Stock may be adjusted from time to time as hereinafter set forth.

Supplementing, notwithstanding, and in support of the foregoing, the Company and the original Holder hereof ("\_\_\_\_\_"), intend that the number of shares issuable hereunder shall be \_\_\_\_\_, which represents \_\_\_\_\_% of the issued and outstanding Common Stock.

The shares of Common Stock deliverable upon such exercise, and as adjusted from time to time, are hereinafter referred to as "Warrant Stock" and the exercise price for a share of Common Stock in effect at any time and as adjusted from time to time is hereinafter sometimes referred to as the "Exercise Price".

The term "Warrant" used above and throughout this Certificate shall mean this Warrant or successor Warrants issued in exchange for it for any reason pursuant to the terms and condition contained herein.

(1) Exercise of Warrant. Subject to the provisions of paragraphs 6 and 7 hereof, this Warrant may be exercised in whole or in part at any time or from time to time on or after \_\_\_\_\_, but not later than 5:00 p.m., Chicago Time, on \_\_\_\_\_, or if \_\_\_\_\_, is a day on which U.S. banking institutions are authorized by law to close, then on the next succeeding day which shall not be such a day, by presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, with a copy of the Purchase Form attached hereto duly executed and accompanied by payment of the Exercise Price for the number of shares specified in such form, together with all federal and state taxes applicable upon such exercise, if any, and the Company shall promptly issue and deliver stock certificates for the number of shares purchased to the Holder hereof within two (2) business days in conformity with industry practice. The Company may unilaterally extend the time within which this Warrant may be exercised but is not obligated to do so.

If this Warrant should be exercised in part only or all or a portion of it renewed as provided for in paragraph 7 hereof or otherwise, the Company shall, upon surrender of this Warrant for cancellation, execute and deliver a new Warrant, containing terms and conditions identical to this Warrant except as provided for herein, evidencing the right of the Holder(s) to purchase the balance of the shares purchasable hereunder.

Upon receipt of this Warrant, the executed Purchase Form and the Exercise Price by the Company or, if then applicable, by its stock transfer agent, the Holder(s) shall be deemed to be the holder(s) of record of the shares of Common Stock issuable upon such exercise, notwithstanding that the stock transfer books of the Company shall then be closed or that certificates representing such shares of Common Stock shall not then be actually delivered to the Holder(s), their agents or designees. The Company shall keep detailed records of the disposition of this, successor Warrants, and any Warrant issuable hereunder, each bearing a serial number, and shall make such records available to Holder(s) or their agents upon request.

(2) Reservation of Shares. The Company hereby represents and warrants that at all times subsequent hereto there shall be reserved for issuance and/or delivery upon exercise of this Warrant such number of shares of its Common Stock as shall be required for issuance or delivery upon exercise of this Warrant or any Warrant issuable hereunder.

(3) Fractional Shares. No fractional shares or scrip representing fractional shares shall be issued upon exercise of this Warrant. With respect to any fraction of a share called for upon any exercises hereof, the Company shall pay to the Holder(s) an amount in cash equal to such fraction multiplied by the

current market value of such fractional share, determined as follows:

(a) If the Common Stock is listed on a national securities exchange or admitted to unlisted trading privileges on such exchange, the current value shall be the last reported sale price of the Common Stock on such exchange on the last business day prior to the date of exercise of this Warrant

or if no such sale is made on such day on such exchange; or

(b) If the Common Stock is not so listed or admitted to unlisted trading privileges, the current value shall be the mean of the last reported bid and asked prices reported by the National Association of Securities Dealers Automated Quotation System (or, if not so quoted on NASDQ), by the National Quotation Bureau, Inc.) on the last business day prior to the day of the exercise of this Warrant; or

(c) If the Common Stock is not so listed or admitted to unlisted trading privileges and bid and asked prices are not so reported, the current fair market value shall be an amount, not less than book value or the last known price paid by a purchaser for said Common Stock, determined in a reasonable manner as may be prescribed by the Board of Directors of the Company.

(4) Exchange, Assignment or Loss of Warrant. Subject to applicable securities laws and the terms of the legend set forth in paragraph 11(b) hereof, this Warrant certificate is fully exchangeable and (by definition) assignable, without expense, at the option of the Holder(s), upon presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, for other Warrant certificates of different denominations entitling the Holder(s) hereof to purchase in the aggregate the same number of shares of Common Stock purchasable hereunder.

Any assignment hereof shall be made by surrender of this Warrant to the Company or at the office of its stock transfer agent, if any, with a written, executed assignment, instructions and funds sufficient to pay transfer tax (if any); whereupon the Company shall, without charge, execute and deliver a new Warrant certificate in the name of the assignee(s) named in such instrument of assignment and this Warrant certificate shall promptly be cancelled. This Warrant may be divided upon presentation hereof at the office of the Company or at the office of its stock transfer agent, if any, together with a written notice, specifying the names and denominations in which new Warrants are to be issued, and signed by the Holder hereof. The terms "Warrant" and "Warrants" as used herein include any Warrants issued in substitution for or replacement of this Warrant, or into which this Warrant may be divided or exchanged.

Upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of this Warrant, and, in the case of loss, theft or destruction, of reasonably satisfactory indemnification, and upon surrender and cancellation of this Warrant, if mutilated, the Company will execute and deliver a new Warrant of like tenure and date. Any such new Warrant executed and delivered shall constitute an additional contractual obligation on the part of the Company, whether or not this Warrant so lost, stolen, destroyed or mutilated shall be at any time enforceable by anyone. Nevertheless, neither the Company or the Holder(s) anticipate that this Warrant or any successor Warrant shall itself be registered (rather than the underlying shares shall be registered), the Company shall not impose unreasonable burdens on the Holder(s) with respect to indemnification if same becomes necessary.

(5) Rights of the Holders. The Holder(s) shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company, either at law or equity, and the rights of the Holder(s) are limited to those expressed in the Warrant and are not enforceable against the Company except to the extent set

forth herein, PROVIDED HOWEVER, that the Company shall, in a timely manner, provide Holder(s) with a copy of each and every press release, mailing to shareholders and periodic filing with the U.S. Securities and Exchange Commission made by the Company, and provided that the Company shall be, at all times during the tenure of this Warrant or its successors, in compliance with all of its contractual obligations to Riker and its affiliates.

(6) Adjustments to Exercise Price and Number of Shares.

(a) The Company shall not be required to give effect to any adjustment in the Exercise Price unless and until the net effect of one or more adjustments, determined as above provided, shall have required a change of the Exercise Price by at least one cent, (\$00.01 U.S.) but when the cumulative net effect of more than one adjustment so determined shall be to change the actual Exercise Price by at least one cent, such change in the Exercise Price shall thereupon be given effect.

Notwithstanding anything else in this paragraph which might be interpreted to the contrary, should at any time subsequent to the issuance of this Warrant but during the tenure of this Warrant and any renewals or extensions as are provided for herein, any person or entity shall be issued an option or warrant exercisable to purchase stock of the Company or stock of the Company is sold to such person or entity at a price per share less than the then relevant Exercise Price as determined as provided herein, an immediate adjustment in the Exercise Price for this Warrant (and successor Warrants to this Warrant) shall be made. The effect of this adjustment shall be to make the Exercise Price under this Warrant equal to the lesser exercise, option or sale price referenced above. However, this adjustment shall not have the effect of increasing the number of shares purchasable hereunder. Rather it shall reduce the aggregate amount paid, assuming full exercise of this Warrant, to an amount equal to the number of shares otherwise then purchasable hereunder multiplied by the newly adjusted Exercise Price pursuant to this adjustment.

(b) The \_\_\_\_\_ shares issuable hereunder shall be adjusted so that number of shares issuable hereunder shall be equal, at all times after issuance of this Warrant, to \_\_\_\_\_% of the total issued and outstanding Common Stock of the Company until the Company completes its next public offering of securities.

(c) Whenever reference is made in this paragraph 6 to the issue or sale of shares of Common Stock, the term "Common Stock" shall mean the Common Stock of the Company of the class authorized as of the date hereof and any other classes of stock ranking on a parity with or convertible into such Common Stock providing, as is contemplated, it is the Common Stock of the Company which is to be offered and sold at the next public offering of registered Common Shares of the Company. However, as of the date of grant and sale of this Warrant and subject to the provisions of paragraph 10 hereof, shares issuable upon exercise hereof shall include only shares of the class designated as Common Stock of the Company as of the date hereof.

(7) Renewal of Exercise Rights. If, while this Warrant or any portion of it remains in effect, Holder(s) wish to extend their rights to exercise all or a portion of this Warrant which would otherwise expire and be lost to them, they may do so by paying to the Company, a sum equal to five percent (5%) of the

then relevant Exercise Price pertaining to that portion of the Warrant which would otherwise expire (the "Renewal Fee") and the Company shall extend that portion of the Warrant for a further period of five (5) years from the date of receipt of the Renewal Fee but, in no case, beyond 5:00 p.m., Chicago Time, on \_\_\_\_\_, and shall issue a new Warrant, identical in every respect to this Warrant, except that such new Warrant shall reflect the fact that Holder(s) shall have an additional five (5) years to exercise their rights to purchase that portion of the Warrant Stock for which they have paid a Renewal Fee. This provision extends to this Warrant and all successor Warrants issuable hereunder.

This provision is included partially to permit Holder(s) to coordinate their exercise of this Warrant and sale of Warrant Stock so as to minimize the Costs and Expenses and time of the Company's management in complying with the provisions of this Warrant. Payment of the Renewal Fee will confirm no new rights upon the Holder(s) except to extend and renew the time period during which Holder(s) may exercise existing rights under this Warrant.

(8) Officer's Certificate. Whenever the Exercise Price shall be adjusted as required by the provisions of paragraph 6 hereof, the Company shall forthwith file in the custody of its Secretary or an Assistant Secretary at its principal office, and with its stock transfer agent, if any, an officer's certificate showing the adjusted Exercise Price determined as herein provided and setting forth in reasonable detail the facts requiring such adjustment. Each such officer's certificate shall be made available at all reasonable times for inspection by the Holder(s) and the Company shall, forthwith after each such adjustment, deliver a copy of such certificate to the Holder(s) and each of them. Unless disputed in writing by the Holder hereof within thirty (30) days, such certificate shall be conclusive as to the correctness of such adjustment.

(9) General Notices to Warrant Holders. So long as any portion of this Warrant (or any successor Warrant) shall be outstanding and unexercised (a) if the Company shall pay any dividend or make any distribution upon the Common Stock or (b) if the Company shall offer to the holders of Common Stock for subscription or purchase by them any shares of stock of any class or any other rights or (c) if any capital reorganization of the Company, reclassification of the capital stock of the Company, consolidation or merger of the Company with or into another corporation, sale, lease or transfer of all or substantially all of the property and assets of the Company to another corporation or engage in voluntary or involuntary dissolution, liquidation or winding up of the company, then the Company shall cause to be delivered to the Holder(s), at least thirty (30) days prior to the relevant date, a notice containing a brief description of the proposed action and stating the date of which a record is to be taken for the purpose of such dividend, distribution of rights, or such reclassification, reorganization, consolidation, merger, conveyance, lease, dissolution, liquidation or winding up is to take place and the date, if any, is to be fixed as of which the holders of Common Stock of record shall be entitled to exchange their shares of Common Stock of record for securities or other property deliverable upon such reclassification, reorganization, consolidation, merger, conveyance, dissolution, liquidation or winding up.

(10) Reclassification, Reorganization or Merger. In case of any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the Company (other than a change in par value, or from par value to no par value, or from no par value to par value) or as a result of an

issuance of Common Stock by way of dividend or other distribution or of a subdivision or combination, or in case of any consolidation or merger of the Company with or into another corporation (other than a merger with a subsidiary in which merger the Company is the continuing corporation and which does not result in any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the class issuable upon exercise of this Warrant) or in case of any sale or conveyance to another corporation of the property of the Company as an entirety or substantially as an entirety (collectively, a "Triggering Event"), the Company shall use good faith efforts to cause effective provision to be made so that the Holder(s) shall have the right thereafter (and shall have said right for the same period of time remaining on any unexercised portion of this Warrant), without immediately exercising this Warrant, to purchase the kind and amount of shares of stock and other securities and property receivable upon such reclassification, capital reorganization or other change, consolidation, merger, sale or conveyance.

Any such provision shall include provision for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Warrant. However, in the event that the Company, using its good faith efforts, is unable to negotiate with the acquiring entity the assumption of the Warrants as provided in the preceding portion of this paragraph, then and in such event this Warrant shall terminate, to the extent not previously exercised, as of the record date for such transaction upon and only upon payment of a "Retirement Fee" to the Holder(s) hereof.

This Retirement Fee shall consist of the same kind of property (including cash, if any) to be received by the Company's stockholders pursuant to the Triggering Event (and, at parity with holders of Common Stock, treated in accordance with all the other terms and conditions, including timing and manner of payment for the purchase) and the Company herein agrees that said Retirement Fee may be arrived at by private negotiation between the Company and the Holder(s) or may be arbitrated in accordance with the provisions herein provided.

However, the Company now and specifically agrees that, in the event of such private negotiation, it shall accept an amount to be paid to the Holder(s) (as a senior obligation of the company in any such transaction) in arbitration or negotiation which is not less than the lowest sum per Warrant which shall result from application of any then applicable Warrant Valuation Techniques (such as the Black-Scholes Model) which may be applied to publicly traded warrants covering publicly traded common stock, it being intended by the Company and the Holder(s) that the Retirement Fee should reflect: (a) the difference between the purchase and exercise price per share plus (b) a warrant premium factor commonly determinable by the aforementioned models. Said Retirement Fee shall be a senior obligation of the Company and shall be paid to Holder(s) from first proceeds of any sale or merger in cash unless otherwise negotiated between the Company and \_\_\_\_\_ (the original Holder).

All subsequent Holders shall agree, by acceptance of assignment of any portion of the Warrant covered by this certificate, to be bound by this provision. All costs and expenses directly attributable to the determination of the Retirement Fee (including but not limited to the costs of outside appraisal(s)) shall be at the expense of the Company.



The foregoing provisions of this section 10 shall similarly apply to successive reclassification, consolidations, mergers, sales, or conveyances. In the event that in any such capital reorganization or reclassification, consolidation, merger, sale or conveyance, additional shares of Common Stock shall be issued in exchange, conversion, substitution or payment, in whole or in part, for or of a security of the Company other than Common Stock, any such issue shall be treated as an issue of Common Stock covered by the provisions of paragraphs 3, 6, and 9 hereof, with the amount of the consideration received upon the issue thereof being determined by the Board of Directors of the Company in consultation with the Company's auditors, such determination to be final and binding on the Holder(s).

(11) Transfer to Comply with the Securities Act of 1933.  
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(a) This Warrant or the Warrant Stock or any other security issued or issuable upon exercise of this Warrant may not be sold, transferred or otherwise disposed of except to a person who, in the opinion of counsel reasonably satisfactory to the Company, is a person to whom this Warrant or such Warrant Stock may legally be transferred pursuant to paragraph 4 hereof without registration and without the delivery of a current prospectus under the Securities Act with respect thereto; and then only against receipt by the Company of an agreement from such person to comply with the provisions of this paragraph 11 with respect to any resale or other disposition of such securities.

(b) The Company may cause the following legend to be set forth on each certificate representing Warrant Stock or any other security issued or issuable upon exercise of this Warrant not theretofore distributed to the public pursuant to paragraphs 12, 13, or 14 hereof, unless counsel for the Company is of the opinion as to any such certificate that such legend is unnecessary.

"The securities represented by this certificate may not be offered for sale, sold or otherwise transferred except pursuant to an effective registration statement under the Securities Act of 1933 (the "Act"), or pursuant to an exemption from registration under the Act."

(12) Demand Registration. If at any time, after the next public offering of registered Common Shares of the Company (as previously covered and defined herein) \_\_\_\_\_ shall decide to sell or otherwise dispose of Warrant Stock then owned or to be owned upon intended exercise of this Warrant by \_\_\_\_\_, then \_\_\_\_\_ and only \_\_\_\_\_ may give written notice to the Company of the proposed disposition, specifying the number of shares of Warrant Stock to be sold or disposed of and requesting that the Company prepare and file a registration statement under the Securities Act of 1933, as amended (the "Securities Act"), covering such Warrant Stock.

The Company shall within 10 days thereafter give written notice to the other Holders of Warrants or Warrant Stock of such request and each of the other Holders shall have the option for a period of 30 days after receipt by it (them)

of notice from the Company to include its (their) Warrant Stock in such registration statement. The Company shall use its best efforts to cause an appropriate registration statement (the "Registration Statement") covering such Warrant Stock to be filed with the Securities and Exchange Commission (the "Commission") and to become effective as soon as reasonably practicable and to remain effective until the completion of the distribution of the Warrant Stock to be offered or sold; provided, however, that not more than once in any twelve month period the Company shall have the right to postpone for a period of up to 60 days any demand made pursuant to this Warrant if the underwriters for such offering advise the Company in writing that market conditions make such a postponement advisable to the Company.

The Holder(s) whose Warrant Stock is (are) included in a Registration Statement is (are) hereinafter referred to as the "Selling Shareholder(s)".

Each notice delivered by a Selling Shareholder(s) to the Company pursuant to this paragraph 12 shall specify the Warrant Stock intended to be offered and sold by such Selling Shareholder(s), express such Selling Shareholder(s) present intent to offer such Common Shares for distribution, and contain the undertaking of such Selling Shareholder(s) to provide all information and materials and to take all action as may be required in order to permit the Company to comply with all applicable requirements of the Securities Act, and any rules and regulations promulgated thereunder, and to obtain acceleration of the effective date of such Registration Statement.

The Company shall not be obligated to file more than three Registration Statements pursuant to the foregoing provisions of this paragraph 12. The Company shall bear all of the Costs and Expenses (as hereinafter defined in paragraph 20 hereof) of the first such registration. The Selling Shareholder(s) shall bear the costs and expenses of all further registrations pursuant to this paragraph 12. A demand for registration under this paragraph 12 will not count as such until the Registration Statement has become effective.

(13) Shelf Registration By Original Holder. At any time and from time to time during the term of this Warrant or its successors (including renewals and extensions as provided for herein) \_\_\_\_\_, and only \_\_\_\_\_ (as the original Holder hereof), may demand (and actually expects) that the Company will file a Registration Statement with the Commission for the registration of underlying shares issuable upon exercise of this Warrant or any part thereof, whether or not said Warrant has, in the interim been assigned or re-assigned to other parties.

In this event, the Company shall pay all of the Costs and Expenses of said Registration for each such demand except that the Holder shall be responsible, if such demand is made by the Holder during a period in which the Company is unable or unqualified to file a "short form" S-3 Statement (or its then relevant equivalent) for paying all of the Costs and Expenses of said Registration which are estimated to exceed costs for a similar Registration assuming the Company had been, as of the date of the demand, a reporting Company for three (3) years and could file a "short form" statement. In this case, the costs payable by the Holder shall be determinable by securities counsel to the Company and both the Company and the Holder are entitled to rely on such an estimate.

Once filed, the Company shall be obligated to continue this "shelf registration" for the maximum time allowable under the then relevant regulations, at its sole expense.

(14) Procedure for Demand Registration. In connection with the filing of a Registration Statement pursuant to paragraph 12 hereof, and in supplementation and not in limitation of the provisions thereof, the Company shall:

(a) Notify the Selling Shareholder(s) as to the filing of the Registration Statement and of all amendments or supplements thereto filed thirty (30) days prior to the effective date of said Registration Statement;

(b) Notify the Selling Shareholder(s), promptly after the Company shall receive notice thereof, of the time when said Registration Statement became effective or when any amendment or supplement to any prospectus forming a part of said Registration Statement has been filed;

(c) Notify the Selling Shareholder(s) promptly of any request by the Commission for the amending or supplementing of such Registration Statement or prospectus or for additional information;

(d) Prepare and promptly file with the Commission, and promptly notify the Selling Shareholder(s) of the filing of, and amendments or supplements to such Registration Statement or prospectus as may be necessary to correct any statements or omissions if, at any time when a prospectus relating to the Warrant Stock is required to be delivered under the Securities Act, any event with respect to the Company shall have occurred as a result of which any such prospectus or any other prospectus as then in effect would include an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein not misleading; and, in prepare and file with the Commission, promptly upon the Selling Shareholder(s)' written request, any amendments or supplements to such Registration Statement or prospectus which may be reasonably necessary or advisable in connection with the distribution of the Warrant Stock;

(e) Prepare promptly upon request of the Selling Shareholder(s) or any underwriters for the Selling Shareholder(s) such amendment or amendments to such Registration Statement and such prospectus or prospectuses as may be reasonably necessary to permit compliance with the requirements of Section 10 (a) (3) of the Securities Act;

(f) Advise the Selling Shareholders promptly after the Company shall receive notice or obtain knowledge of the issuance of any stop order by the Commission suspending the effectiveness of any such Registration Statement or amendment thereto or of the initiation or threatening of any proceeding for that purpose, and promptly use its best efforts to prevent the issuance of any stop order or obtain its withdrawal promptly if such stop order would be issued;

(g) Use its best efforts to qualify as soon as reasonably practicable the Warrant Stock for sale under the securities or blue-sky laws of

such states and jurisdictions within the United States as shall be reasonably requested by the Selling Shareholder(s); provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business, to become subject to taxation or to file a consent to service of process generally in any of the aforesaid states or jurisdiction;

(h) Furnish the Selling Shareholder(s), as soon as available, copies of any Registration Statement and each preliminary or final prospectus, or supplement or amendment required to be prepared pursuant thereto, all in such quantities as the Selling Shareholder(s) may from time to time reasonably request, and;

(i) If requested by the Selling Shareholder(s), enter into an agreement with the underwriters of the Warrant Stock being registered containing customary provisions and reflecting the foregoing.

(15) Incidental Registration. Other than as covering in paragraph 13 hereof, if at any time the Company subsequent to the next public offering of registered Common Shares of the Company, shall propose the filing of a Registration Statement on an appropriate form under the Securities Act for the registration of any securities of the Company, other than a registration statement on Form S-4 or S-8 or any equivalent form of registration statement then in effect, then the Company shall give the Holder(s) notice of such proposed registration and shall include in any Registration Statement relating to such securities all or a portion of the Warrant Stock then owned or to be owned by such Holder(s), which such Holder(s) shall request (such Holder(s) to be considered "Selling Shareholder(s)"), by notice given by such Selling Shareholder(s) to the Company within 15 business days after the giving of such notice by the Company, within 15 business days after the giving of such notice by the Company, to be so included. In the event of the inclusion of Warrant Stock pursuant to this paragraph 15, the Company shall bear the Costs and Expenses of such registration; provided, however that the Selling Shareholder(s) shall pay the fees and disbursements of their own counsel and, pro-rata based upon the number of shares of Warrant Stock included therein as these relate to the total number of Common Shares to be offered or sold, the Securities Act registration fees and underwriters discounts and compensation attributable to the inclusion of such Warrant Stock; and, provided further, however, that amounts to which any person or entity shall become entitled pursuant to this sentence shall not include amounts which may become payable pursuant to paragraphs 16 or 17 hereof. Nothing in this paragraph 15 shall require the registration of Warrant Stock in a Registration Statement relating solely to (a) securities to be issued by the Company in connection with the acquisition of the stock or the assets of another corporation, or the merger or consolidation of any other corporation by or with the Company or any of its subsidiaries, or an exchange offer with any corporation, (b) securities to be offered to the then existing security holders of the Company, or (c) securities to be offered to employees of the Company. In the event the distribution of securities of the Company covered by a Registration Statement referred to in this paragraph 15 is to be underwritten, then the Company's obligation to include Warrant Stock in such a Registration Statement shall be subject, at the option of the Company, to the following further conditions:

(a) The distribution for the account of the Selling Shareholders shall be underwritten by the same underwriters who are underwriting

the distribution of the securities for the account of the Company and/or any other persons whose securities are covered by such Registration Statement and the Selling Shareholder(s) shall enter into an agreement with such underwriters containing customary provisions.

(b) If the Selling Shareholders are included in the Registration Statement and if the underwriting agreement entered into with the aforesaid underwriters contains restrictions upon the sale of securities of the Company, other than the securities which are to be included in the proposed distribution, for a period not exceeding 90 days from the effective date of the Registration Statement, then such restrictions shall be binding upon the Selling Shareholder(s) with respect to any Warrant Stock not covered by the Registration Statement and, if requested by the underwriter, the Selling Shareholder(s) shall enter into a written agreement to that effect.

(c) If the underwriters shall state in writing that they are unwilling to include any or all of the Selling Shareholder(s) Warrant Stock in the proposed underwriting because such inclusion would materially interfere with the orderly sale and distribution of the securities being offered by the Company, then the number of the Selling Shareholder(s)' shares of Warrant Stock to be included shall be reduced pro rata on the basis of the number of shares of Warrant Stock originally requested to be included by such Selling Shareholder(s), or there shall be no inclusion of the shares of the Selling Shareholder(s) in the Registration Statement not proposed distribution, in accordance with such statement by the underwriters.

However, if in such an event, the Holder(s) hereof shall not be able to include at least fifty percent (50%) of the Warrant Stock originally requested to be included, then the Company shall agree to pay all of the Costs and Expenses of a Shelf Registration to be filed at a later date.

(16) Indemnification by the Company. The Company shall indemnify and hold harmless each Selling Shareholder, any underwriter (as defined in the Securities Act) for the Selling Shareholder, and each person, if any, who controls the Selling Shareholder or such underwriter within the meaning of the Securities Act (but, in the case of an underwriter or a controlling person, only if such underwriter or controlling person indemnifies the persons mentioned in paragraph 17(b) hereof in the manner set forth therein) against any losses, claims, damages or liabilities, joint or several, to which the Selling Shareholder or any such underwriter or controlling person becomes subject, under the Securities Act or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) are caused by any untrue statement or alleged untrue statement of any material fact contained in any preliminary prospectus (if used prior to the effective date of the Registration Statement), or contained, on the effective date thereof, in any Registration Statement under which the Selling Shareholder(s)' shares of Warrant Stock were registered under the Securities Act, the prospectus contained therein, or any amendment or supplement thereto, arising out of or based upon the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading; the Company shall reimburse the Selling Shareholder, or any such underwriter or controlling person, in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the Company shall not be liable to any such person in any such case to the extent that any such loss,

claim, damage, liability or action arises out of or is based upon any untrue statement or alleged untrue statement or omission or alleged omission made in reliance upon and in conformity with information furnished in writing to the Company by such person expressly for inclusion in any of the foregoing documents.

(17) Indemnification by Selling Shareholders. Each individual Selling Shareholder shall:

(a) Furnish to the Company in writing all information concerning it and its holdings of securities of the Company as shall be required in connection with the preparation and filing of any Registration Statement covering any Shares of Warrant Stock.

(b) Indemnify and hold harmless the Company, each of its directors, each of its officers who has signed a Registration Statement, each person, if any, who controls the Company within the meaning of the Securities Act and any underwriter (as defined in the Securities Act) for the Company, against any losses, claims, damages or liabilities to which any such director, officer, controlling person or underwriter may become subject under the Securities Act or otherwise, insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) are caused by any untrue statement of any material fact contained in any preliminary prospectus (if used prior to the effective date of the Registration Statement) or contained, on the effective date thereof, in any Registration Statement under which the Selling Shareholder's securities were registered under the Securities Act, the prospectus contained therein, or any amendment or supplement thereto, or arising out of or based upon the omission to state therein a material fact required to be stated therein or necessary to make the statement therein not misleading; in each case to the extent, but only to the extent, that such untrue statement or omission was made in reliance upon and in conformity with information furnished to the Company in writing by the Selling Shareholder expressly for inclusion in any of the foregoing documents, and the Selling Shareholder shall reimburse the Company and any such director, officer, controlling person or underwriter for any legal or other expenses reasonably incurred by the Company or any such director, officer, controlling person or underwriter in connection with investigating or defending any such loss, claim, damage, liability or action.

(18) Notification by Selling Shareholders. The Selling Shareholder(s) and each other person indemnified pursuant to paragraph 16 hereof shall, in the event it receives notice of the commencement of any action against it which is based upon an alleged act or omission which, if proven, would result in the Company having to indemnify it pursuant to paragraph 16 hereof, promptly notify the Company, in writing, of the commencement of such action and permit the Company, if the Company so notifies the Selling Shareholder(s) within 10 days after receipt by the Company of notice of the commencement of the action, to participate in and to assume the defense of such action with counsel reasonably satisfactory to the Selling Shareholder(s) or such other indemnified person, as the case may be. The omission to notify the Company promptly of the commencement of any such action shall not relieve the Company of any liability to indemnify the Selling Shareholder(s) or such other indemnified person, as the case may be, under paragraph 16 hereof, except to the extent that the Company shall suffer any loss by reason of such failure to give notice which it may have pursuant to the rights conveyed to the Holders) in this Warrant.

(19) Notification by the Company to Selling Shareholders. The Company agrees that, in the event it receives notice of the commencement of any action against it which is based upon an alleged act or omission which, if proven, would result in a Selling Shareholder having to indemnify the Company pursuant to paragraph 17(b) hereof, the Company will promptly notify the Selling Shareholder in writing of the commencement of such action and permit the Selling Shareholder, if the Selling Shareholder so notifies the Company within 10 days after receipt by the Selling Shareholder of notice of the commencement of the action, to participate in and assume the defense of such action with counsel reasonably satisfactory to the Company. The omission to notify the Selling Shareholder promptly of the commencement of any such action shall not relieve the Selling Shareholder of liability to indemnify the Company under paragraph 17(b) hereof, except to the extent that the Selling Shareholder shall suffer any loss by reason of such failure to give notice, and shall not relieve the Selling Shareholder of any other liabilities which it may have under this or any other agreement then in effect between the Company and the Selling Shareholder.

(20) Costs and Expenses. As used in this Warrant, "Costs and Expenses" shall include all of the costs and expenses relating to the respective Registration Statement(s) involved, including but not limited to, registration fees, filing and qualification fees, blue-sky expenses, printing and mailing expenses, fees and expenses of Company's counsel and, if/when appropriate, fees and expenses of counsel designated by the Selling Shareholder(s) (provided, however, that no more than one such counsel for the Selling Shareholder(s) shall be designated on any occasion).

(21) Addresses. All notices, certificates, waiver and other communications required or permitted to be given hereunder to any of the parties by any other party shall be in writing and shall be delivered personally or sent by next day delivery service or registered or certified mail, postage prepaid, as follows:

(a) If to the Company, addressed to:

Cheung Laboratories, Inc.  
10220-I Old Columbia Road  
Columbia, MD 21046-1705  
Attention: Mr. John Mon, General Manager

(b) If to a Holder, addressed to the address of each such Holder as shall, from time to time, appear on the records of the Company or those of the Company's transfer agent as may be the case.

Any notice delivered personally or sent by next day delivery service shall be deemed to have been given on the date so delivered, and any notice delivered by registered or certified mail shall be deemed to have been given on the date it is received. Any party may change the address to which notices hereunder are to be sent by giving written notice of such change of address in the manner provided for giving notice.

(22) Waiver. No waiver by a Holder of any right hereunder shall be effective unless it is in writing which specifically refers to the provision hereof under which such right arises, and no such waiver shall operate or be construed as a waiver of any subsequent breach, whether of a similar or dissimilar nature.

(23) Entire Warrant. This Warrant may be amended, supplemented or modified only by a written instrument executed by the Company and the Holder(s). While separate executed letters proposing and/or accepting amendment(s) sent to the Company by the Holder(s) or to the Holder(s) by the Company shall, for the purposes of this paragraph 23, constitute a valid agreement as to the relationship then created by and between the Company and the individual Holder in question, only \_\_\_\_\_(as the original Holder) may, by agreement with the Company, bind all subsequent Holders to one single written instrument which shall serve to amend the terms and conditions hereof, and to which by their acceptance of an assignment of any portion of this Warrant, they implicitly agree to be bound by.

(24) Applicable Law. This Warrant and the legal relations among the parties hereto shall be governed by and construed in accordance with the substantive laws of the State of Illinois applicable to contracts made and to be performed therein without giving effect to the principles of conflict of laws thereof.

(25) Appraisal Rights. In the event that the Company's board of directors has not approved and the Company has not executed the next public offering of the Company's Common Stock prior to the second anniversary of the issuance of this Warrant, a majority in interest of the Holder(s) may, in their sole discretion and at any time thereafter, give notice to the Company that they wish to avail themselves of Appraisal Rights rather than force the Company into filing a Registration Statement against its will by demanding registration hereunder.

Should this event occur, the Company and the Holder(s) shall meet together to appraise the value of the Warrant(s) and shall proceed to do so in the same fashion and spirit as is provided for in the first paragraph of section 10 hereof in determining a Retirement Fee to be paid the Holders upon termination of the Warrant(s).

(26) Binding Effect. The provisions contained in this Warrant shall be binding upon and inure to the benefit of the Company and the Holders and their respective successors, permitted assigns, heirs and legal representatives. Any person to whom all or a part of a Holder's rights and obligations hereunder are assigned shall fulfill such of the assigning Holder's obligations hereunder as have been assigned, and shall be entitled to all of the rights and benefits hereunder to the extent that such person has assumed such Holder's obligations. The rights and powers of each successive Holder hereunder are granted to such Holder as an owner of Warrants or Warrant Stock as the case may be. Any subsequent Holder whether becoming such by transfer, assignment, operation of law or otherwise, shall have the same rights and powers which a Holder owning the same number of Warrants and/or Warrant Stock has hereunder, and shall be entitled to exercise such rights and powers until such Holder or subsequent Holder no longer owns any Warrants or Warrant Stock. Except as provided in this paragraph 26, this Warrant does not create, and shall not be construed as creating, any rights enforceable by any person not a Holder.



(27) Validity. If any term, provision, covenant or restriction of this Warrant is held by a court of competent jurisdiction to be invalid, void or unenforceable, the Company agrees that such term, provision, covenant or restriction shall be reformed to the extent possible consistent with such judicial holding to reflect the intent of the Company and the original Holder as stated herein and the remainder of the terms, provisions, covenants and restrictions of this Warrant shall remain in full force and effect and shall in no way be affected, impaired or invalidated. It is hereby stipulated and declared to be the intention of the Company that it would have executed this Warrant including the remaining terms, provisions, covenants and restrictions without including any of such provision of term which may be hereafter declared invalid, void or unenforceable.

This Warrant (Serial Number: \_\_\_\_\_) is granted and sold as of the date first written above.

Cheung Laboratories, Inc.

By: \_\_\_\_\_  
Augustine Cheung, Chairman

PURCHASE FORM

Dated: \_\_\_\_\_

Cheung Laboratories, Inc.  
10220-1 Old Columbia Road  
Columbia, MD 21046-1705

Attention: Mr. John Mon, General Manager

Attached herewith is Cheung Laboratories, Inc.'s Common Stock Purchase Warrant, Serial Number: \_\_\_\_\_, giving the Holder the right to purchase \_\_\_\_\_ shares.

I/We hereby notify you that I/we are exercising my/our right to purchase \_\_\_\_\_ shares and have enclosed herewith my/our check in the amount of \$\_\_\_\_\_, representing the aggregate exercise price of said shares. If transfer taxes (federal or state) are applicable to this transaction, I/we understand that you will be billing me/us for said taxes, which I/we agree will be promptly remitted to you within ten (10) days of my/our receipt of notification.

I/We hereby state that the shares being purchased are to be held by me/us for investment purposes and not with a view to sale, except pursuant to an effective registration statement or an exemption therefrom.

Please cancel the enclosed warrant and, if applicable, send me/us a Warrant, in partial substitution on identical terms, for the remaining shares not being purchased pursuant to this notification.

Yours very truly,

Holder of Warrant, Serial Number \_\_\_\_\_

- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_

Void after 5:00 p.m., Chicago Time, on June 1, 2001 (unless extended as provided below).

Warrant to Purchase  
 \_\_\_\_\_ Shares of  
 Common Stock as  
 adjusted herein, dated  
 May 28, 1996

CERTIFICATE OF  
 WARRANT TO PURCHASE COMMON STOCK  
 OF  
 CHEUNG LABORATORIES, INC.

This Is To Certify That, FOR CASH AND OTHER VALUE RECEIVED,

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its nominees, or assigns (hereinafter, the "Holder(s)") are entitled to purchase, subject to the provisions of this Warrant (its successors, divisions or additions), from Cheung Laboratories, Inc., a corporation duly organized, in good standing within its domicile, and whose offices as of the date hereof are at 10220-I Old Columbia Road, Columbia, MD 21046 (hereinafter, the "Company"), at any time on or after October 1, 1996, and not later than 5:00 p.m., Chicago Time, on June 1, 2001, unless extended or renewed as provided in paragraphs 1 and 7 below, restricted and legended shares of common stock of the Company ("Common Stock") at a purchase price equal to Forty One Cents (\$0.41 U.S.) per share as adjusted herein. Total investment shall be defined as \$\_\_\_\_\_.

The number of shares of Common Stock to be received upon the exercise of this Warrant and the price to be paid for a share of Common Stock may be adjusted from time to time as hereinafter set forth. Supplementing, and in support of the foregoing, the Company, as of the date of this Warrant, the number of shares issuable hereunder shall be \_\_\_\_\_, which represents \_\_\_\_\_% ("Percentage Interest") of the issued and outstanding Common Stock on a fully diluted basis.

The shares of Common Stock deliverable upon such exercise, and as adjusted from time to time, are hereinafter referred to as "Warrant Stock" and the exercise price for a share of Common Stock in effect at any time and as adjusted from time to time is hereinafter sometimes referred to as the "Exercise Price".

The term "Warrant" used above and throughout this Certificate shall mean this Warrant or successor Warrants issued in exchange for it for any reason pursuant to the terms and conditions contained herein.

1. Exercise of Warrant. Subject to the provisions of paragraphs 6 and 7 hereof, this Warrant may be exercised in whole or in part at any time or from time to time on or after the date first written above but not later than 5:00 p.m., Chicago Time, on June 1, 2001 or if June 1, 2001 is a day on which U.S. banking institutions are authorized by law to close, then on the next succeeding day which shall not be such a day, by presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, with a copy of the Purchase Form attached hereto duly executed and accompanied by payment of the Exercise Price for the number of shares specified in such form, together with all federal and state taxes applicable upon such exercise, if any, and the Company shall promptly issue and deliver stock certificates for the number of shares purchased to the Holder hereof within two (2) business days in conformity with industry practice. The Company may unilaterally extend the time within which this Warrant may be exercised but is not obligated to do so.

If this Warrant should be exercised in part only or all or a portion of it renewed as provided for in paragraph 7 hereof or otherwise, the Company shall, upon surrender of this Warrant for cancellation, execute and deliver a new Warrant, containing terms and conditions identical to this Warrant except as provided for herein, evidencing the right of the Holder(s) to purchase the balance of the shares purchasable hereunder.

Upon receipt of this Warrant, the executed Purchase Form and the Exercise Price by the Company or, if then applicable, by its stock transfer agent, the Holder(s) shall be deemed to be the holder(s) of record of the shares of Common Stock issuable upon such exercise, notwithstanding that the stock transfer books of the Company shall then be closed or that certificates representing such shares of Common Stock shall not then be actually delivered to the Holder(s), their agents or designees. The Company shall keep detailed records of the disposition of this, successor Warrants, and any Warrant issuable hereunder, each bearing a serial number, and shall make such records available to Holder(s) or their agents upon request.

2. Reservation of Shares. The Company hereby represents and warrants that at all times subsequent hereto there shall be reserved for issuance and/or delivery upon exercise of this Warrant such number of shares of its Common Stock as shall be required for issuance or delivery upon exercise of this Warrant or any Warrant issuable hereunder.

3. Fractional Shares. No fractional shares or scrip representing fractional share shall be issued upon exercise of this Warrant. With respect to any fraction of a share called for upon any exercises hereof, the Company shall pay to the Holder(s) an amount in cash equal to such fraction multiplied by the current market value of such fractional share, determined as follows:

(a) If the Common Stock is listed on a national securities exchange or admitted to unlisted trading privileges on such exchange, the

current value shall be the last reported sale price of the Common Stock on such exchange on the last business day prior to the date of exercise of this Warrant or if no such sale is made on such day on such exchange; or

(b) If the Common Stock is not so listed or admitted to unlisted trading privileges, the current value shall be the mean of the last reported bid and asked prices reported by the National Association of Securities Dealers Automated Quotation System (or, if not so quoted on NASDAQ, by the National Quotation Bureau, Inc.) on the last business day prior to the day of the exercise of this Warrant; or

(c) If the Common Stock is not so listed or admitted to unlisted trading privileges and bid and asked prices are not so reported, the current fair market value shall be an amount, not less than book value or the last known price paid by a purchaser for said Common Stock, determined in a reasonable manner as may be prescribed by the Board of Directors of the Company.

4. Exchange, Assignment of Loss of Warrant. Subject to applicable securities laws and the terms of the legend set forth in paragraph 11(b) hereof, this Warrant certificate is fully exchangeable and (by definition) assignable, without expense, at the option of the Holder(s), upon presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, for other Warrant certificates of different denominations entitling the Holder(s) thereof to purchase in the aggregate the same number of shares of Common Stock purchasable hereunder.

Any assignment hereof shall be made by surrender of this Warrant to the Company or at the office of its stock transfer agent, if any, with a written, executed assignment, instructions and funds sufficient to pay transfer tax (if any); whereupon the Company shall, without charge, execute and deliver a new Warrant certificate in the name of the assignee(s) named in such instrument of assignment and this Warrant certificate shall promptly be canceled. This Warrant may be divided upon presentation hereof at the office of the Company or at the office of its stock transfer agent, if any, together with a written notice, specifying the names and denominations in which new Warrants are to be issued, and signed by the Holder thereof. The terms "Warrant" and "Warrants" as used herein include any Warrants issued in substitution for or replacement of this Warrant, or into which this Warrant may be divided or exchanged.

Upon receipt of the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of this Warrant, and, in the case of loss, theft or destruction, of reasonably satisfactory indemnification, and upon surrender and cancellation of this Warrant, if mutilated, the Company will execute and deliver a new Warrant of like tenure and date. Any such new Warrant executed and delivered shall constitute an additional contractual obligation on the part of the Company, whether or not this Warrant so lost, stolen, destroyed or mutilated shall be at any time enforceable by anyone. Nevertheless, neither the Company or the Holder(s) anticipate that this Warrant or any successor Warrant shall itself be registered (rather than the underlying shares shall be registered), the Company shall not impose unreasonable burdens on the Holder(s) with respect to indemnification if same becomes necessary.

5. Rights of the Holders. The Holder(s) shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company, either at law or equity, and the rights of the Holder(s) are limited to those expressed in the Warrant and are not enforceable against the Company except to the extent set forth herein, PROVIDED HOWEVER, that the Company shall, in a timely manner, provide Holder(s) with a copy of each and every press release, mailing to shareholders and periodic filing with the U.S. Securities and Exchange Commission made by the Company, and provided that the Company shall be, at all times during the tenure of this Warrant or its successors, in compliance with all its contractual obligations to \_\_\_\_\_ and its affiliates.

6. Adjustments to Exercise Price and Number of Shares.  
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(a) In the case of a dividend or other distribution on any stock of the Company or subdivision or combination of the outstanding shares of Common Stock, the exercise price and the number of shares issuable hereunder shall be adjusted as follows: the Exercise Price shall be proportionately decreased in the case of each such issuance (on the day following the date fixed for determining shareholders entitled to receive such dividend or distribution) or proportionately decreased in the case of each such subdivision or proportionally increased in the case of each such combination (on the date that such subdivision or combination shall become effective).

Upon any adjustment of the Exercise Price, the Holder(s) of this Warrant shall thereafter (until another such adjustment) be entitled to purchase, at the new Exercise Price, the number of shares, calculated to the nearest full share, obtained by multiplying the number of shares of Common Stock initially issuable upon exercise of this Warrant by the Exercise Price in effect on the date hereof and dividing the product so obtained by the new Exercise Price.

(b) Anything in this paragraph 6 to the contrary notwithstanding, the Company shall not be required to give effect to any adjustment in the Exercise Price unless and until the net effect of one or more adjustments, determined as above provided, shall have required a change of the Exercise Price by at least one cent, (\$0.01 U.S.) but when the cumulative net effect of more than one adjustment so determined shall be to change the actual Exercise Price by at least one cent, such change in the Exercise Price shall thereupon be given effect.

(c) Anything in this paragraph 6 to the contrary notwithstanding, if, subsequent to the grant and sale of this Warrant and for a period ending the day after the date that the Company's next public offering is completed [a public offering being defined as one in which the Company is in receipt of funds of not less than Five Million Dollars (\$5,000,000.00 U.S.) raised by an underwriter pursuant to a Registration Statement (the Form of which shall then be applicable) declared effective by the Securities and Exchange Commission (the "SEC"), and funds received in full by the Company], covering the issuance and sale of said shares to the public, the Company shall issue Common Stock or securities convertible or exercisable into Common Stock by way of sale for cash or cash equivalent proceeds or by grant of options to retain management, consultants, employees, or for services or value of any kind, then; immediately upon consummation of such sale, issuance, or grant, an adjustment shall be made in the Exercise Price and the number of shares issuable under this Warrant such that the Holder(s) hereof, after such sale, issuance, or grant,

shall be entitled to purchase shares sufficient so that Holder(s) shall maintain the right to acquire the Percentage Interest of the Company's outstanding shares (on a fully diluted basis), for the Total Investment (the "Anti-Dilution Feature").

Further, such adjustment to the Exercise Price and number of shares of Common Stock issuable hereunder shall be determined by assuming that all convertible or exercisable securities issued during the period in which this Anti-Dilution Feature is operative (defined above) have been converted or exercised upon issuance whether or not such securities shall actually have been converted or exercised as of the date at which the adjustment is made.

Notwithstanding anything else in this paragraph which might be interpreted to the contrary, should at any time subsequent to the issuance of this Warrant but during the tenure of this Warrant and any renewals or extensions as are provided for herein, any person or entity shall be issued an option or warrant exercisable to purchase stock of the Company or stock of the Company is sold to such person or entity at a price per share less than the then relevant Exercise Price as determined as provided herein, an immediate adjustment in the Exercise Price for this Warrant (and successor Warrants to this Warrant) shall be made. The effect of this adjustment shall be to make the Exercise Price under this Warrant equal to the lesser exercise option or sale price referenced above. However, this adjustment shall not have the effect of increasing the number of shares purchasable hereunder. Rather it shall reduce the aggregate amount paid, assuming full exercise of this Warrant, to an amount equal to the number of shares otherwise then purchasable hereunder multiplied by the newly adjusted Exercise Price pursuant to this adjustment.

(d) Whenever reference is made in this paragraph 6 to the issue or sale of shares of Common Stock, the term "Common Stock" shall mean the Common Stock of the Company of the class authorized as of the date hereof and any other classes of stock ranking on a parity with or convertible into such Common Stock providing, as is contemplated, it is the Common Stock of the Company which is to be offered and sold at the next public offering of registered Common Shares of the Company. However, as of the date of grant and sale of this Warrant and subject to the provisions of paragraph 10 hereof, shares issuable upon exercise hereof shall include only shares of the class designated as Common Stock of the Company as of the date hereof.

7. Renewal of Exercise Rights. If, while this Warrant or any portion of it remains in effect, Holder(s) wish to extend their rights to exercise all or a portion of this Warrant which would otherwise expire and be lost to them, they may do so by paying to the Company, a sum equal to five percent (5%) of the then relevant Exercise Price pertaining to that portion of the Warrant which would otherwise expire (the "Renewal Fee") and the Company shall extend that portion of the Warrant for a further period of five (5) years from the date of receipt of the Renewal Fee but, in no case, beyond 5:00 p.m., Chicago Time, on June 1, 2006, and shall issue a new Warrant, identical in every respect to this Warrant, except that such new Warrant shall reflect the fact that Holder(s) shall have an additional five (5) years to exercise their rights to purchase that portion of the Warrant Stock for which they have paid a Renewal Fee. This provision extends to this Warrant and all successor Warrants issuable hereunder.

This provision is included partially to permit Holder(s) to coordinate their exercise of this Warrant and sale of Warrant Stock so as to minimize the Costs

and Expenses and time of the Company's management in complying with the provisions of this Warrant. Payment of the Renewal Fee will confirm no new rights upon the Holder(s) except to extend and renew the time period during which Holder(s) may exercise existing rights under this Warrant.

8. Officer's Certificate. Whenever the Exercise Price shall be adjusted as required by the provisions of paragraph 6 hereof, the Company shall forthwith file in the custody of its Secretary or an Assistant Secretary at its principal office, and with its stock transfer agent, if any, an officer's certificate showing the adjusted Exercise Price determined as herein provided and setting forth in reasonable detail the facts requiring such adjustment. Each such officer's certificate shall be made available at all reasonable times for inspection by the Holder(s) and the Company shall, forthwith after each such adjustment, deliver a copy of such certificate to the Holder(s) and each of them. Unless disputed in writing by the Holder hereof within thirty (30) days, such certificate shall be conclusive as to the correctness of such adjustment.

9. General Notices to Warrant Holders. So long as any portion of this Warrant (or any successor Warrant) shall be outstanding and unexercised (a) if the Company shall pay any dividend or make any distribution upon the Common Stock or (b) if the Company shall offer to the holders of Common Stock for subscription or purchase by them any shares of stock of any class or any other rights or (c) if any capital reorganization of the Company, reclassification of the capital stock of the Company, consolidation or merger of the Company with or into another corporation, sale, lease or transfer of all or substantially all of the property and assets of the Company to another corporation or engage in voluntary or involuntary dissolution, liquidation or winding up of the company, then the Company shall cause to be delivered to the Holder(s), at least thirty (30) days prior to the relevant date, a notice containing a brief description of the proposed action and stating the date of which a record is to be taken for the purpose of such dividend, distribution of rights, or such reclassification, reorganization, consolidation, merger, conveyance, lease, dissolution, liquidation or winding up is to take place and the date, if any, is to be fixed as of which the holders of Common Stock of record shall be entitled to exchange their shares of Common Stock of record for securities or other property deliverable upon such reclassification, reorganization, consolidation, merger, conveyance, dissolution, liquidation or winding up.

10. Reclassification, Reorganization or Merger. In case of any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the Company (other than a change in par value, or from par value to no par value, or from no par value to par value) or as a result of an issuance of Common Stock by way of dividend or other distribution or of a subdivision or combination, or in case of any consolidation or merger of the Company with or into another corporation (other than a merger with a subsidiary in which merger the Company is the continuing corporation and which does not result in any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the class issuable upon exercise of this Warrant) or in case of any sale or conveyance to another corporation of the property of the Company as an entirety or substantially as an entirety (collectively, a "Triggering Event"), the Company shall use good faith efforts to cause effective provision to be made so that the Holder(s) shall have the right thereafter (and shall have said right for the same period of time remaining on any unexercised portion of this Warrant), without immediately exercising this Warrant, to purchase the kind and amount of shares of stock and



other securities and property receivable upon such reclassification, capital reorganization or other change, consolidation, merger, sale or conveyance.

Any such provision shall include provision for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Warrant. However, in the event that the Company, using its good faith efforts, is unable to negotiate with the acquiring entity the assumption of the Warrants as provided in the preceding portion of this paragraph, then and in such event this Warrant shall terminate, to the extent not previously exercised, as of the record date for such transaction upon and only upon payment of a "Retirement Fee" to the Holder(s) hereof.

This Retirement Fee shall consist of the same kind of property (including cash, if any) to be received by the Company's stockholders pursuant to the Triggering Event (and, at parity with holders of Common Stock, treated in accordance with all the other terms and conditions, including timing and manner of payment for the purchase) and the Company herein agrees that said Retirement Fee may be arrived at by private negotiation between the Company and the Holder(s) or may be arbitrated in accordance with the provisions herein provided.

However, the Company now and specifically agrees that, in the event of such private negotiation, it shall accept an amount to be paid to the Holder(s) (as a senior obligation of the company in any such transaction) in arbitration or negotiation which is not less than the lowest sum per Warrant which shall result from application of any then applicable Warrant Valuation Techniques (such as the Black-Scholes Model) which may be applied to publicly traded warrants covering publicly traded common stock, it being intended by the Company and the Holder(s) that the Retirement Fee should reflect: (a) the difference between the purchase and exercise price per share plus (b) a warrant premium factor commonly determinable by the aforementioned models. Said Retirement Fee shall be a senior obligation of the Company and shall be paid to Holder(s) from first proceeds of any sale or merger in cash unless otherwise negotiated between the Company and 4 (the original Holder).

All subsequent Holders shall agree, by acceptance of assignment of any portion of the Warrant covered by this certificate, to be bound by this provision. All costs and expenses directly attributable to the determination of the Retirement Fee (including but not limited to the costs of outside appraisal(s)) shall be at the expense of the Company.

The foregoing provisions of this section 10 shall similarly apply to successive reclassification, consolidations, mergers, sales, or conveyances. In the event that in any such capital reorganization or reclassification, consolidation, merger, sale or conveyance, additional shares of Common Stock shall be issued in exchange, conversion, substitution or payment, in whole or in part, for or of a security of the Company other than Common Stock, any such issue shall be treated as an issue of Common Stock covered by the provisions of paragraphs 3, 6, and 9 hereof, with the amount of the consideration received upon the issue thereof being determined by the Board of Directors of the Company in consultation with the Company's auditors, such determination to be final and binding on the Holder(s).

11. Transfer to Comply with the Securities Act of 1933.  
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(a) This Warrant or the Warrant Stock or any other security issued or issuable upon exercise of this Warrant may not be sold, transferred or otherwise disposed of except to a person who, in the opinion of counsel reasonably satisfactory to the Company, is a person to whom this Warrant or such Warrant Stock may legally be transferred pursuant to paragraph 4 hereof without registration and without the delivery of a current prospectus under the Securities Act with respect thereto; and then only against receipt by the Company of an agreement from such person to comply with the provisions of this paragraph 11 with respect to any resale or other disposition of such securities.

(b) The Company may cause the following legend to be set forth on each certificate representing Warrant Stock or any other security issued or issuable upon exercise of this Warrant not theretofore distributed to the public pursuant to paragraphs 12, 13, or 14 hereof, unless counsel for the Company is of the opinion as to any such certificate that such legend is unnecessary.

"The securities represented by this certificate may not be offered for sale, sold or otherwise transferred except pursuant to an effective registration statement under the Securities Act of 1933 (the "Act"), or pursuant to an exemption from registration under the Act."

12. Demand Registration. If at any time, after the next public offering of registered Common Shares of the Company (as previously covered and defined herein) the Holder(s), or any of them, shall decide to sell or otherwise dispose of Warrant Stock then owned or to be owned upon intended exercise of this Warrant by such Holder(s), such Holder(s) may give written notice to the Company of the proposed disposition (but, if other than \_\_\_\_\_, must simultaneously give notice to \_\_\_\_\_), specifying the number of shares of Warrant Stock to be sold or disposed of and requesting that the Company prepare and file a registration statement under the Securities Act of 1933, as amended (the "Securities Act"), covering such Warrant Stock.

The Company shall within 10 days thereafter give written notice to the other Holders of Warrants or Warrant Stock of such request and each of the other Holders shall have the option for a period of 30 days after receipt by it (them) of notice from the Company to include its (their) Warrant Stock in such registration statement. The Company shall use its best efforts to cause an appropriate registration statement (the "Registration Statement") covering such Warrant Stock to be filed with the Securities and Exchange Commission (the "Commission") and to become effective as soon as reasonably practicable and to remain effective until the completion of the distribution of the Warrant Stock to be offered or sold; provided, however, that not more than once in any twelve month period the Company shall have the right to postpone for a period of up to 60 days any demand made pursuant to this Warrant if the underwriters for such offering advise the Company in writing that market conditions make such a postponement advisable to the Company.

The Holder(s) whose Warrant Stock is (are) included in a Registration Statement is (are) hereinafter referred to as the "Selling Shareholder(s)".

Each notice delivered by a Selling Shareholder(s) to the Company pursuant to this paragraph 12 shall specify the Warrant Stock intended to be offered and sold by such Selling Shareholder(s), express such Selling Shareholder(s) present intent to offer such Common Shares for distribution, and contain the undertaking of such Selling Shareholder(s) to provide all information and materials and to take all action as may be required in order to permit the Company to comply with all applicable requirements of the Securities Act, and any rules and regulations promulgated thereunder, and to obtain acceleration of the effective date of such Registration Statement.

The Company shall not be obligated to file more than three Registration Statements pursuant to the foregoing provisions of this paragraph 12. The Company shall bear all of the Costs and Expenses (as hereinafter defined in paragraph 20 hereof) of the first such registration. The Selling Shareholder(s) shall bear the costs and expenses of all further registrations pursuant to this paragraph 12. A demand for registration under this paragraph 12 will not count as such until the Registration Statement has become effective.

13. Shelf Registration By Original Holder. At any time and from time to time during the term of this Warrant or its successors (including renewals and extensions as provided for herein) \_\_\_\_\_, and only \_\_\_\_\_ (as the original Holder hereof), may demand (and actually expects) that the Company will file a Registration Statement with the Commission for the registration of underlying shares issuable upon exercise of this Warrant or any part thereof, whether or not said Warrant has, in the interim been assigned or re-assigned to other parties. In this event, the Company shall pay all of the Costs and Expenses of said Registration for each such demand.

Once filed, the Company shall be obligated to continue this "shelf registration" for the maximum time allowable under the then relevant regulations, at its sole expense.

14. Procedure for Demand Registration. In connection with the filing of a Registration Statement pursuant to paragraph 12 hereof, and in supplementation and not in limitation of the provisions thereof, the Company shall:

(a) Notify the Selling Shareholder(s) as to the filing of the Registration Statement and of all amendments or supplements thereto filed thirty (30) days prior to the effective date of said Registration Statement;

(b) Notify the Selling Shareholder(s), promptly after the Company shall receive notice thereof, of the time when said Registration Statement became effective or when any amendment or supplement to any prospectus forming a part of said Registration Statement has been filed;

(c) Notify the Selling Shareholder(s) promptly of any request by the Commission for the amending or supplementing of such Registration Statement or prospectus or for additional information;

(d) Prepare and promptly file with the Commission, and promptly notify the Selling Shareholder(s) of the filing of, and amendments or supplements to such Registration Statement or prospectus as may be necessary to correct any statements or omissions if, at any time when a prospectus relating to the Warrant Stock is required to be delivered under the Securities Act, any event with respect to the Company shall have occurred as a result of which any such prospectus or any other prospectus as then in effect would include an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein not misleading; and, in prepare and file with the Commission, promptly upon the Selling Shareholder(s)' written request, any amendments or supplements to such Registration Statement or prospectus which may be reasonably necessary or advisable in connection with the distribution of the Warrant Stock;

(e) Prepare promptly upon request of the Selling Shareholder(s) or any underwriters for the Selling Shareholder(s) such amendment or amendments to such Registration Statement and such prospectus or prospectuses as may be reasonably necessary to permit compliance with the requirements of Section 10 (a) (3) of the Securities Act;

(f) Advise the Selling Shareholders promptly after the Company shall receive notice or obtain knowledge of the issuance of any stop order by the Commission suspending the effectiveness of any such Registration Statement or amendment thereto or of the initiation or threatening of any proceeding for that purpose, and promptly use its best efforts to prevent the issuance of any stop order or obtain its withdrawal promptly if such stop order would be issued;

(g) Use its best efforts to qualify as soon as reasonably practicable the Warrant Stock for sale under the securities or blue-sky laws of such states and jurisdictions within the United States as shall be reasonably requested by the Selling Shareholder(s); provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business, to become subject to taxation or to file a consent to service of process generally in any of the aforesaid states or jurisdiction;

(h) Furnish the Selling Shareholder(s), as soon as available, copies of any Registration Statement and each preliminary or final prospectus, or supplement or amendment required to be prepared pursuant thereto, all in such quantities as the Selling Shareholder(s) may from time to time reasonably request, and;

(i) If requested by the Selling Shareholder(s), enter into an agreement with the underwriters of the Warrant Stock being registered containing customary provisions and reflecting the foregoing.

15. Incidental Registration. Other than as covering in paragraph 13 hereof, if at any time the Company subsequent to the next public offering of

registered Common Shares of the Company, shall propose the filing of a Registration Statement on an appropriate form under the Securities Act for the registration of any securities of the Company, other than a registration statement on Form S-4 or S-8 or any equivalent form of registration statement then in effect, then the Company shall give the Holder(s) notice of such proposed registration and shall include in any Registration Statement relating to such securities all or a portion of the Warrant Stock then owned or to be owned by such Holder(s), which such Holder(s) shall request (such Holder(s) to be considered "Selling Shareholder(s)"), by notice given by such Selling Shareholder(s) to the Company within 15 business days after the giving of such notice by the Company, within 15 business days after the giving of such notice by the Company, to be so included. In the event of the inclusion of Warrant Stock pursuant to this paragraph 15, the Company shall bear the Costs and Expenses of such registration; provided, however that the Selling Shareholder(s) shall pay the fees and disbursements of their own counsel and, pro-rata based upon the number of shares of Warrant Stock included therein as these relate to the total number of Common Shares to be offered or sold, the Securities Act registration fees and underwriters discounts and compensation attributable to the inclusion of such Warrant Stock; and, provided further, however, that amounts to which any person or entity shall become entitled pursuant to this sentence shall not include amounts which may become payable pursuant to paragraphs 16 or 17 hereof. Nothing in this paragraph 15 shall require the registration of Warrant Stock in a Registration Statement relating solely to (a) securities to be issued by the Company in connection with the acquisition of the stock or the assets of another corporation, or the merger or consolidation of any other corporation by or with the Company or any of its subsidiaries, or an exchange offer with any corporation, (b) securities to be offered to the then existing security holders of the Company, or (c) securities to be offered to employees of the Company. In the event the distribution of securities of the Company covered by a Registration Statement referred to in this paragraph 15 is to be underwritten, then the Company's obligation to include Warrant Stock in such a Registration Statement shall be subject, at the option of the Company, to the following further conditions:

(a) The distribution for the account of the Selling Shareholders shall be underwritten by the same underwriters who are underwriting the distribution of the securities for the account of the Company and/or any other persons whose securities are covered by such Registration Statement and the Selling Shareholder(s) shall enter into an agreement with such underwriters containing customary provisions.

(b) If the Selling Shareholders are included in the Registration Statement and if the underwriting agreement entered into with the aforesaid underwriters contains restrictions upon the sale of securities of the Company, other than the securities which are to be included in the proposed distribution, for a period not exceeding 90 days from the effective date of the Registration Statement, then such restrictions shall be binding upon the Selling Shareholder(s) with respect to any Warrant Stock not covered by the Registration Statement and, if requested by the underwriter, the Selling Shareholder(s) shall enter into a written agreement to that effect.

(c) If the underwriters shall state in writing that they are unwilling to include any or all of the Selling Shareholder(s) Warrant Stock in the proposed underwriting because such inclusion would materially interfere with the orderly sale and distribution of the securities being offered by the Company, then the number of the Selling Shareholder(s)' shares of Warrant Stock

to be included shall be reduced pro rata on the basis of the number of shares of Warrant Stock originally requested to be included by such Selling Shareholder(s), or there shall be no inclusion of the shares of the Selling Shareholder(s) in the Registration Statement not proposed distribution, in accordance with such statement by the underwriters.

However, if in such an event, the Holder(s) hereof shall not be able to include at least fifty percent (50%) of the Warrant Stock originally requested to be included, then the Company shall agree to pay all of the Costs and Expenses of a Shelf Registration to be filed at a later date.

16. Indemnification by the Company. The Company shall indemnify and hold harmless each Selling Shareholder, any underwriter (as defined in the Securities Act) for the Selling Shareholder, and each person, if any, who controls the Selling Shareholder or such underwriter within the meaning of the Securities Act (but, in the case of an underwriter or a controlling person, only if such underwriter or controlling person indemnifies the persons mentioned in paragraph 17(b) hereof in the manner set forth therein) against any losses, claims, damages or liabilities, joint or several, to which the Selling Shareholder or any such underwriter or controlling person becomes subject, under the Securities Act or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) are caused by any untrue statement or alleged untrue statement of any material fact contained in any preliminary prospectus (if used prior to the effective date of the Registration Statement), or contained, on the effective date thereof, in any Registration Statement under which the Selling Shareholder(s)' shares of Warrant Stock were registered under the Securities Act, the prospectus contained therein, or any amendment or supplement thereto, arising out of or based upon the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading; the Company shall reimburse the Selling Shareholder, or any such underwriter or controlling person, in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the Company shall not be liable to any such person in any such case to the extent that any such loss, claim, damage, liability or action arises out of or is based upon any untrue statement or alleged untrue statement or omission or alleged omission made in reliance upon and in conformity with information furnished in writing to the Company by such person expressly for inclusion in any of the foregoing documents.

17. Indemnification by Selling Shareholders. Each individual Selling Shareholder shall:

(a) Furnish to the Company in writing all information concerning it and its holdings of securities of the Company as shall be required in connection with the preparation and filing of any Registration Statement covering any Shares of Warrant Stock.

(b) Indemnify and hold harmless the Company, each of its directors, each of its officers who has signed a Registration Statement, each person, if any, who controls the Company within the meaning of the Securities Act and any underwriter (as defined in the Securities Act) for the Company, against any losses, claims, damages or liabilities to which any such director, officer, controlling person or underwriter may become subject under the

Securities Act or otherwise, insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) are caused by any untrue statement of any material fact contained in any preliminary prospectus (if used prior to the effective date of the Registration Statement) or contained, on the effective date thereof, in any Registration Statement under which the Selling Shareholder's securities were registered under the Securities Act, the prospectus contained therein, or any amendment or supplement thereto, or arising out of or based upon the omission to state therein a material fact required to be stated therein or necessary to make the statement therein not misleading; in each case to the extent, but only to the extent, that such untrue statement or omission was made in reliance upon and in conformity with information furnished to the Company in writing by the Selling Shareholder expressly for inclusion in any of the foregoing documents, and the Selling Shareholder shall reimburse the Company and any such director, officer, controlling person or underwriter for any legal or other expenses reasonably incurred by the Company or any such director, officer, controlling person or underwriter in connection with investigating or defending any such loss, claim, damage, liability or action.

18. Notification by Selling Shareholders. The Selling Shareholder(s) and each other person indemnified pursuant to paragraph 16 hereof shall, in the event it receives notice of the commencement of any action against it which is based upon an alleged act or omission which, if proven, would result in the Company having to indemnify it pursuant to paragraph 16 hereof, promptly notify the Company, in writing, of the commencement of such action and permit the Company, if the Company so notifies the Selling Shareholder(s) within 10 days after receipt by the Company of notice of the commencement of the action, to participate in and to assume the defense of such action with counsel reasonably satisfactory to the Selling Shareholder(s) or such other indemnified person, as the case may be. The omission to notify the Company promptly of the commencement of any such action shall not relieve the Company of any liability to indemnify the Selling Shareholder(s) or such other indemnified person, as the case may be, under paragraph 16 hereof, except to the extent that the Company shall suffer any loss by reason of such failure to give notice which it may have pursuant to the rights conveyed to the Holders) in this Warrant.

19. Notification by the Company to Selling Shareholders. The Company agrees that, in the event it receives notice of the commencement of any action against it which is based upon an alleged act or omission which, if proven, would result in a Selling Shareholder having to indemnify the Company pursuant to paragraph 17(b) hereof, the Company will promptly notify the Selling Shareholder in writing of the commencement of such action and permit the Selling Shareholder, if the Selling Shareholder so notifies the Company within 10 days after receipt by the Selling Shareholder of notice of the commencement of the action, to participate in and assume the defense of such action with counsel reasonably satisfactory to the Company. The omission to notify the Selling Shareholder promptly of the commencement of any such action shall not relieve the Selling Shareholder of liability to indemnify the Company under paragraph 17(b) hereof, except to the extent that the Selling Shareholder shall suffer any loss by reason of such failure to give notice, and shall not relieve the Selling Shareholder of any other liabilities which it may have under this or any other agreement then in effect between the Company and the Selling Shareholder.

20. Costs and Expenses. As used in this Warrant, "Costs and Expenses" shall include all of the costs and expenses relating to the respective Registration Statement(s) involved, including but not limited to, registration fees, filing and qualification fees, blue-sky expenses, printing and mailing expenses, fees and expenses of Company's counsel and, if/when appropriate, fees and expenses of counsel designated by the Selling Shareholder(s) (provided, however, that no more than one such counsel for the Selling Shareholder(s) shall be designated on any occasion).

21. Addresses. All notices, certificates, waiver and other communications required or permitted to be given hereunder to any of the parties by any other party shall be in writing and shall be delivered personally or sent by next day delivery service or registered or certified mail, postage prepaid, as follows:

(a) If to the Company, addressed to:

Cheung Laboratories, Inc.  
10220-I Old Columbia Road  
Columbia, MD 21046-1705  
Attention: Mr. John Mon, General Manager

(b) If to a Holder, addressed to the address of each such Holder as shall, from time to time, appear on the records of the Company or those of the Company's transfer agent as may be the case.

Any notice delivered personally or sent by next day delivery service shall be deemed to have been given on the date so delivered, and any notice delivered by registered or certified mail shall be deemed to have been given on the date it is received. Any party may change the address to which notices hereunder are to be sent by giving written notice of such change of address in the manner provided for giving notice.

22. Waiver. No waiver by a Holder of any right hereunder shall be effective unless it is in writing which specifically refers to the provision hereof under which such right arises, and no such waiver shall operate or be construed as a waiver of any subsequent breach, whether of a similar or dissimilar nature.

23. Entire Warrant. This Warrant may be amended, supplemented or modified only by a written instrument executed by the Company and the Holder(s). While separate executed letters proposing and/or accepting amendment(s) sent to the Company by the Holder(s) or to the Holder(s) by the Company shall, for the purposes of this paragraph 23, constitute a valid agreement as to the relationship then created by and between the Company and the individual Holder in question, only \_\_\_\_\_ (as the original Holder) may, by agreement with the Company, bind all subsequent Holders to one single written instrument which shall serve to amend the terms and conditions hereof, and to which by their acceptance of an assignment of any portion of this Warrant, they implicitly agree to be bound by.



24. Applicable Law. This Warrant and the legal relations among the parties hereto shall be governed by and construed in accordance with the substantive laws of the State of Illinois applicable to contracts made and to be performed therein without giving effect to the principles of conflict of laws thereof.

25. Appraisal Rights. In the event that the Company's board of directors has not approved and the Company has not executed the next public offering of the Company's Common Stock prior to the second anniversary of the issuance of this Warrant, a majority in interest of the Holder(s) may, in their sole discretion and at any time thereafter, give notice to the Company that they wish to avail themselves of Appraisal Rights rather than force the Company into filing a Registration Statement against its will by demanding registration hereunder.

Should this event occur, the Company and the Holder(s) shall meet together to appraise the value of the Warrant(s) and shall proceed to do so in the same fashion and spirit as is provided for in the first paragraph of section 10 hereof in determining a Retirement Fee to be paid the Holders upon termination of the Warrant(s).

26. Binding Effect. The provisions contained in this Warrant shall be binding upon and inure to the benefit of the Company and the Holders and their respective successors, permitted assigns, heirs and legal representatives. Any person to whom all or a part of a Holder's rights and obligations hereunder are assigned shall fulfill such of the assigning Holder's obligations hereunder as have been assigned, and shall be entitled to all of the rights and benefits hereunder to the extent that such person has assumed such Holder's obligations. The rights and powers of each successive Holder hereunder are granted to such Holder as an owner of Warrants or Warrant Stock as the case may be. Any subsequent Holder whether becoming such by transfer, assignment, operation of law or otherwise, shall have the same rights and powers which a Holder owning the same number of Warrants and/or Warrant Stock has hereunder, and shall be entitled to exercise such rights and powers until such Holder or subsequent Holder no longer owns any Warrants or Warrant Stock. Except as provided in this paragraph 26, this Warrant does not create, and shall not be construed as creating, any rights enforceable by any person not a Holder.

27. Validity. If any term, provision, covenant or restriction of this Warrant is held by a court of competent jurisdiction to be invalid, void or unenforceable, the Company agrees that such term, provision, covenant or restriction shall be reformed to the extent possible consistent with such judicial holding to reflect the intent of the Company and the original Holder as stated herein and the remainder of the terms, provisions, covenants and restrictions of this Warrant shall remain in full force and effect and shall in no way be affected, impaired or invalidated. It is hereby stipulated and declared to be the intention of the Company that it would have executed this Warrant including the remaining terms, provisions, covenants and restrictions without including any of such provision of term which may be hereafter declared invalid, void or unenforceable.

This Warrant (Serial Number: \_\_\_\_\_) is granted and sold on the date first above written.

Cheung Laboratories, Inc.

By: \_\_\_\_\_  
Augustine Cheung, President

Attest:

- - - - -  
Secretary

PURCHASE FORM

Dated: \_\_\_\_\_

Cheung Laboratories, Inc.  
10220-1 Old Columbia Road  
Columbia, MD 21046-1705

Attention: Mr. John Mon, General Manager

Attached herewith is Cheung Laboratories, Inc.'s Common Stock Purchase Warrant, Serial Number: \_\_\_\_\_, giving the Holder the right to purchase \_\_\_\_\_ shares.

I/We hereby notify you that I/we are exercising my/our right to purchase \_\_\_\_\_ shares and have enclosed herewith my/our check in the amount of \$\_\_\_\_\_, representing the aggregate exercise price of said shares. If transfer taxes (federal or state) are applicable to this transaction, I/we understand that you will be billing me/us for said taxes, which I/we agree will be promptly remitted to you within ten (10) days of my/our receipt of notification.

I/We hereby state that the shares being purchased are to be held by me/us for investment purposes and not with a view to sale, except pursuant to an effective registration statement or an exemption therefrom.

Please cancel the enclosed warrant and, if applicable, send me/us a warrant, in partial substitution on identical terms, for the remaining shares not being purchased pursuant to this notification.

Yours very truly,

Holder of Warrant, Serial Number \_\_\_\_\_

- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED OR ANY STATE SECURITIES LAWS AND NEITHER THE SECURITIES NOR ANY INTEREST THEREIN MAY BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR SUCH LAWS OR AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT AND SUCH LAWS WHICH, IN THE OPINION OF COUNSEL FOR THE HOLDER, WHICH COUNSEL AND OPINION ARE REASONABLY SATISFACTORY TO COUNSEL FOR THIS CORPORATION, IS AVAILABLE.

\_\_\_\_\_, 199\_\_

WARRANT TO PURCHASE SHARES OF COMMON  
STOCK OF CHEUNG LABORATORIES, INC.

This certifies that \_\_\_\_\_ (the "Holder"), for a value received, is entitled, subject to the adjustment and to the other terms set forth below, to purchase from Cheung Laboratories, Inc., a Maryland corporation (the "Company"), at the Stock Purchase Price (as defined below) that number of fully paid and nonassessable shares of the Company's \$0.01 par value Common Stock (the "Stock") as equals \$\_\_\_\_\_ divided by the Stock Purchase Price. Stock Purchase Price shall be the average price of the common stock of the public or private offerings conducted subsequent to the offering set forth in the Memorandum of the Company dated January 6, 1997 as supplemented June 12, 1997 and ending December 27, 1997 by the Company which raise, in the aggregate, not less than \$8,000,000 (hereafter collectively referred to as the "Offering"). This Warrant shall be exercisable at any time on and after six months from the date of the next public stock offering ("Next Public Offering") of the Company (the "Commencement Date") but not later than 5:00 P.M. (New York Time) on the Expiration Date (as defined below), upon surrender to the Company at its principle office at 10220-I Old Columbia Road, Columbia, Maryland 21046-1705, Attention: Dr. Augustine Cheung, Chairman of the Board of Directors (or at such other location as the Company may advise Holder in writing) of this Warrant properly endorsed with the form of Subscription Agreement attached hereto duly filled in and signed and upon payment in cash or cashier's check of the aggregate Stock Purchase Price for the number of shares for which this Warrant is being exercised determined in accordance with the provisions hereof. The Stock Purchase Price and, in some cases, the number of shares purchasable hereunder are subject to adjustment as provided in Section 3 of this Warrant. This Warrant and all rights hereunder, to the extent not exercised in the manner set forth herein shall terminate and become null and void on the Expiration Date. "Expiration Date" means 5:00 P.M. (New York Time) on the fifth anniversary of the Commencement Date. In the event that the Holder does not exercise this Warrant pursuant to the terms of this Warrant, then this Warrant shall expire, be cancelled, and be null and void. This Warrant is issued pursuant to the subscription agreement dated the same date as this Warrant and executed by the Holder, for the Purchase of a secured convertible promissory note in the principal amount of \$\_\_\_\_\_.

This Warrant is subject to the following terms and conditions:

1. Exercise: Issuance of Certificates; Payment for Shares; Conversion Right.

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1.1 Duration of Exercise of Warrant. This Warrant is exercisable at the option of the Holder at any time or from time to time but not earlier than on the Commencement Date or later than 5:00 P.M. (New York Time) on the Expiration Date for all or a portion of the shares of Stock which may be purchased hereunder. The Company agrees that the shares of Stock purchased under this Warrant shall be and are deemed to be issued to Holder as the record owner of such shares at the close of business on the date on which this Warrant shall have been

surrendered and payment made for such shares. Subject to the provisions of Section 2, certificates for the shares of Stock so purchased, together with any other securities or property to which Holder is entitled upon such exercise, shall be delivered to Holder by the Company or its transfer agent at the Company's expense within a reasonable time after the rights represented by this Warrant have been exercised. Each stock certificate so delivered shall be in such denominations of Stock as may be requested by Holder and shall be registered in the name of Holder or such other name as shall be designated by Holder. If, upon exercise of this Warrant, fewer than all of the shares of Stock evidenced by this Warrant are purchased prior to the Expiration Date of this Warrant, one or more new warrants substantially in the form of, and on the terms in, this Warrant will be issued for the remaining number of shares of Stock not purchased upon exercise of this Warrant.

2. Shares to Be Fully Paid: Reservation of Shares. The Company covenants and agrees that all shares of Stock which may be issued upon the exercise of this Warrant (the "Warrant Shares") shall, upon issuance, be duly authorized, validly issued, fully paid and nonassessable and free from all preemptive rights of any stockholder and free of all taxes, liens, and charges with respect to the issuance thereof. The Company will take all such reasonable actions as may be necessary to assure that such shares of Stock may be issued as provided herein without violation of any applicable law or regulation, or of any requirements of any domestic securities exchange or automated quotation system upon which the Stock may be listed.

3. Adjustment of Stock Purchase Price and Number of Shares. The Stock Purchase Price and, in some cases, the number of shares purchasable upon the exercise of this Warrant shall be subject to adjustment from time to time upon the occurrence of certain events described in this Section 3.

3.1 Split or Combination of Stock and Stock Dividend: In case the Company shall at any time subdivide its outstanding shares of Stock into a greater number of shares or declare a dividend upon its Stock payable solely in shares of Stock, the Stock Purchase Price in effect immediately prior to such subdivision or declaration shall be proportionally reduced, and the number of shares issuable upon exercise of the Warrant shall be proportionately increased. Conversely, in case the outstanding shares of Stock of the Company shall be combined into a smaller number of shares (such as a reverse stock split, but not to include the anticipated redemption of 4,000,000 shares of stock from Mr. Gao pursuant to a Redemption Agreement, as amended, now in effect with Mr. Gao) the Stock Purchase Price in effect immediately prior to such combination shall be proportionately increased, and the number of shares issuable upon exercise of the Warrant shall be proportionately reduced.

3.2 Dilutive Issuances. If prior to completion of the Company's Next Public Offering, the Company shall sell or issue at any time after the date of this Warrant and prior to its termination, shares of Stock (other than Excluded Stock, as defined in Section 3.2.5) at a consideration per share less than the Stock Purchase Price, then, upon such sale or issuance, the Stock Purchase Price shall be reduced to the lower of the prices (calculated to the nearest cent) determined as follows: by dividing (i) the sum of (A) the total number of shares of Stock Outstanding (as defined in Section 3.2.1) below and subject to adjustment in the manner set forth in Section 3.1) immediately prior to such issuance or sale multiplied by the then-existing Stock Purchase Price, plus (B) the aggregate of the amount of all consideration, if any, received by the Company upon such issuance or sale, by (ii) the total number of shares of Stock Outstanding immediately after such issuance or sale.

3.2.1 Definitions. For purposes of this Section 3.2, the following definitions shall apply:

(a) "Convertible Securities" shall mean any indebtedness or equity securities convertible into or exchangeable for Stock.

(b) "Options" shall mean any rights, warrants or options to subscribe for or purchase Stock or Convertible Securities.

(c) "Stock Outstanding: shall mean the aggregate of all Stock of the Company outstanding and all Stock issuable upon exercise of all outstanding Options and conversion of all outstanding Convertible Securities.

3.2.2 For the purposes of this Section 3.2, the following provisions shall also be applicable:

(a) Cash Consideration. In the case of the issuance or sale of additional Stock for cash, the consideration received by the Company therefor shall be deemed to be the amount of cash received by the Company for such shares (or, if such shares are offered by the Company for subscription, the subscription price, or, if such shares are sold to underwriters or dealers for public offering without a subscription offering, the public offering price), without deducting therefrom any compensation or discount paid or allowed to underwriters or dealers or others performing similar services or for any expenses incurred in connection therewith.

(b) Non-Cash Consideration. In case of the issuance (other than upon conversion or exchange of Convertible Securities) or sale of additional Stock, Options or Convertible Securities for a consideration other than cash or a consideration a part of which shall be other than cash, the fair market value of such consideration as determined by the Board of Directors of the Company in the good faith exercise of its business judgment, irrespective of the accounting treatment thereof, shall be deemed to be the value, for purposes of this Section 3, of the consideration other than cash received by the Company for such securities.

(c) Options and Convertible Securities. In case the Company shall in any manner issue or grant any Options or any Convertible Securities, the total maximum number of shares of Stock issuable upon the exercise of such Options or upon conversion or exchange of the total maximum amount of such Convertible Securities at the time such Convertible Securities first become convertible or exchangeable shall (as of the date of issue or grant of such Options or, in the case of the issue or sale of Convertible Securities other than where the same are issuable upon the exercise of Options, as of the date of such issue or sale) be deemed to be issued and to be outstanding for the purpose of this Section 3.2 and to have been issued for the sum of the amount (if any) paid for such Options or Convertible Securities plus the amount (if any) payable upon the exercise of such Options or upon conversion or exchange of such Convertible Securities at the time such Convertible Securities first become convertible or exchangeable; provided that, subject to the provisions of Section 3.2.3, no further adjustment of the Stock Purchase Price shall be made upon the actual issuance of any such Stock or Convertible Securities or upon the conversion or exchange of any such Convertible Securities.

3.2.3 Change in Option Price or Conversion. In the event that the purchase price provided for in any Option referred to in subsection 3.2.2.(c), or the rate at which any Convertible Securities referred to in subsection 3.2.2.(c) are convertible into or exchangeable for shares of Stock shall change at any time or any additional consideration shall be payable in connection with the exercise of any Option or the conversion or exchange of any Convertible Security (other than under or by reason of provisions designed to protect against dilution upon the occurrence of events of the type described in this Section 3), then, for purposes of any adjustment required by Section 3.2, the Stock Purchase Price in effect at the time of such event shall forthwith be readjusted to the Stock Purchase Price that would have been in effect at such time had such Options or Convertible Securities still

outstanding provided for such changed purchase price, conversion rate or additional consideration, as the case may be, at the time initially granted, issued or sold, provided that if such readjustment is an increase in the Stock Purchase Price, such readjustment shall not exceed the amount (as adjusted by Sections 3.2 and 3.2) by which the Stock Purchase Price was decreased pursuant to Section 3.2 upon the issuance of the Option or Convertible Security.

3.2.4 Termination of Option or Conversion Rights. In the event of the termination or expiration of any right to purchase Stock under any Option granted after the date of this Warrant or of any right to convert or exchange Convertible Securities issued after the date of this Warrant, the Stock Purchase Price shall, upon such termination, be readjusted after the Stock Purchase Price that would have been in effect at the time of such expiration or termination had such Option or Convertible Security, to the extent outstanding immediately prior to such expiration or termination, never been issued, and the shares of Stock issuable thereunder shall not longer be deemed to be Stock Outstanding, provided that if such readjustment is an increase in the Stock Purchase Price, such readjustment shall not exceed the amount (as adjusted by Sections 3.1 and 3.2) by which the Stock Purchase Price was decreased pursuant to Section 3.2 upon the issuance of the Option or Convertible Security. The termination or expiration of any right to purchase Stock under any Option granted prior to the date of this Warrant or of any right to convert or exchange Convertible Securities issued prior to the date of this Warrant shall not trigger any adjustment to the Stock Purchase Price, but the shares of Stock issuable under such Options or Convertible Securities shall not longer be counted in determining the number of shares of Stock Outstanding on the date of issuance of this Warrant for purposes of subsequent calculations under this Section 3.2

3.2.5 Excluded Stock. Notwithstanding anything herein to the contrary, the Stock Purchase Price shall not be adjusted pursuant to this Section 3.2 by virtue of the issuance and/or sale of Excluded Stock, which shall mean the following: (a) Stock, Options or Convertible Securities representing up to 2,000,000 shares of Stock (or such greater number of shares of Stock as authorized by the Board of Directors) in the aggregate to be issued and/or sold to employees, advisors, directors or officers of, or consultants to, the Company or any of its subsidiaries pursuant to a stock grant, stock option plan, restricted stock agreements, stock purchase plan, pension or profit sharing plan or other stock agreement or arrangement approved by the Company's Board of Directors, (b) the issuance of shares of Stock, Options and/or Convertible Securities pursuant to Options and/or Convertible Securities outstanding as of the date of this Warrant; (c) issuance of shares of Stock and/or Convertible Securities to the Placement Agent in respect of the transaction represented by the subscription agreement related to the issuance of this Warrant; and (d) the issuance of shares of Stock, Options or Convertible Securities as a stock dividend or upon any split or combination of shares of Stock or Convertible Securities. For all purposes of this Section 3.2, all shares of Excluded Stock shall be deemed to have been issued for an amount of consideration per share equal to the initial Stock Purchase Price (subject to adjustment in the manner set forth in Section 3.1).

3.3 Notice of Adjustment. Promptly after adjustment of the Stock Purchase Price or any increase or decrease in the number of shares purchasable upon the exercise of this Warrant, the Company shall give written notice thereof, by first-class mail, postage prepaid, addressed to the registered Holder of this Warrant at the address of such Holder as shown on the books of the Company. The notice shall be signed by the Company's President or Chief Executive Officer and shall state the effective date of the adjustment and the Stock Purchase Price resulting from such adjustment and the increase or decrease, if any, in the number of shares purchasable at such price upon the exercise of this Warrant, setting forth in reasonable detail the method of calculation and the facts upon which such calculation is based.

3.4 Notices. If at any time:  
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3.4.1 the Company shall declare any cash dividend upon its Stock;

3.4.2 the Company shall declare any dividend upon its Stock payable in stock (other than a dividend payable solely in shares of Stock) or make any special dividend or other distribution to the Holder of its Stock;

3.4.3 there shall be any consolidation or merger of the Company with another corporation, or a sale of all or substantially all of the Company's assets to another corporation; or

3.4.4 there shall be a voluntary or involuntary dissolution, liquidation or winding-up of the Company

then, in any one or more of said cases, the Company shall give, by certified or registered mail, postage prepaid, addressed to the registered Holder of this Warrant at the address of such Holder as shown on the books of the Company, (i) at least 30 days prior written notice of the date on which the books of the Company shall close or a record shall be taken for such dividend, distribution or subscription rights or for determining rights to vote in respect of any such dissolution, liquidation or winding-up; (ii) at least 10 days prior written notice of the date on which the books of the Company shall close or a record shall be taken for determining rights to vote in respect of any such reorganization, reclassification, consolidation, merger or sale, and (iii) in the case of any such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding-up, at least 30 days written notice of the date when the same shall take place. Any notice given in accordance with clause (i) above shall also specify, in the case of any such dividend, distribution or option rights, the date on which the Holder of Stock shall be entitled thereto. Any notice given in accordance with clause (iii) above shall also specify the date on which the Holder(s) of Stock shall be entitled to exchange their Stock for securities or other property deliverable upon such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding-up, as the case may be. If the Holder of the Warrant does not exercise this Warrant prior to the occurrence of an event described above, except as provided in Sections 3.1 and 3.5, the Holder shall not be entitled to receive the benefits accruing to existing holders of the Stock in such event. Notwithstanding anything herein to the contrary, if and to the extent the Holder chooses to exercise this Warrant within the 10-day period following receipt of the notice specified in clause (ii) above, the Holder may elect to pay the aggregate Stock Purchase Price by delivering to the Company cash or a cashier's check in the amount of the aggregate par value of the shares of Stock to be purchased and the Holder's full recourse Promissory Note in the amount of the balance of the aggregate Stock Purchase Price, which Note shall be payable to the order of the Company in a single sum on the 30th day following the date of receipt of such notice and shall bear interest at the lowest applicable federal short-term rate (using monthly compounding) as established pursuant to Section 1274(d) of the Internal Revenue Code of 1986, as amended, or any successor provision; provided, however, that if the Holder elects to deliver such a Promissory Note to the Company, the Holder will pledge to the Company all Stock issued in connection with the exercise of this Warrant, and the Company shall retain possession of the certificates evidencing such Stock, until such time as the Note is paid in full.

3.5 Changes in Stock. In case at any time following the Commencement Date hereof, the Company shall be a party to any transaction (including, without limitation, a merger, consolidation, sale of all or substantially all of the Company's assets or recapitalization of the Stock) in which the previously outstanding Stock shall be changed into or exchanged for different securities of the Company or common stock or other securities of another corporation or interests in a noncorporate entity or other property (including cash) or any combination of any of the foregoing (each such transaction being herein called the "Transaction" and the date of consummation of the Transaction being herein called the "Consummation Date"), then as a condition of the consummation of the Transaction, lawful and adequate provisions shall be made so that each Holder, upon the exercise hereof on or before the Consummation Date, shall be entitled to receive, and



this Warrant shall thereafter represent the right to receive, in lieu of the Stock issuable upon such exercise prior to the Consummation Date, the highest amount of securities or other property to which such Holder would actually have been entitled as a stockholder upon the consummation of the Transaction if such Holder had exercised such Warrant immediately prior thereto. The provisions of this Section 3.5 shall similarly apply to successive Transactions.

3.6 Termination of Dilutive Protection. Immediately following the Next Public Offering all antidilution provisions of this Section 3 shall become null, void and of no further force or effect.

4. Issue Tax. The issuance of certificates for shares of Stock upon the exercise of the Warrant shall be made without charge to the Holder of the Warrant for any issue tax in respect thereof, provided, however, that the Company shall not be required to pay any tax which may be payable in respect of any transfer involved in the issuance and delivery of any certificates in a name other than that of the then Holder of the Warrant being exercised.

5. No Voting or Dividend Rights; Limitation of Liability. Nothing contained in this Warrant shall be construed as conferring upon the Holder hereof the right to vote or to consent or to receive notice as a stockholder in respect of meetings of stockholders for the election of directors of the Company or any other matters or any rights whatsoever as a stockholder of the Company. Except for the adjustment to the Stock Purchase Price pursuant to Section 3.1 in the event of a dividend on the Stock payable in shares of Stock, no dividends or interest shall be payable or accrued in respect of this Warrant or the interest represented hereby or the shares purchasable hereunder until, and only to the extent that, this Warrant shall have been exercised. No provisions hereof, in the absence of affirmative action by the Holder to purchase shares of Stock, and no mere enumeration herein of the rights or privileges of the Holder hereof, shall give rise to any liability of such Holder for the Stock Purchase Price or as a stockholder of the Company whether such liability is asserted by the Company or by its creditors.

6. Restrictions on Transferability of Securities; Compliance with Securities Act.  
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6.1 Restrictions on Transferability. This Warrant and the Warrant Shares (the "Securities") shall not be transferable in the absence of Registration under the Act (as defined below) or an exemption therefrom under said Act.

6.2 Restrictive Legend. Each certificate representing the Securities or any other securities issued in respect of the Securities upon any stock split, stock dividend, recapitalization, merger, consolidation or similar event, shall be stamped or otherwise imprinted with a legend substantially in the following form (in addition to any legend required under applicable state securities laws):

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS AND NEITHER THE SECURITIES NOR ANY INTEREST THEREIN MAY BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR SUCH LAWS OR AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT AND SUCH LAWS WHICH, IN THE OPINION OF COUNSEL FOR THE HOLDER, WHICH COUNSEL AND OPINION ARE REASONABLY SATISFACTORY TO COUNSEL FOR THIS COMPANY, IS AVAILABLE.

7. Registration Rights. The Holder of this Warrant shall have the registration rights set forth in the Registration Rights Agreement of even date.

8. Modification and Waiver. This Warrant and any provision hereof may be changed, waived, discharged or terminated only by an instrument in writing signed by the party against which enforcement of the same is sought.

9. Notices. Any notice, request or other document required or permitted to be given or delivered to the Holder hereof or the Company shall be delivered

or shall be sent by certified or registered mail, postage prepaid, to each such Holder at its address as shown on the books of the Company or to the Company at the address indicated therefor in the first paragraph of this Warrant.

10. Description Headings and Governing Law. The descriptive headings of the several sections and paragraphs of this Warrant are inserted for convenience only and do not constitute a part of this Warrant. This Warrant shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the internal laws of the State of Maryland.

11. Lost Warrants or Stock Certificates. The Company represents and warrants to Holder the upon receipt of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of any Warrant or stock certificate and, in the case of any such loss, theft or destruction, and if requested, upon receipt of an indemnity bond reasonably satisfactory to the Company, or in the case of any such mutilation, upon surrender and cancellation of such Warrant or stock certificate, the Company at its expense will make and deliver a new Warrant or stock certificate, of like tenor, in lieu of the lost, stolen, destroyed or mutilated Warrant or stock certificate.

12. Fractional Shares. No fractional shares shall be issued upon exercise of this Warrant. The Company shall, in lieu of issuing any fractional share pay the Holder entitled to such fraction a sum in cash equal to the fair market value of any such fractional interest as it shall appear on the public market, or if there is no public market for such shares, then as shall be reasonably determined by the Company.

IN WITNESS WHEREOF, the Company has caused this Warrant to be executed by its officer, thereunto duly authorized as of this \_\_\_\_ day of \_\_\_\_\_, \_\_\_\_.

CHEUNG LABORATORIES, INC.

By: \_\_\_\_\_

Signature

By: \_\_\_\_\_

Print Name

Title: \_\_\_\_\_

FORM OF SUBSCRIPTION AGREEMENT

(To be signed and delivered upon exercise of Warrant)

[DATE]

Attention: \_\_\_\_\_  
Cheung Laboratories, Inc.  
10220-I Old Columbia Road  
Columbia, Maryland 21046-1705

Dear \_\_\_\_\_:

The undersigned, the Holder of the within Warrant, hereby irrevocably elects to exercise the purchase rights represented by such Warrant for, and to purchase thereunder, \_\_\_\_\_ shares of Common Stock, par value \$0.01 per share (the "Common Stock") of Cheung Laboratories, Inc. (the "Company") and subject to the following paragraph, herewith makes payment of \_\_\_\_\_ Dollars (\$\_\_\_\_\_) therefor and requests that the certificates for such shares be issued in the name of, and delivered to, \_\_\_\_\_ whose address is \_\_\_\_\_.

If the shares issuable upon the exercise of this Warrant are not covered by a registration statement effective under the Securities Act of 1933, as amended, (the "Securities Act"), the undersigned represents as of the date hereof that:

(i) the undersigned is acquiring such Common Stock for investment for his own account, not as nominee or agent, and not with a view to the distribution thereof and the undersigned has not signed or otherwise arranged for the selling, granting any participation in, or otherwise distributing the same,

(ii) the undersigned has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of the undersigned's investment in the Common Stock,

(iii) the undersigned has received all of the information the undersigned has requested from the Company and considers necessary or appropriate for deciding whether to purchase the shares of Common Stock,

(iv) the undersigned has the ability to bear the economic risk of his prospective investment,

(v) the undersigned is able, without materially impairing his financial condition, to hold the shares of Common Stock for an indefinite period of time and to suffer complete loss on his investment,

(vi) the undersigned understands and agrees that (A) he may be unable to readily liquidate his investment in the shares of Common Stock and that the shares must be held indefinitely unless a subsequent disposition thereof is registered or qualified under the Securities Act and applicable state securities or Blue Sky laws or is exempt from such registration or qualification, and that the Company is not required to register the same or to take any action or make such an exemption available except to the extent provided in the within Warrant, and (B) the exemption from registration under the Securities Act afforded by Rule 144 promulgated by the Securities and Exchange Commission ("Rule 144") depends upon the satisfaction of various

conditions by the undersigned and the Company and that, if applicable, Rule 144 affords the basis for sales under certain circumstances in limited amounts, and that if such exemption is utilized by the undersigned, such conditions must be fully complied with by the undersigned and the Company, as required by Rule 144,

(vii) the undersigned is (A) familiar with the definition of and the undersigned is an "accredited investor" within the meaning of such term under Rule 501 of Regulation D promulgated under the Securities Act, or (B) is providing representations and warranties reasonably satisfactory to the Company and its counsel, to the effect that the sale and issuance of Common Stock upon exercise of such Warrant may be made without registration under the Securities Act or any applicable state securities and Blue Sky laws, and

(viii) the address set forth above is the true and correct address of the undersigned's residence.

Dated: \_\_\_\_\_

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Signature

Signature must conform in all respects to the name of Holder as specified on the face of the Warrant.

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED OR ANY STATE SECURITIES LAWS AND NEITHER THE SECURITIES NOR ANY INTEREST THEREIN MAY BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR SUCH LAWS OR AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT AND SUCH LAWS WHICH, IN THE OPINION OF COUNSEL FOR THE HOLDER, WHICH COUNSEL AND OPINION ARE REASONABLY SATISFACTORY TO COUNSEL FOR THIS CORPORATION, IS AVAILABLE.

WARRANT TO PURCHASE SHARES OF COMMON  
STOCK OF CHEUNG LABORATORIES, INC.

This certifies that \_\_\_\_\_ (the "Holder"), for a value received, is entitled, subject to the adjustment and to the other terms set forth below, to purchase from Cheung Laboratories, Inc., a Maryland corporation (the "Company"), at the Stock Purchase Price (as defined below) \_\_\_\_\_ shares of fully paid and nonassessable shares of the Company's \$0.01 par value Common Stock (the "Stock") of the Company. The Stock Purchase Price shall be the average price of the common stock of the public or private offerings conducted subsequent to the offering set forth in the Memorandum of the Company dated January 6, 1997 and ending December 27, 1997 by the Company which raise, in the aggregate, not less than \$8,000,000 (hereafter collectively referred to as the "Offering"). This Warrant shall be exercisable at any time on and after six months from the date of the next public stock offering ("Next Public Offering") of the Company (the "Commencement Date") but not later than 5:00 P.M. (New York Time) on the Expiration Date (as defined below), upon surrender to the Company at its principle office at 10220-I Old Columbia Road, Columbia, Maryland 21046-1705, Attention: Dr. Augustine Cheung, Chairman of the Board of Directors (or at such other location as the Company may advise Holder in writing) of this Warrant properly endorsed with the form of Subscription Agreement attached hereto duly filled in and signed and upon payment in cash or cashier's check of the aggregate Stock Purchase Price for the number of shares for which this Warrant is being exercised determined in accordance with the provisions hereof. The Stock Purchase Price and, in some cases, the number of shares purchasable hereunder are subject to adjustment as provided in Section 3 of this Warrant. This Warrant and all rights hereunder, to the extent not exercised in the manner set forth herein shall terminate and become null and void on the Expiration Date. "Expiration Date" means 5:00 P.M. (New York Time) on the fifth anniversary

of the Commencement Date. In the event that the Holder does not exercise this Warrant pursuant to the terms of this Warrant, then this Warrant shall expire, be cancelled, and be null and void.

This Warrant is subject to the following terms and conditions:

1. Exercise: Issuance of Certificates; Payment for Shares; Conversion Right.  
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1.1 Duration of Exercise of Warrant. This Warrant is exercisable at the option of the Holder at any time or from time to time but not earlier than on the Commencement Date or later than 5:00 P.M. (New York Time) on the Expiration Date for all or a portion of the shares of Stock which may be purchased hereunder. The Company agrees that the shares of Stock purchased under this Warrant shall be and are deemed to be issued to Holder as the record owner of such shares at the close of business on the date on which this Warrant shall have been surrendered and payment made for such shares. Subject to the provisions of Section 2, certificates for the shares of Stock so purchased, together with any other securities or property to which Holder is entitled upon such exercise, shall be delivered to Holder by the Company or its transfer agent at the Company's expense within a reasonable time after the rights represented by this Warrant have been exercised. Each stock certificate so delivered shall be in such denominations of Stock as may be requested by Holder and shall be registered in the name of Holder or such other name as shall be designated by Holder. If, upon exercise of this Warrant, fewer than all of the shares of Stock evidenced by this Warrant are purchased prior to the Expiration Date of this Warrant, one or more new warrants substantially in the form of, and on the terms in, this Warrant will be issued for the remaining number of shares of Stock not purchased upon exercise of this Warrant.

2. Shares to Be Fully Paid: Reservation of Shares. The Company covenants and agrees that all shares of Stock which may be issued upon the exercise of this Warrant (the "Warrant Shares") shall, upon issuance, be duly authorized, validly issued, fully paid and nonassessable and free from all preemptive rights of any stockholder and free of all taxes, liens, and charges with respect to the issuance thereof. The Company will take all such reasonable actions as may be necessary to assure that such shares of Stock may be issued as provided herein without violation of any applicable law or regulation, or of any requirements of any domestic securities exchange or automated quotation system upon which the Stock may be listed.

3. Adjustment of Stock Purchase Price and Number of Shares. The Stock Purchase Price and, in some cases, the number of shares purchasable upon the exercise of this Warrant shall be subject to adjustment from time to time upon

the occurrence of certain events described in this Section 3.

3.1 Split or Combination of Stock and Stock Dividend: In case the Company shall at any time subdivide its outstanding shares of Stock into a greater number of shares or declare a dividend upon its Stock payable solely in shares of Stock, the Stock Purchase Price in effect immediately prior to such subdivision or declaration shall be proportionally reduced, and the number of shares issuable upon exercise of the Warrant shall be proportionately increased. Conversely, in case the outstanding shares of Stock of the Company shall be combined into a smaller number of shares (such as a reverse stock split), the Stock Purchase Price in effect immediately prior to such combination shall be proportionately increased, and the number of shares issuable upon exercise of the Warrant shall be proportionately reduced.

3.2 Dilutive Issuances. If prior to completion of the Company's Next Public Offering, the Company shall sell or issue at any time after the date of this Warrant and prior to its termination, shares of Stock (other than Excluded Stock, as defined in Section 3.2.5) at a consideration per share less than the Stock Purchase Price, then, upon such sale or issuance, the Stock Purchase Price shall be reduced to the lower of the prices (calculated to the nearest cent) determined as follows: by dividing (i) the sum of (A) the total number of shares of Stock Outstanding (as defined in Section 3.2.1) below and subject to adjustment in the manner set forth in Section 3.1) immediately prior to such issuance or sale multiplied by the then-existing Stock Purchase Price, plus (B) the aggregate of the amount of all consideration, if any, received by the Company upon such issuance or sale, by (ii) the total number of shares of Stock Outstanding immediately after such issuance or sale.

3.2.1 Definitions. For purposes of this Section 3.2, the following definitions shall apply:

(a) "Convertible Securities" shall mean any indebtedness or equity securities convertible into or exchangeable for Stock.

(b) "Options" shall mean any rights, warrants or options to subscribe for or purchase Stock or Convertible Securities.

(c) "Stock Outstanding: shall mean the aggregate of all Stock of the Company outstanding and all Stock issuable upon exercise of all outstanding Options and conversion of all outstanding Convertible Securities.

3.2.2 For the purposes of this Section 3.2, the following provisions shall also be applicable:

(a) Cash Consideration. In the case of the issuance or sale of additional Stock for cash, the

consideration received by the Company therefor shall be deemed to be the amount of cash received by the Company for such shares (or, if such shares are offered by the Company for subscription, the subscription price, or, if such shares are sold to underwriters or dealers for public offering without a subscription offering, the public offering price), without deducting therefrom any compensation or discount paid or allowed to underwriters or dealers or others performing similar services or for any expenses incurred in connection therewith.

(b) Non-Cash Consideration. In case of the issuance (other than upon conversion or exchange of Convertible Securities) or sale of additional Stock, Options or Convertible Securities for a consideration other than cash or a consideration a part of which shall be other than cash, the fair market value of such consideration as determined by the Board of Directors of the Company in the good faith exercise of its business judgment, irrespective of the accounting treatment thereof, shall be deemed to be the value, for purposes of this Section 3, of the consideration other than cash received by the Company for such securities.

(c) Options and Convertible Securities. In case the Company shall in any manner issue or grant any Options or any Convertible Securities, the total maximum number of shares of Stock issuable upon the exercise of such Options or upon conversion or exchange of the total maximum amount of such Convertible Securities at the time such Convertible Securities first become convertible or exchangeable shall (as of the date of issue or grant of such Options or, in the case of the issue or sale of Convertible Securities other than where the same are issuable upon the exercise of Options, as of the date of such issue or sale) be deemed to be issued and to be outstanding for the purpose of this Section 3.2 and to have been issued for the sum of the amount (if any) paid for such Options or Convertible Securities plus the amount (if any) payable upon the exercise of such Options or upon conversion or exchange of such Convertible Securities at the time such Convertible Securities first become convertible or exchangeable; provided that, subject to the provisions of Section 3.2.3, no further adjustment of the Stock Purchase Price shall be made upon the actual issuance of any such Stock or Convertible Securities or upon the conversion or exchange of any such Convertible Securities.

3.2.3 Change in Option Price or Conversion. In the event that the purchase price provided for in any Option referred to in subsection 3.2.2.(c), or the rate at which any



Convertible Securities referred to in subsection 3.2.2.(c) are convertible into or exchangeable for shares of Stock shall change at any time or any additional consideration shall be payable in connection with the exercise of any Option or the conversion or exchange of any Convertible Security (other than under or by reason of provisions designed to protect against dilution upon the occurrence of events of the type described in this Section 3), then, for purposes of any adjustment required by Section 3.2, the Stock Purchase Price in effect at the time of such event shall forthwith be readjusted to the Stock Purchase Price that would have been in effect at such time had such Options or Convertible Securities still outstanding provided for such changed purchase price, conversion rate or additional consideration, as the case may be, at the time initially granted, issued or sold, provided that if such readjustment is an increase in the Stock Purchase Price, such readjustment shall not exceed the amount (as adjusted by Sections 3.2 and 3.2) by which the Stock Purchase Price was decreased pursuant to Section 3.2 upon the issuance of the Option or Convertible Security.

3.2.4 Termination of Option or Conversion Rights. In the event of the termination or expiration of any right to purchase Stock under any Option granted after the date of this Warrant or of any right to convert or exchange Convertible Securities issued after the date of this Warrant, the Stock Purchase Price shall, upon such termination, be readjusted after the Stock Purchase Price that would have been in effect at the time of such expiration or termination had such Option or Convertible Security, to the extent outstanding immediately prior to such expiration or termination, never been issued, and the shares of Stock issuable thereunder shall not longer be deemed to be Stock Outstanding, provided that if such readjustment is an increase in the Stock Purchase Price, such readjustment shall not exceed the amount (as adjusted by Sections 3.1 and 3.2) by which the Stock Purchase Price was decreased pursuant to Section 3.2 upon the issuance of the Option or Convertible Security. The termination or expiration of any right to purchase Stock under any Option granted prior to the date of this Warrant or of any right to convert or exchange Convertible Securities issued prior to the date of this Warrant shall not trigger any adjustment to the Stock Purchase Price, but the shares of Stock issuable under such Options or Convertible Securities shall not longer be counted in determining the number of shares of Stock Outstanding on the date of issuance of this Warrant for purposes of subsequent calculations under this Section 3.2

3.2.5 Excluded Stock. Notwithstanding anything herein to the contrary, the Stock Purchase Price shall not be adjusted pursuant to this Section 3.2 by virtue of the issuance and/or sale of Excluded Stock, which shall mean the following: (a) Stock, Options or Convertible Securities representing up to 2,000,000 shares of Stock (or such greater number of shares of Stock as authorized by the Board of

Directors) in the aggregate to be issued and/or sold to employees, advisors, directors or officers of, or consultants to, the Company or any of its subsidiaries pursuant to a stock grant, stock option plan, restricted stock agreements, stock purchase plan, pension or profit sharing plan or other stock agreement or arrangement approved by the Company's Board of Directors, (b) the issuance of shares of Stock, Options and/or Convertible Securities pursuant to Options and/or Convertible Securities outstanding as of the date of this Warrant; (c) issuance of shares of Stock and/or Convertible Securities to the Placement Agent in respect of the transaction represented by the subscription agreement related to the issuance of this Warrant; and (d) the issuance of shares of Stock, Options or Convertible Securities as a stock dividend or upon any split or combination of shares of Stock or Convertible Securities. For all purposes of this Section 3.2, all shares of Excluded Stock shall be deemed to have been issued for an amount of consideration per share equal to the initial Stock Purchase Price (subject to adjustment in the manner set forth in Section 3.1).

3.3 Notice of Adjustment. Promptly after adjustment of the Stock Purchase Price or any increase or decrease in the number of shares purchasable upon the exercise of this Warrant, the Company shall give written notice thereof, by first-class mail, postage prepaid, addressed to the registered Holder of this Warrant at the address of such Holder as shown on the books of the Company. The notice shall be signed by the Company's President or Chief Executive Officer and shall state the effective date of the adjustment and the Stock Purchase Price resulting from such adjustment and the increase or decrease, if any, in the number of shares purchasable at such price upon the exercise of this Warrant, setting forth in reasonable detail the method of calculation and the facts upon which such calculation is based.

3.4 Notices. If at any time:

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3.4.1 the Company shall declare any cash dividend upon its Stock;

3.4.2 the Company shall declare any dividend upon its Stock payable in stock (other than a dividend payable solely in shares of Stock) or make any special dividend or other distribution to the Holder of its Stock;

3.4.3 there shall be any consolidation or merger of the Company with another corporation, or a sale of all or substantially all of the Company's assets to another corporation; or

3.4.4 there shall be a voluntary or involuntary dissolution, liquidation or winding-up of the Company

then, in any one or more of said cases, the Company shall give, by certified or registered mail, postage prepaid, addressed to the registered Holder of this Warrant at the address of such Holder as shown on the books of the Company, (i) at least 30 days prior written notice of the date on which the books of the Company shall close or a record shall be taken for such dividend, distribution or subscription rights or for determining rights to vote in respect of any such dissolution, liquidation or winding-up; (ii) at least 10 days prior written notice of the date on which the books of the Company shall close or a record shall be taken for determining rights to vote in respect of any such reorganization, reclassification, consolidation, merger or sale, and (iii) in the case of any such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding-up, at least 30 days written notice of the date when the same shall take place. Any notice given in accordance with clause (i) above shall also specify, in the case of any such dividend, distribution or option rights, the date on which the Holder of Stock shall be entitled thereto. Any notice given in accordance with clause (iii) above shall also specify the date on which the Holder(s) of Stock shall be entitled to exchange their Stock for securities or other property deliverable upon such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding-up, as the case may be. If the Holder of the Warrant does not exercise this Warrant prior to the occurrence of an event described above, except as provided in Sections 3.1 and 3.5, the Holder shall not be entitled to receive the benefits accruing to existing holders of the Stock in such event. Notwithstanding anything herein to the contrary, if and to the extent the Holder chooses to exercise this Warrant within the 10-day period following receipt of the notice specified in clause (ii) above, the Holder may elect to pay the aggregate Stock Purchase Price by delivering to the Company cash or a cashier's check in the amount of the aggregate par value of the shares of Stock to be purchased and the Holder's full recourse Promissory Note in the amount of the balance of the aggregate Stock Purchase Price, which Note shall be payable to the order of the Company in a single sum on the 30th day following the date of receipt of such notice and shall bear interest at the lowest applicable federal short-term rate (using monthly compounding) as established pursuant to Section 1274(d) of the Internal Revenue Code of 1986, as amended, or any successor provision; provided, however, that if the Holder elects to deliver such a Promissory Note to the Company, the Holder will pledge to the Company all Stock issued in connection with the exercise of this Warrant, and the Company shall retain possession of the certificates evidencing such Stock, until such time as the Note is paid in full.

3.5 Changes in Stock. In case at any time following the Commencement Date hereof, the Company shall be a party to any transaction (including, without limitation, a merger, consolidation, sale of all or substantially all of the Company's assets or recapitalization of the Stock) in which the previously outstanding Stock shall be changed into or exchanged for different securities of the Company or common stock or other securities of another corporation or interests in a noncorporate entity or other property (including

cash) or any combination of any of the foregoing (each such transaction being herein called the "Transaction" and the date of consummation of the Transaction being herein called the "Consummation Date"), then as a condition of the consummation of the Transaction, lawful and adequate provisions shall be made so that each Holder, upon the exercise hereof on or before the Consummation Date, shall be entitled to receive, and this Warrant shall thereafter represent the right to receive, in lieu of the Stock issuable upon such exercise prior to the Consummation Date, the highest amount of securities or other property to which such Holder would actually have been entitled as a stockholder upon the consummation of the Transaction if such Holder had exercised such Warrant immediately prior thereto. The provisions of this Section 3.5 shall similarly apply to successive Transactions.

3.6 Termination of Dilutive Protection. Immediately following the Next Public Offering all antidilution provisions of this Section 3 shall become null, void and of no further force or effect.

4. Issue Tax. The issuance of certificates for shares of Stock upon the exercise of the Warrant shall be made without charge to the Holder of the Warrant for any issue tax in respect thereof, provided, however, that the Company shall not be required to pay any tax which may be payable in respect of any transfer involved in the issuance and delivery of any certificates in a name other than that of the then Holder of the Warrant being exercised.

5. No Voting or Dividend Rights; Limitation of Liability. Nothing contained in this Warrant shall be construed as conferring upon the Holder hereof the right to vote or to consent or to receive notice as a stockholder in respect of meetings of stockholders for the election of directors of the Company or any other matters or any rights whatsoever as a stockholder of the Company. Except for the adjustment to the Stock Purchase Price pursuant to Section 3.1 in the event of a dividend on the Stock payable in shares of Stock, no dividends or interest shall be payable or accrued in respect of this Warrant or the interest represented hereby or the shares purchasable hereunder until, and only to the extent that, this Warrant shall have been exercised. No provisions hereof, in the absence of affirmative action by the Holder to purchase shares of Stock, and no mere enumeration herein of the rights or privileges of the Holder hereof, shall give rise to any liability of such Holder for the Stock Purchase Price or as a stockholder of the Company whether such liability is asserted by the Company or by its creditors.

6. Restrictions on Transferability of Securities; Compliance with Securities Act.

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6.1 Restrictions on Transferability. This Warrant and the Warrant Shares (the "Securities") shall not be transferable in the absence of Registration under the Act (as defined below) or an exemption therefrom under said Act.

6.2 Restrictive Legend. Each certificate representing the Securities or any other securities issued in respect of the Securities

upon any stock split, stock dividend, recapitalization, merger, consolidation or similar event, shall be stamped or otherwise imprinted with a legend substantially in the following form (in addition to any legend required under applicable state securities laws):

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS AND NEITHER THE SECURITIES NOR ANY INTEREST THEREIN MAY BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR SUCH LAWS OR AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT AND SUCH LAWS WHICH, IN THE OPINION OF COUNSEL FOR THE HOLDER, WHICH COUNSEL AND OPINION ARE REASONABLY SATISFACTORY TO COUNSEL FOR THIS COMPANY, IS AVAILABLE.

7. Registration Rights. The Holder of this Warrant shall have the registration rights set forth in the Registration Rights Agreement of even date.

8. Modification and Waiver. This Warrant and any provision hereof may be changed, waived, discharged or terminated only by an instrument in writing signed by the party against which enforcement of the same is sought.

9. Notices. Any notice, request or other document required or permitted to be given or delivered to the Holder hereof or the Company shall be delivered or shall be sent by certified or registered mail, postage prepaid, to each such Holder at its address as shown on the books of the Company or to the Company at the address indicated therefor in the first paragraph of this Warrant.

10. Description Headings and Governing Law. The descriptive headings of the several sections and paragraphs of this Warrant are inserted for convenience only and do not constitute a part of this Warrant. This Warrant shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the internal laws of the State of Maryland.

11. Lost Warrants or Stock Certificates. The Company represents and warrants to Holder the upon receipt of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of any Warrant or stock certificate and, in the case of any such loss, theft or destruction, and if requested, upon receipt of an indemnity bond reasonably satisfactory to the Company, or in the case of any such mutilation, upon surrender and cancellation of such Warrant or stock certificate, the Company at its expense will make and deliver a new Warrant or stock certificate, of like tenor, in lieu of the lost, stolen, destroyed or mutilated Warrant or stock certificate.

12. Fractional Shares. No fractional shares shall be issued upon exercise of this Warrant. The Company shall, in lieu of issuing any fractional share pay the Holder entitled to such fraction a sum in cash equal to the fair market value of any such fractional interest as it shall appear on the public market, or if there is no public market for such shares, then as shall be reasonably determined by the Company.

IN WITNESS WHEREOF, the Company has caused this warrant to be executed by its officer, thereunto duly authorized as of this \_\_\_\_ day of \_\_\_\_\_, \_\_\_\_.

CHEUNG LABORATORIES, INC.

By: \_\_\_\_\_  
Signature

By: \_\_\_\_\_  
Print Name  
Title: \_\_\_\_\_

PURCHASE FORM

Dated: \_\_\_\_\_

Cheung Laboratories, Inc.  
10220-1 Old Columbia Road  
Columbia, MD 21046-1705

Attention: Mr. John Mon, General Manager

Attached herewith is Cheung Laboratories, Inc.'s Common Stock Purchase Warrant, Serial Number: \_\_\_\_\_, giving the Holder the right to purchase \_\_\_\_\_ shares.

I/We hereby notify you that I/we are exercising my/our right to purchase \_\_\_\_\_ shares and have enclosed herewith my/our check in the amount of \$\_\_\_\_\_, representing the aggregate exercise price of said shares. If transfer taxes (federal or state) are applicable to this transaction, I/we understand that you will be billing me/us for said taxes, which I/we agree will be promptly remitted to you within ten (10) days of my/our receipt of notification.

I/We hereby state that the shares being purchased are to be held by me/us for investment purposes and not with a view to sale, except pursuant to an effective registration statement or an exemption therefrom.

Please cancel the enclosed warrant and, if applicable, send me/us a Warrant, in partial substitution on identical terms, for the remaining shares not being purchased pursuant to this notification.

Yours very truly,

Holder of Warrant, Serial Number \_\_\_\_\_

- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_  
- \_\_\_\_\_

Void after 5:00 p.m., New York Time, on May 15, 2001(unless extended as provided below)

Option to Purchase certain  
Shares of Common Stock,  
dated May 16, 1996.

CERTIFICATE OF  
OPTION TO PURCHASE COMMON STOCK  
OF  
CHEUNG LABORATORIES, INC.

This Is To Certify That, FOR VALUE RECEIVED, \_\_\_\_\_, his/her nominees, or assigns (hereinafter, the "Holder(s)") are entitled to purchase, subject to the provisions of this Option (its successors, divisions or additions), from Cheung Laboratories, Inc., a corporation duly organized, in good standing within its domicile, and whose offices as of the date hereof are at 10220-I Old Columbia Road, Columbia, MD 21046 (hereinafter, the "Company"), \_\_\_\_\_( )shares of restricted and legended common stock of the Company ("Common Stock") at a purchase price (the "Stock Purchase Price") equal to Thirty Five Cents (\$00.35 U.S.)per share in such amounts and at such times as are provided herein. The Stock Purchase Price and, in some cases, the number of shares purchasable hereunder are subject to adjustment as provided in Section 3 of this Option. This Option shall be exercisable in whole or in part at any time after May 16, 1996 (the " Commencement Date"), unless extended in accordance with Section 9, not later than 5:00 P.M. (New York Time) on the Expiration Date (as defined below), upon surrender to the Company at its principle office at 10220-I Old Columbia Road, Columbia, Maryland 21046-1705, Attention: Chairman of the Board of Directors (or at such other location as the Company may advise Holder(s) in writing) of this Option properly endorsed with the form of Subscription Agreement attached hereto duly filled in and signed and upon payment in cash or cashier's check of the aggregate Stock Purchase Price for the number of shares for which this Option is being exercised determined in accordance with the provisions hereof. Unless extended in accordance with Section 9, this Option and all rights hereunder, to the extent not exercised in the manner set forth herein shall terminate and become null and void on the Expiration Date."Expiration Date" means 5:00 P.M. (New York Time) on the fifth anniversary of the Commencement Date. In the event that the Holder(s) does not exercise this Option pursuant to the terms of this Option, then this Option shall expire, be canceled, and be null and void.

This Option is subject to the following terms and conditions:

1. Exercise: Issuance of Certificates; Payment for Shares; Conversion Right.

1.1 Duration of Exercise of Option. This Option is exercisable at the option of the Holder(s) at any time or from time to time after the Commencement Date but not later than 5:00 P.M. (New York Time) on the Expiration Date(unless extended in accordance with Section 9), for all or a portion of the shares of Stock which may be purchased hereunder. The Company agrees that the shares of Stock purchased under this Option shall be and are deemed to be issued to Holder(s) as the record owner of such shares at the close of business on the date on which this Option shall have been surrendered and payment made for such shares. Subject to the provisions of Section 2, certificates for the shares of Stock so purchased, together with any other securities or property to which Holder(s) is entitled upon such exercise, shall be delivered to Holder(s) by the Company or its transfer agent at the Company's expense within a reasonable time after the rights represented by this Option have been exercised. Each stock certificate so delivered shall be in such denominations of Stock as may be requested by

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Holder(s) and shall be registered in the name of Holder(s) or such other name as shall be designated by Holder(s). If, upon exercise of this Option, fewer than all of the shares of Stock evidenced by this Option are purchased prior to the Expiration Date of this Option, one or more new options substantially in the form of, and on the terms in, this Option will be issued for the remaining number of shares of Stock not purchased upon exercise of this Option.

2. Shares to Be Fully Paid: Reservation of Shares. The Company covenants and agrees that all shares of Stock which may be issued upon the exercise of this Option (the "Option Shares") shall, upon issuance, be duly authorized, validly issued, fully paid and nonassessable and free from all preemptive rights of any stockholder and free of all taxes, liens, and charges with respect to the issuance thereof. The Company will take all such reasonable actions as may be necessary to assure that such shares of Stock may be issued as provided herein without violation of any applicable law or regulation, or of any requirements of any domestic securities exchange or automated quotation system upon which the Stock may be listed.

3. Adjustment of Stock Purchase Price and Number of Shares. The Stock Purchase Price and, in some cases, the number of shares purchasable upon the exercise of this Option shall be subject to adjustment from time to time upon the occurrence of certain events described in this Section 3.

3.1 Split or Combination of Stock and Stock Dividend: In case



the Company shall at any time subdivide its outstanding shares of Stock into a greater number of shares or declare a dividend upon its Stock payable solely in shares of Stock, the Stock Purchase Price in effect immediately prior to such subdivision or declaration shall be proportionally reduced, and the number of shares issuable upon exercise of the Option shall be proportionately increased. Conversely, in case the outstanding shares of Stock of the Company shall be combined into a smaller number of shares (such as a reverse stock split, but not to include the anticipated redemption of 20,000,000 shares of stock from Mr. Gao Yu Wen) the Stock Purchase Price in effect immediately prior to such combination shall be proportionately increased, and the number of shares issuable upon exercise of the Option shall be proportionately reduced.

3.2 Dilutive Issuances. If prior to completion of the Company's Next Public Offering, the Company shall sell or issue at any time after the Commencement Date of this Option and prior to its termination, shares of Common Stock at a consideration per share less than \$00.35, or convertible securities with conversion rate less than \$00.35 per share, or Warrants or Options with strike price less than \$00.35 per share, then, upon such sale or issuance, the Stock Purchase Price shall be reduced to the lowest of the above.

3.3 Notice of Adjustment. Promptly after adjustment of the Stock Purchase Price or any increase or decrease in the number of shares purchasable upon the exercise of this Option, the Company shall give written notice thereof, by first-class mail, postage prepaid, addressed to the registered Holder(s) of this Option at the address of such Holder(s) as shown on the books of the Company. The notice shall be signed by the Company's President or Chief Executive Officer and shall state the effective date of the adjustment and the Stock Purchase Price resulting from such adjustment and the increase or decrease, if any, in the number of shares purchasable at such price upon the exercise of this Option, setting forth in reasonable detail the method of calculation and the facts upon which such calculation is based.

3.4 Notices. If at any time:

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3.4.1 the Company shall declare any cash dividend upon its Stock;

3.4.2 the Company shall declare any dividend upon its Stock payable in stock (other than a dividend payable solely in shares of Stock) or make any special dividend or other distribution to the Holder of its Stock;

3.4.3 there shall be any consolidation or merger of the Company with another corporation, or a sale of all or substantially all of the Company's assets to another corporation; or

3.4.4 there shall be a voluntary or involuntary dissolution, liquidation or winding-up of the Company

then, in any one or more of said cases, the Company shall give, by certified or registered mail, postage prepaid, addressed to the registered Holder(s) of this Option at the address of such Holder(s) as shown on the books of the Company, (i) at least 30 days prior written notice of the date on which the books of the Company shall close or a record shall be taken for such dividend, distribution or subscription rights or for determining rights to vote in respect of any such dissolution, liquidation or winding-up; (ii) at least 10 days prior written notice of the date on which the books of the Company shall close or a record shall be taken for determining rights to vote in respect of any such reorganization, reclassification, consolidation, merger or sale, and (iii) in the case of any such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding-up, at least 30 days written notice of the date when the same shall take place. Any notice given in accordance with clause (i) above shall also specify, in the case of any such dividend, distribution or option rights, the date on which the Holder of Stock shall be entitled thereto. Any notice given in accordance with clause (iii) above shall also specify the date on which the Holder(s) of Stock shall be entitled to exchange their Stock for securities or other property deliverable upon such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding-up, as the case may be. If the Holder(s) of the Option does not exercise this Option prior to the occurrence of an event described above, except as provided in Sections 3.1 and 3.5, the Holder(s) shall not be entitled to receive the benefits accruing to existing holders of the Stock in such event. Notwithstanding anything herein to the contrary, if and to the extent the Holder(s) chooses to exercise this Option within the 10-day period following receipt of the notice specified in clause (ii) above, the Holder(s) may elect to pay the aggregate Stock Purchase Price by delivering to the Company cash or a cashier's check in the amount of the aggregate par value of the shares of Stock to be purchased and the Holder's full recourse Promissory Note in the amount of the balance of the aggregate Stock Purchase Price, which Note shall be payable to the order of the Company in a single sum on the 30th day following the date of receipt of such notice and shall bear interest at the lowest applicable federal short-term rate (using monthly compounding) as established pursuant to Section 1274(d) of the Internal Revenue Code of 1986, as amended, or any successor provision; provided, however, that if the Holder(s) elects to deliver such a Promissory Note to the Company, the Holder(s) will pledge to the Company all Stock issued in connection with the exercise of this Option, and the Company shall retain possession of the certificates evidencing such Stock, until such time as the Note is paid in full.

3.5 Changes in Stock. In case at any time following the Commencement Date hereof, the Company shall be a party to any transaction (including, without limitation, a merger, consolidation, sale of all or substantially all of the Company's assets or recapitalization of the Stock) in which the previously outstanding Stock shall be changed into or exchanged for different securities of the Company or common stock or other securities of another corporation or interests in a noncorporate entity or other property (including cash) or any combination of any of the foregoing (each such transaction being herein called the "Transaction" and the date of consummation of the Transaction being herein called the "Consummation Date"), then as a condition of the consummation of the Transaction, lawful and adequate provisions shall be made so that each Holder, upon the exercise hereof on or before the Consummation Date, shall be entitled to receive, and this Option shall thereafter represent the right to receive, in lieu of the Stock issuable upon such exercise prior to the Consummation Date, the highest amount of securities or other property to which such Holder would actually have been entitled as a stockholder upon the consummation of the Transaction if such Holder had exercised such Option immediately prior thereto. The provisions of this Section 3.5 shall similarly apply to successive Transactions.

4. Issue Tax. The issuance of certificates for shares of Stock upon the exercise of the Option shall be made without charge to the Holder(s) of the Option for any issue tax in respect thereof, provided, however, that the Company shall not be required to pay any tax which may be payable in respect of any transfer involved in the issuance and delivery of any certificates in a name other than that of the then Holder(s) of the Option being exercised.

5. No Voting or Dividend Rights; Limitation of Liability. Nothing contained in this Option shall be construed as conferring upon the Holder(s) hereof the right to vote or to consent or to receive notice as a stockholder in respect of meetings of stockholders for the election of directors of the Company or any other matters or any rights whatsoever as a stockholder of the Company. Except for the adjustment to the Stock Purchase Price pursuant to Section 3.1 in the event of a dividend on the Stock payable in shares of Stock, no dividends or interest shall be payable or accrued in respect of this Option or the interest represented hereby or the shares purchasable hereunder until, and only to the extent that, this Option shall have been exercised. No provisions hereof, in the absence of affirmative action by the Holder(s) to purchase shares of Stock, and no mere enumeration herein of the rights or privileges of the Holder(s) hereof, shall give rise to any liability of such Holder(s) for the Stock Purchase Price or as a stockholder of the Company whether such liability is asserted by the Company or by its creditors.

6. Exchange, Assignment or Loss of Option. Subject to applicable securities laws and the terms of the legend set forth in Section 7.2 hereof, this Option certificate is fully exchangeable and (by definition) assignable, without expense, at the option of the Holder(s), upon presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, for other Option certificates of different denominations entitling the Holder(s) hereof to purchase in the aggregate the same number of shares of Common Stock purchasable hereunder.

Any assignment hereof shall be made by surrender of this Option to the Company or at the office of its stock transfer agent, if any, with a written, executed assignment, instructions and funds sufficient to pay transfer tax (if any); whereupon the Company shall, without charge, execute and deliver a new Option certificate in the name of the assignee(s) named in such instrument of assignment and this Option certificate shall promptly be canceled. This Option may be divided upon presentation hereof at the office of the Company or at the office of its stock transfer agent, if any, together with a written notice, specifying the names and denominations in which new Options are to be issued, and signed by the Holder hereof. The terms "Option" and "Options" as used herein include any Options issued in substitution for or replacement of this Option, or into which this Option may be divided or exchanged.

Upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of this Option, and, in the case of loss, theft or destruction, of reasonably satisfactory indemnification, and upon surrender and cancellation of this Option, if mutilated, the Company will execute and deliver a new Option of like tenure and date. Any such new Option executed and delivered shall constitute an additional contractual obligation on the part of the Company, whether or not this Option so lost, stolen, destroyed or mutilated shall be at any time enforceable by anyone. Nevertheless, neither the Company or the Holder(s) anticipate that this Option or any successor Option shall itself be registered (rather than the underlying shares shall be registered), the Company shall not impose unreasonable burdens on the Holder(s) with respect to indemnification if same becomes necessary.

7. Restrictions on Transferability of Securities; Compliance with Securities Act.  
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7.1 Restrictions on Transferability. This Option or the Option Stock or any other security issued or issuable upon exercise of this Option may not be sold, transferred or otherwise disposed of except to a person who, in the opinion of counsel reasonably satisfactory to the Company, is a person to whom this Option or such Option Stock may legally be transferred pursuant to this Section 6 hereof without registration and without the delivery of a current prospectus under the Securities Act with respect thereto; and then only against receipt by the Company of an agreement from such person to comply with the provisions of this Section 7 with respect to any resale or other disposition of such securities.

7.2 Restrictive Legend. Each certificate representing the Securities or any other securities issued in respect of the Securities upon any stock split, stock dividend, recapitalization, merger, consolidation or similar event, shall be stamped or otherwise imprinted with a legend substantially in the following form (in addition to any legend required under applicable state securities laws):

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS AND NEITHER THE SECURITIES NOR ANY INTEREST THEREIN MAY BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR SUCH LAWS OR AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT AND SUCH LAWS WHICH, IN THE OPINION OF COUNSEL FOR THE HOLDER, WHICH COUNSEL AND OPINION ARE REASONABLY SATISFACTORY TO COUNSEL FOR THIS COMPANY, IS AVAILABLE.

8. Registration Rights. The Holder(s) of this Option shall have the registration rights set forth as follows:

8.1 Demand Registration. If at any time, after the Next Public Offering of registered Common Shares of the Company the Holder(s) shall decide to sell or otherwise dispose of Option Stock then owned or to be owned upon intended exercise of this Option by the Holder(s), then the Holder(s) may give written notice to the Company of the proposed disposition, specifying the number of shares of Option Stock to be sold or disposed of and requesting that the Company prepare and file a registration statement under the Securities Act of 1933, as amended (the "Securities Act"), covering such Option Stock.

The Company shall within 10 days thereafter give written notice to the other Holders of Option or Option Stock of such request and each of the other Holders shall have the option for a period of 30 days after receipt by it (them) of notice from the Company to include its (their) Option Stock in such registration statement. The Company shall use its best efforts to cause an appropriate registration statement (the "Registration Statement") covering such Option Stock to be filed with the Securities and Exchange Commission (the "Commission") and to become effective as soon as reasonably practicable and to remain effective until the completion of the distribution of the Option Stock to be offered or sold; provided, however, that not more than once in any twelve month period the Company shall have the right to postpone for a period of up to 60 days any demand made pursuant to this Option if the underwriters for such offering advise the Company in writing that market conditions make such a postponement advisable to the Company.

The Holder(s) whose Option Stock is (are) included in a Registration Statement is (are) hereinafter referred to as the "Selling Shareholder(s)".

Each notice delivered by a Selling Shareholder(s) to the Company pursuant to this Section 8.1 shall specify the Option Stock intended to be offered and sold by such Selling Shareholder(s), express such Selling Shareholder(s) present intent to offer such Common Shares for distribution, and contain the undertaking of such Selling Shareholder(s) to provide all information and materials and to take all action as may be required in order to permit the Company to comply with all applicable requirements of the Securities Act, and any rules and regulations promulgated thereunder, and to obtain acceleration of the effective date of such Registration Statement.

The Company shall not be obligated to file more than three Registration Statements pursuant to the foregoing provisions of this Section 8.1. The Company shall bear all of the Costs and Expenses of the first such registration. The Selling Shareholder(s) shall bear the costs and expenses of all further registrations pursuant to this Section 8.1. A demand for registration under this Section 8.1 will not count as such until the Registration Statement has become effective.

8.2 Shelf Registration By Original Holder. At any time and from time to time during the term of this Option or its successors, the original Holder(s), and only the original Holder(s) may demand (and actually expects) that the Company will file a Registration Statement with the Commission for the registration of underlying shares issuable upon exercise of this Option or any part thereof, whether or not said Option has, in the interim been assigned or re-assigned to other parties.

In this event, the Company shall pay all of the Costs and Expenses of said Registration for each such demand except that the Holder(s) shall be responsible, if such demand is made by the Holder(s) during a period in which the Company is unable or unqualified to file a "short form" S-3 Statement (or its then relevant equivalent) for paying all of the Costs and Expenses of said Registration which are estimated to exceed costs for a similar Registration assuming the Company had been, as of the date of the demand, a reporting Company for three (3) years and could file a "short form" statement. In this case, the costs payable by the Holder(s) shall be determinable by securities counsel to the Company and both the Company and the Holder(s) are entitled to rely on such an estimate.

Once filed, the Company shall be obligated to continue this "shelf registration" for the maximum time allowable under the then relevant regulations, at its sole expense.

8.3 Incidental Registration. Other than as covering in Section 8.2 hereof, if at any time the Company shall propose the filing of a Registration Statement on an appropriate form under the Securities Act for the registration of any securities of the Company, other than a registration statement on Form S-4 or S-8 or any equivalent form of registration statement then in effect, then the Company shall give the Holder(s) notice of such proposed registration and shall include in any Registration Statement relating to such securities all or a portion of the Option Stock then owned or to be owned by such Holder(s), which such Holder(s) shall request (such Holder(s) to be considered "Selling Shareholder(s)"), by notice given by such Selling Shareholder(s) to the Company within 15 business days after the giving of such notice by the Company, to be so included. In the event of the inclusion of Option Stock pursuant to this Section 8.3, the Company shall bear the Costs and Expenses of such registration; provided, however that the Selling Shareholder(s) shall pay the fees and disbursements of their own counsel and, pro-rata based upon the number of shares of Option Stock included therein as these relate to the total number of Common Shares to be offered or sold, the Securities Act registration fees and underwriters discounts and compensation attributable to the inclusion of such Option Stock. Nothing in this Section 8.3 shall require the registration of Option Stock in a Registration Statement relating solely to (a) securities to be issued by the Company in connection with the acquisition of the stock or the assets of another corporation, or the merger or consolidation of any other corporation by or with the Company or any of its subsidiaries, or an exchange offer with any corporation, (b) securities to be offered to the then existing security holders of the Company, or (c) securities to be offered to employees of the Company. In the event the distribution of securities of the Company covered by a Registration Statement referred to in this Section 8 is to be underwritten, then the Company's obligation to include Option Stock in such a Registration Statement shall be subject, at the option of the Company, to the following further conditions:

- (a) The distribution for the account of the Selling

Shareholders shall be underwritten by the same underwriters who are underwriting the distribution of the securities for the account of the Company and/or any other persons whose securities are covered by such Registration Statement and the Selling Shareholder(s) shall enter into an agreement with such underwriters containing customary provisions.

(b) If the Selling Shareholders are included in the Registration Statement and if the underwriting agreement entered into with the aforesaid underwriters contains restrictions upon the sale of securities of the Company, other than the securities which are to be included in the proposed distribution, for a period not exceeding 90 days from the effective date of the Registration Statement, then such restrictions shall be binding upon the Selling Shareholder(s) with respect to any Option Stock not covered by the Registration Statement and, if requested by the underwriter, the Selling Shareholder(s) shall enter into a written agreement to that effect.

(c) If the underwriters shall state in writing that they are unwilling to include any or all of the Selling Shareholder(s)' Option Stock in the proposed underwriting because such inclusion would materially interfere with the orderly sale and distribution of the securities being offered by the Company, then the number of the Selling Shareholder(s)' shares of Option Stock to be included shall be reduced pro rata on the basis of the number of shares of Option Stock originally requested to be included by such Selling Shareholder(s), or there shall be no inclusion of the shares of the Selling Shareholder(s) in the Registration Statement not proposed distribution, in accordance with such statement by the underwriters.

However, if in such an event, the Holder(s) hereof shall not be able to include at least fifty percent (50%) of the Option Stock originally requested to be included, then the Company shall agree to pay all of the Costs and Expenses of a Shelf Registration to be filed at a later date.

9. Renewal of Exercise Rights. If, while this Option or any portion of it remains in effect, Holder(s) wish to extend their rights to exercise all or a portion of this Option which would otherwise expire and be lost to them, they may do so by paying to the Company Five Cents(\$00.05) per common share pertaining to that portion of the Option which would otherwise expire (the "Renewal Fee") and the Company shall extend that portion of the Option for a further period of five (5) years from the date of receipt of the Renewal Fee but, in no case, beyond 5:00 p.m., New York Time, on May 15, 2006, and shall issue a new Option, identical in every respect to this Option, except that such new Option shall reflect the fact that Holder(s) shall have an additional five (5) years to exercise their rights to purchase that portion of the Option Stock for which they have paid a Renewal Fee. Payment of the Renewal Fee will confirm no new rights upon the Holder(s) except to extend and renew the time period during which Holder(s) may exercise existing rights under this Option. This provision extends to this Option and all successor Option issuable hereunder.

10. Modification and Waiver. This Option and any provision hereof may be changed, waived, discharged or terminated only by an instrument in writing signed by the party against which enforcement of the same is sought.

11. Notices. Any notice, request or other document required or permitted to be given or delivered to the Holder(s) hereof or the Company shall be delivered or shall be sent by certified or registered mail, postage prepaid, to each such Holder at its address as shown on the books of the Company or to the Company at the address indicated therefor in the first paragraph of this Option.

12. Fractional Shares. No fractional shares shall be issued upon exercise of this Option. The Company shall, in lieu of issuing any fractional share pay the Holder(s) entitled to such fraction a sum in cash equal to the fair market value of any such fractional interest as it shall appear on the public market, or if there is no public market for such shares, then as shall be reasonably determined by the Company.

13. Description Headings and Governing Law. The descriptive headings

of the several sections and paragraphs of this Option are inserted for convenience only and do not constitute a part of this Option. This Option shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the internal laws of the State of Maryland.

14. Validity. If any term, provision, covenant or restriction of this Option is held by a court of competent jurisdiction to be invalid, void or unenforceable, the Company agrees that such term, provision, covenant or restriction shall be reformed to the extent possible consistent with such judicial holding to reflect the intent of the Company and the original Holder as stated herein and the remainder of the terms, provisions, covenants and restrictions of this Option shall remain in full force and effect and shall in no way be affected, impaired or invalidated. It is hereby stipulated and declared to be the intention of the Company that it would have executed this Option including the remaining terms, provisions, covenants and restrictions without including any of such provision of term which may be hereafter declared invalid, void or unenforceable.

IN WITNESS WHEREOF, the Company has caused this Option (Serial Number: \_\_\_\_\_) to be executed by its officer, thereunto duly authorized as of this 16th day of May, 1996.

CHEUNG LABORATORIES, INC.

By: \_\_\_\_\_  
Signature

By: Augustine Y. Cheung  
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Print Name

Title: President and Chief Executive Officer  
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Form of Warrant

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED OR ANY STATE SECURITIES LAWS AND NEITHER THE SECURITIES NOR ANY INTEREST THEREIN MAY BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR SUCH LAWS OR AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT AND SUCH LAWS WHICH, IN THE OPINION OF COUNSEL FOR THE HOLDER, WHICH COUNSEL AND OPINION ARE REASONABLY SATISFACTORY TO COUNSEL FOR THIS CORPORATION, IS AVAILABLE.

Warrant Certificate No.: \_\_\_\_\_

Date of Issue: \_\_\_\_\_

Void after 5:00 p.m. New York time on \_\_\_\_\_.

CELSION CORPORATION

This certifies that \_\_\_\_\_ (the "Holder"), for a value received, is entitled, subject to the adjustment and to the other terms set forth below, to purchase from Celsion Corporation, a Maryland corporation (the "Company"), (i) \_\_\_\_\_ fully paid and non-assessable shares of the Common Stock, par value \$0.01 per share, of the Company (the "Common Stock") at the Exercise Price of \$0.50 per share, and (ii) \_\_\_\_\_ fully paid and non-assessable shares of the Common Stock at the Exercise Price of \$1.00 per share. The Warrant shall be exercisable at any time on and after the date hereof but not later than 5:00 P.M. (New York time) on the third anniversary of the date hereof (the "Expiration Date"), upon surrender to the Company at its principle office at 10220-I Old Columbia Road, Columbia, MD 21046-1705, Attention: Dr. Augustine Cheung, Chairman of the Board and Chief Executive Officer (or at such other location as the Company may advise the Holder in writing) of this Warrant properly endorsed with the Purchase Form attached hereto duly filled in and signed and upon payment in cash or cashier's check of the aggregate Exercise Price for the number of shares for which this Warrant is being exercised determined in accordance with the provisions hereof. From and after April 1, 1999, the Company, at its option, may redeem in whole or in part this Warrant (i) for an amount equal to \$0.01 per share with respect to the shares of Common Stock having an exercise price of \$0.50 per share if the adjusted price of the Common Stock rises to more than \$1.00 per share, and (ii) for an amount equal to \$0.01 per share with respect to the shares of Common Stock

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having an exercise price of \$1.00 per share if the adjusted price of the Common Stock rises to more than \$2.00 per share. The Company must give at least thirty (30) days notice of such redemption, during which period the holders of the Warrants may exercise their Warrants in accordance with the terms thereof. The Exercise Price and, in some cases, the number of shares purchasable hereunder are subject to adjustment as provided in Section (g) of this Warrant. This Warrant and all rights hereunder, to the extent not exercised in the manner set forth herein shall terminate and become null and void on the Expiration Date. In the event that the Holder does not exercise this Warrant pursuant to the terms of this Warrant, then this Warrant shall expire, be canceled, and be null and void.

(a) Exercise of Warrant. This Warrant may be exercised in whole or in part at any time or from time to time on or after the date hereof, but not later than 5:00 p.m. New York time, on the Expiration Date. If such date is a day on which banking institutions are authorized by law to close, then the expiration date shall be on the next succeeding day which shall not be such a day. This Warrant may be exercised by presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, with written notice duly executed and accompanied by payment in cash or cash equivalent of the Exercise Price for the number of shares specified in such notice, together with all federal and state taxes applicable upon such exercise. If this Warrant should be exercised in part only, the Company shall, upon surrender of this Warrant for cancellation, execute and deliver a new Warrant evidencing the right of the holder to purchase the balance of the shares purchasable hereunder. Upon receipt by the Company of this Warrant at the office or agency of the Company, in proper form for exercise, the Holder shall be deemed to be the holder of record of the shares of Common Stock issuable upon such exercise, notwithstanding that the stock transfer books of the Company shall then be closed or that certificates representing such shares of Common Stock shall not then be actually delivered to the Holder.

(b) Reservation of Shares. The Company hereby agrees that at all times there shall be reserved for issuance and/or delivery upon exercise of this Warrant such number of shares of its Common Stock as shall be required for issuance or delivery upon exercise of this Warrant.

(c) Fractional Shares. No fractional shares or script representing fractional shares shall be issued upon the exercise of this Warrant. With respect to any fraction of a share called for upon any exercise hereof, the Company shall pay to the Holder an amount in cash equal to such fraction multiplied by the current market value of such fractional share, determined as follows:

(1) If the Common Stock is listed on a national securities exchange, admitted to unlisted trading privileges on such exchange or quoted on the Nasdaq National Market System or other interdealer



trading systems providing last sale information, the current value shall be the last reported sale price of the Common Stock on such exchange, Nasdaq/NMS or trading system on the last business day prior to the date of exercise of this Warrant or if no such sale is made on such day, the average closing bid and asked prices for such day on such exchange, Nasdaq/NMS or trading system; or

(2) If the Common Stock is not so listed or admitted to unlisted trading privileges, the current value shall be the mean of the last reported bid and asked prices reported by an interdealer quotation system deemed reliable by the Company on the last business day prior to the date of the exercise of this Warrant; provided that if the Common Stock is quoted on more than one such system, the Company shall utilize, in order of priority, Nasdaq, the NASD OTC Bulletin Board or the National Quotation Bureau, Inc.; or

(3) If the Common Stock is not so listed or admitted to unlisted trading privileges and bid and asked prices are not so reported, the current value shall be an amount, not less than book value, determined in such reasonable manner as may be prescribed by the Board of Directors of the Company, such determination to be final and binding on the Holder.

(d) Restrictions on Transfer. The securities represented hereby and the shares to be issued on exercise have not been registered under federal or state securities laws. They may not be sold or offered for sale in the absence of effective registration under such securities laws, or an opinion of counsel satisfactory to the Company that such registration is not required.

(e) Exchange, Assignment or Loss of Warrant. This Warrant is exchangeable, without expense, at the option of the Holder, upon presentation and surrender hereof to the Company or at the office of its stock transfer agent, if any, for other Warrants of different denominations entitling the holder thereof to purchase in the aggregate the same number of shares of Common Stock purchasable hereunder. Subject to compliance with Section (d) hereof, this Warrant is assignable. Any such assignment shall be made by surrender of this Warrant to the Company or at the office of its stock transfer agent, if any, with written notice of assignment duly executed and funds sufficient to pay any transfer tax; whereupon the Company shall, without charge, execute and deliver a new Warrant in the name of the assignee named in such instrument of assignment and this Warrant shall promptly be canceled. This Warrant may be divided or combined with other Warrants which carry the same rights upon presentation hereof at the office of the Company or at the office of its stock transfer agent, if any, together with a written notice specifying the names and denominations in which new Warrants are to be issued and signed by the Holder hereof. The term "Warrant" as used herein includes any Warrant issued in substitution for or replacement of this Warrant, or into which this Warrant may be divided or exchanged and the term "original issue date hereof" shall refer to the date that the Company first issued a Warrant which was subsequently transferred or exchanged for another. Upon receipt by the Company of evidence satisfactory to it of the loss, theft, destruction or mutilation of this Warrant, and (in the case of loss, theft or destruction) of reasonably satisfactory indemnification, and upon surrender and cancellation of this Warrant, if mutilated, the Company will execute and deliver a new Warrant of like tenor and date. Any such new Warrant executed and delivered shall constitute an additional contractual obligation on the part of the Company whether or not this Warrant so lost, stolen, destroyed, or mutilated shall be at any time enforceable by anyone.

(f) Rights of the Holder. The Holder shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company either at law or in equity, and the rights of the Holder are limited to those expressed in this Warrant and are not enforceable against the Company except to the extent set forth herein.

(g) Anti-Dilution Provisions.  
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(1) Adjustment of Number of Shares. Anything in this Section (g) to the contrary notwithstanding, in case the Company shall at any time issue Common Stock by way of dividend or other distribution on any stock of the Company or subdivide or combine the outstanding shares of Common Stock, the Exercise Price shall be proportionately decreased in the case of such issuance (on the day following the date fixed for determining shareholders entitled to receive such dividend or other distribution) or decreased in the case of such subdivision or increased in the case of such combination (on the date that such subdivision or combination shall become effective).

(2) No Adjustment for Small Amounts. Anything in this Section (g) to the contrary notwithstanding, the Company shall not be required to give effect to any adjustment in the Exercise Price unless and until the net effect of one or more adjustments, determined as above provided, shall have required a change of the Exercise Price by at least one cent, but when the cumulative net effect of more than one adjustment so determined shall be to change the actual Exercise Price by at least one cent, such change in the Exercise Price shall thereupon be given effect.

(3) Number of Shares Adjusted. Upon any adjustment of the Exercise Price other than pursuant to Section (g)(1) hereof, the holder of this Warrant shall thereafter (until another such adjustment) be entitled to purchase, at the new Exercise Price, the number of shares, calculated to the nearest full share, obtained by multiplying the number of shares of Common Stock initially issuable upon exercise of this Warrant by the Exercise Price in effect on the date hereof and dividing the product so obtained by the new Exercise Price.

(4) Common Stock Defined. Whenever reference is made in this Section (g) to the issue or sale of shares of Common Stock, the term "Common Stock" shall mean the common shares of the Company of the class authorized as of the date hereof and any other class of stock ranking on a parity with such Common Stock. However, subject to the provisions of Section (j) hereof, shares issuable upon exercise hereof shall include only shares of the class designated as Common Stock of the Company as of the date hereof.

(h) Officer's Certificate. Whenever the Exercise Price shall be adjusted as required by the provisions of Section (g) hereof, the Company shall

forthwith file in the custody of its Secretary or an Assistant Secretary at its principal office, and with its stock transfer agent, if any, an officer's certificate showing the adjusted Exercise Price determined as herein provided and setting forth in reasonable detail the facts requiring such adjustment. Each such officer's certificate shall be made available at all reasonable times for inspection by the Holder and the Company shall, forthwith after each such adjustment, deliver a copy of such certificate to the Holder. Such certificate shall be conclusive as to the correctness of such adjustment.

(i) Notice to Warrant Holders. So long as this Warrant shall be outstanding and unexercised (i) if the Company shall pay any dividend or make any distribution upon the Common Stock, or (ii) if the Company shall offer to the holders of Common Stock for subscription or purchase by them any shares of stock of any class or any other rights or (iii) if any capital reorganization of the Company, reclassification of the capital stock of the Company, consolidation or merger of the Company with or into another corporation, sale, lease or transfer of all or substantially all of the property and assets of the Company to another corporation, or voluntary or involuntary dissolution, liquidation or winding up of the Company shall be effected, then, in any such case, the Company shall cause to be delivered to the Holder, at least ten (10) days prior to the date specified in (x) or (y) below, as the case may be, a notice containing a brief description of the proposed action and stating the date on which (x) a record is to be taken for the purpose of such dividend, distribution or rights, or (y) such reclassification, reorganization, consolidation, merger, conveyance, lease, dissolution, liquidation or winding up is to take place and the date, if any, is to be fixed, as of which the holders of Common Stock of record shall be entitled to exchange their shares of Common Stock for securities or other property deliverable upon such reclassification, reorganization, consolidation, merger, conveyance, dissolution, liquidation or winding up.

(j) Reclassification, Reorganization or Merger. In case of any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the Company (other than a change in par value, or from par value to no par value or from no par value to par value, or as a result of an issuance of Common Stock by way of dividend or other distribution or of a subdivision or combination), or in case of any consolidation or merger of the Company with or into another corporation (other than a merger in which the Company is the continuing corporation and which does not result in any reclassification, capital reorganization or other change of outstanding shares of Common Stock of the class issuable upon exercise of this Warrant) or in case of any sale or conveyance to another corporation of the property of the Company as an entirety or substantially as an entirety, the Company shall cause effective provision to be made so that the Holder shall have the right thereafter, by exercising this Warrant, to purchase the kind and amount of shares of stock and other securities and property receivable upon such reclassification, capital reorganization or other change, consolidation, merger, sale or conveyance. Any such provision shall include provisions for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Warrant. The foregoing provisions of this Section (j) shall similarly apply to successive reclassifications, capital reorganizations and changes of shares of Common Stock and to successive consolidations, mergers, sale or conveyances. In the event that in any such capital reorganization or reclassification, consolidation, merger, sale or conveyance, additional shares of Common Stock shall be issued in exchange, conversion, substitution or

payment, in whole or in part, for or of a security of the Company other than Common Stock, any such issue shall be treated as an issue of Common Stock covered by the provisions of Subsection (g)(1) hereof with the amount of the consideration received upon the issue thereof being determined by the Board of Directors of the Company, such determination to be final and binding on the holder.

(k) Applicable Law. This Warrant shall be governed by, and construed in accordance with, the laws of the State of Maryland.

(l) Optional Waiver. Holder may waive by signed writing any rights of Holder contained herein.

(m) IN ADDITION TO THE RESTRICTIONS ON TRANSFERABILITY DESCRIBED HEREIN, THE SECURITIES ISSUABLE ON EXERCISE OF THIS WARRANT SHALL NOT BE SOLD, PLEDGED, TRANSFERRED, HYPOTHECATED OR ASSIGNED WITHIN 7 DAYS BEFORE OR 180 DAYS AFTER THE DATE OF EFFECTIVENESS OF A REGISTRATION STATEMENT FILED BY THE COMPANY WITH THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH A PUBLIC OFFERING OF THE COMPANY'S SECURITIES. THIS RESTRICTION IS IN ADDITION TO AND NOT IN LIEU OF THE RESTRICTIONS CONTAINED HEREIN AND AS SUCH, THIS 180 DAY PERIOD MAY EXPIRE PRIOR TO OR BEYOND THE RESTRICTIONS IMPOSED HEREIN. THIS RESTRICTION SHALL OBLIGATE ALL SUCCESSORS IN INTEREST TO THE SHARES ISSUED ON EXERCISE. CERTIFICATES REPRESENTING THE WARRANT STOCK SHALL BEAR A LEGEND EVIDENCING THIS RESTRICTION.

THIS WARRANT CERTIFICATE is granted and sold as of the date first above written.

CELSION CORPORATION

By: \_\_\_\_\_  
Name:  
Title:

Attest:

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Name:  
Title:

PURCHASE FORM

Dated: \_\_\_\_\_

Celsion Corporation  
10220-I Old Columbia Road  
Columbia, MD 21046-1705  
Attention: Mr. John Mon, Secretary

Dear Mr. Mon:

Attached hereto is Celsion Corporation's Warrant Certificate No. \_\_\_\_\_, giving the Holder thereof the right to purchase (i) \_\_\_\_\_ shares of the Common Stock, par value \$0.01 per share, of the Company (the "Common Stock") at the Exercise Price of \$0.50 per share, and (ii) \_\_\_\_\_ shares of the Common Stock at the Exercise Price of \$1.00 per share..

I/we hereby notify you that I/we are exercising my/our right to purchase \_\_\_\_\_ shares of the Common Stock at the Exercise Price of \$0.50 per share and \_\_\_\_\_ shares of the Common Stock at the Exercise Price of \$1.00 per share (collectively, the "Shares") and have enclosed herewith my/our check in the amount of \$\_\_\_\_\_, representing the aggregate exercise price of the Shares. If transfer taxes (federal or state) are applicable to this transaction, I/we understand that you will be billing me/us for said taxes, which I/we agree will be promptly remitted to you within ten (10) days of my/our receipt of notification.

I/we hereby state that the Shares being purchased are to be held by me/us for investment purposes and not with a view to sale, except pursuant to an effective registration statement or an exemption therefrom.

Please cancel the enclosed Warrant Certificate and, if applicable, send me/us a Warrant Certificate, in partial substitution on identical terms, for the remaining shares not being purchased pursuant to this notification.

Yours very truly,

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Please type or print:

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Name  
-----  
Address  
-----  
City                      State                      Zip Code

REGISTRATION RIGHTS AGREEMENT

THIS REGISTRATION RIGHTS AGREEMENT (the "Agreement") is made by Cheung Laboratories, Inc., a Maryland corporation (the "Company"), for the benefit of the undersigned investor ("Investor", collectively, the "Investors"). This Agreement shall become effective upon acceptance and closing in respect of the related subscription for the Senior Secured Convertible Promissory Notes ("Notes") and the shares of common stock underlying the Notes, and the associated warrants to purchase common stock of the Company ("Warrants"). The Notes and the Warrants are collectively referred to herein as the "Securities." The common stock of the Company into which the Notes are convertible and the common stock issuable upon exercise of the Warrants shall be referred to herein collectively as the "Underlying Stock."

R E C I T A L S

A. The Investors desire to purchase from the Company, and the Company desires to issue and sell to the Investors, up to an aggregate of \$1,505,000 in face amount of Notes and associated Warrants as described in the Confidential Offering Memorandum dated January 6, 1997 as amended June 12, 1997 and all of the Exhibits thereto (the "Offering Memorandum").

B. As further inducement for the Investors to purchase the Notes and Warrants from the Company, the Company hereby undertakes to register under the Securities Act of 1933, as amended, and the rules and regulations thereunder (collectively, the "Securities Act"), the Underlying Stock upon the first to occur of (i) six months after the Company effects a registration, or (ii) July 10, 1998, on any applicable form, of newly issued common stock at any time while the Investor holds the Notes, the Warrants, or some or all of the Underlying Stock. This Agreement sets forth the terms and conditions of such undertaking.

The Company and the Investor agree as follows:

1. Definitions. For purposes of this Agreement:

(a) The terms "register," "registered" and "registration" refer to a registration effected by preparing and filing a registration statement or statements or similar documents in compliance with the Securities Act and pursuant to Rule 415 under the Securities Act or any successor rule providing for offering securities on a continuous basis ("Rule 415"), and the declaration or ordering of effectiveness of such registration statement or document by the Securities and Exchange Commission (the "SEC").

(b) The term "Registerable Securities" means (i) the Underlying Stock, and (ii) any common stock of the Company issued as (or issuable upon the conversion or exercise of any convertible security, warrant, right or other security which is issued as) a dividend or other distribution with respect to, or in exchange for or in replacement of any Note, Warrant, or any Underlying Stock, excluding in all cases, however, any Registerable Securities sold by a holder of such Registerable Securities in a transaction in which its registration rights under this Agreement are not assigned.

(c) The Investors and assignees with registration rights assigned to them pursuant to Section 8 of this Agreement may be referred to herein collectively as "Holders" of Registerable Securities and each may be referred to herein as a "Holder" of Registerable Securities.

2. Registration.

(a) Automatic Registration Right - (i) Subject to the

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provisions of Section 3(a), below and no earlier than six months after the final closing date (the "Closing Date") of a registered offering of the common stock of the Company to the general public covered by a registration statement under the Securities Act ("Public Offering"), the Company shall use good faith efforts to effect the registration under the Securities Act of all Registerable Securities; provided, however, that a Holder of Registerable Securities may inform the Company in writing that it wishes to exclude all or a portion of its Registerable Securities from such registration and upon such notice, such Registerable Securities shall be excluded from such registration.

(i) The holders of a majority in interest of the Registerable Securities shall have the right to select the managing underwriters, if any, and to approve the terms of the underwriting agreement in respect of such registration, subject to the approval of the Company, which shall not be unreasonably withheld.

(iii) The Company is obligated to use good faith efforts to effect only one such registration pursuant to this Section 2(a) of this Agreement.

(b) Piggyback Registration

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(i) On an unlimited number of occasions until the

third anniversary of the Closing of the Company's offering of the Notes and Warrants, and subject to the terms of this Agreement and excluding the Public Offering, in the event the Company decides to register any of its common stock (either for its own account or the account of a security holder or holders, other than in connection with a registration being effected pursuant to Section 2(a) above) on an SEC form (other than S-4 or S-8 or successor forms) that would be suitable for a registration involving Registerable Securities, the Company will: (x) promptly give each Holder of Registerable Securities written notice thereof (which shall include a list of jurisdictions in which the Company intends to qualify such securities under the applicable Blue Sky or other state securities laws) and (y) include in such registration (and in any related qualification under the Blue Sky laws or other state securities laws), and in any underwriting involved therein, all the Registerable Securities specified in a written request delivered to the Company by any Holder of Registerable Securities within 20 days after delivery of such written notice from the Company. Nothing contained in this Section 2(b) shall limit the ability of the Company to withdraw a Registration Statement it has filed either before or after effectiveness.

(ii) If the registration of which the Company gives notice pursuant to Section 2(b)(i) is for a registered public offering involving an underwriting, the Company shall so advise the Holders of Registerable Securities as a part of the written notice given pursuant to Section 2(b)(i). In such event the right of any Holder of Registerable Securities to registration shall be conditioned upon such underwriting and the inclusion of such Holders' Registerable Securities in such underwriting to the extent provided in this Section 2(b). All Holders of Registerable Securities proposing to distribute their securities through such an underwriting shall (together with the Company and the other holders distributing their securities through such underwriting) enter into an underwriting agreement with the Underwriter's representative for such offering; provided that such holders shall have no right to participate in the selection of the underwriters for an offering pursuant to this Section 2(b).

(iii) In the event the Underwriters' representative advises the Holders of Registerable Securities seeking registration of Registerable Securities pursuant to this Section 2(b) in writing that market factors (including, without limitation, the aggregate number of shares of common stock requested to be registered, the general condition of the market, and the status of the persons proposing to sell securities pursuant to this registration) require a limitation



of the number of shares to be underwritten, the Underwriter's representative may exclude some or all Registerable Securities from such registration and underwriting. In such event, the Underwriters' representative shall so advise all Holders of Registerable Securities of the number of shares of Registerable Securities that may be included in such registration and underwriting (if any), and the number of shares of Registerable Securities that may be included in such registration and underwriting (if any) shall be allocated among all holders seeking registration in proportion, as nearly as practicable, to the number of shares proposed to be included in the registration by the Holder. The number of shares of Registerable Securities to be included in such underwriting shall not be reduced unless all other securities (other than those sold by the Company) are similarly limited from the underwriting. No Registerable Securities or other securities excluded from the underwriting by reason of this Section 2(b) shall be included in such Registration Statement.

(iv) If any Holder of Registerable Securities, or a holder of other securities entitled (upon request) to be included in such registration, disapproves of the terms of any underwriting, such Holder may elect to withdraw therefrom by written notice to the Company delivered at least 20 days prior to the effective date of the Registration Statement.

3. Obligations of the Company. When required under this Agreement to effect the registration of the Registerable Securities, the Company shall, as expeditiously as reasonably possible, use good faith efforts to:

(a) Prepare and file with the SEC a registration statement or statements or similar documents (the "Registration Statement") with respect to all Registerable Securities, other than any Registerable Securities excluded by Holders of Registerable Securities pursuant to Section 2(a). The Registration Statement shall be filed not later than six months after the Closing of the Public Offering and the Company will use good faith efforts to cause such Registration Statement to become effective. The Company will use good faith efforts to keep the Registration Statement effective pursuant to Rule 415 at all times until the earlier of (i) the third anniversary of the final closing date of the Company's offering of Notes and Warrants to the Investors, or (ii) the date on which all Investors can sell any of the Registerable Securities pursuant to Rule 144 of the Securities Act without restriction under Rule 144(e) thereof; provided, however, that if a public offering of common stock by the Company is closed on a date that is more than two years following the first date each Holder of Registerable Securities held such Registerable Securities, the Company shall have no obligation to file a Registration Statement in respect of such Registerable Securities pursuant to this Agreement, except pursuant to Section 2(b).

(b) Prepare and file with the SEC such amendments (including post-effective amendments) and supplements to the Registration Statement and the Prospectus used in connection with the Registration Statement as may be necessary to keep the Registration Statement effective at all times until the earlier of (i) the third anniversary of the final closing date of the Company's offering of the Notes and Warrants, or (ii) the date on which all Investors can sell their respective shares of Registerable Securities pursuant to Rule 144 of the Securities Act without restriction under Rule 144(e) thereof, and to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by the Registration Statement.

(c) Furnish promptly to the Holders of Registerable Securities such numbers of copies of a prospectus, including a preliminary prospectus, and all amendments and supplements thereto, in conformity with the requirements of the Securities Act, and such other documents as the Holders of Registerable Securities may reasonably request in order to facilitate the disposition of Registerable Securities.

(d) Register and qualify the securities covered by the

Registration Statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Investors and prepare and file in those jurisdictions such amendments (including post-effective amendments) and supplements and to take such other actions as may be necessary to maintain such registration and qualification in effect at all times until the earlier of (i) the third anniversary of the final closing date of the Company offering of the Notes and Warrants, or (ii) the date on which all Investors can sell their respective shares of Registerable Securities pursuant to Rule 144 of the Securities Act with out restriction under Rule 144(e) thereof, and to take all other actions necessary or advisable to enable the disposition of such securities in such jurisdictions, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions or to provide any undertaking or make any change in its charter or bylaws which the Board of Directors determines to be contrary to the best interest of the Company and its stockholders.

(e) In the event the holders of a majority in interest of the Registerable Securities select underwriters for the offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, including, without limitation, customary indemnification and contribution obligations, with the managing underwriter of such offering. The Investors shall also enter into and perform their customary obligations under any such agreement including, without limitation, customary indemnification and contribution obligations.

(f) Notify the Holders of Registerable Securities, at any time when a prospectus relating to Registerable Securities covered by the Registration Statement is required to be delivered under the Securities Act, of the happening of any event as a result of which the prospectus included in the Registration Statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing. The Company shall promptly amend or supplement the Registration Statement to correct any such untrue statement or omission.

(g) Notify the Holders of Registerable Securities of the issuance by the SEC of any stop order suspending the effectiveness of the Registration Statement or the initiation of any proceedings for the purposes. The Company will make every reasonable effort to prevent the issuance of any stop order and, if any stop order is issued, to obtain the lifting thereof at the earliest possible time.

(h) Permit a single firm of counsel designated as selling stockholders' counsel by the holders of a majority in interest of the Registerable Securities commencing at a reasonable period of time prior to their filing, to review the Registration Statement and all amendments and supplements thereto and shall not file any document in a form to which such counsel reasonably objects.

(i) Make generally available to its security holders as soon as practicable, but not later than 90 days after the close of the period covered thereby, an earnings statement (in form complying with the provisions of Rule 158 under the Securities Act) covering a 12-month period beginning not later than the first day of the Company's fiscal quarter next following the effective date of the Registration Statement.

(j) At the request of the Holders of Registerable Securities, furnish to the underwriters on the date that Registerable Securities are delivered to the underwriters for sale in connection with a registration pursuant to this Agreement (i) an opinion, dated such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters, and (ii) a letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters.

(k) Make available for inspection by the Holders of Registerable Securities, any underwriters participating in the offering pursuant to the registration and the counsel, accountants or

other agents retained by the Investors, all pertinent financial and other records, corporate documents and properties of the Company, and cause the Company's officers, directors and employees to supply all information reasonably requested by the Investors in connection with the registration.

(l) If the Common Stock is then listed on a national securities exchange, cause the Registerable Securities to be listed on such exchange. If the Common Stock is not then listed on a national securities exchange, use good faith efforts to facilitate the reporting of the Common Stock on NASDAQ.

(m) Provide a transfer agent and registrar, which may be a single entity, for the Registerable Securities not later than the effective date of the Registration Statement.

(n) Take all actions necessary to facilitate the timely preparation and delivery of certificates (not bearing any restrictive legend) representing the Registerable Securities to be sold pursuant to the Registration Statement and to enable such certificates to be in such denominations and registered in such names as the Holders of such Registerable Securities or any underwriters may reasonably request.

(o) Take all other reasonable actions necessary to expedite and facilitate disposition by the Investors of the Registerable Securities pursuant to the Registration Statement.

4. Furnish Information. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Agreement with respect to each Investor that such Investor shall furnish to the Company such information regarding itself, the Registerable Securities held by it, and the intended method of disposition of such securities as shall be reasonably required to effect the registration of the Registerable Securities and shall execute such documents in connection with such registration as the Company may reasonably request.

5. Expenses of Registration. All expenses incurred in connection with registration, filings or qualifications pursuant to Sections 2 and 3, including without limitation, all registration, listing, filing and qualification fees, printers and accounting fees, the fees and disbursements of counsel for the Company and the reasonable fees and disbursements of one counsel for the Investors shall be borne by the Company (except in the case of the automatic registration pursuant to Section 2(a) for which underwriter discounts and commissions shall not be borne by the Company).

6. Indemnification. In the event any Registerable Securities are included in a Registration Statement:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Investor, the directors, employees, agents and the officers of the Company, each person who signs the Registration Statement, and each person, if any, who controls any of them, any underwriter (as defined in the Securities Act) for such Holders of Registerable Securities and each person, if any, who controls any such underwriter within the meaning of the Securities Act or the Securities Exchange Act of 1934, as amended (the "1934 Act"), against any losses, claims, damages, expenses or liabilities (or actions or proceedings, whether commenced or threatened, in respect thereof) arising out of or based upon any of the following statements, omissions or violations (collectively, a "Violation"): (i) any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading, or (iii) any violation or alleged violation by the Company of the

Securities Act, the 1934 Act, any state securities laws or any rule or regulation promulgated under the Securities Act, the 1934 Act or any state securities laws; and the Company will reimburse the Investors and each such underwriter or controlling person, promptly as such expenses are incurred, for any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability, action or proceeding; provided, however, that the indemnity agreement contained in this Section 6(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Company, which consent shall not be unreasonably withheld, nor shall the Company be liable in any such case for any such loss, claim, damage, liability, or action to the extent that it arises out of or is based upon a Violation which occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by the Investors or any such underwriter or controlling person, as the case may be. Such indemnity shall remain in full force and effect regardless of any investigation made by or on behalf of the Investors or any such underwriter or controlling person and shall survive the transfer of the Registerable Securities by the Holders of Registerable Securities.

(b) To the extent permitted by law, each Holder of Registerable Securities, severally and not jointly, will indemnify and hold harmless the Company, each of its directors, each of its officers who have signed the Registration Statement, each person, if any, who controls the Company within the meaning of the Securities Act or the 1934 Act, any underwriter and any other stockholder selling securities pursuant to the Registration Statement of any of its directors or officers or any person who controls such holder or underwriter, against any losses, claims, damages or liabilities (joint or several) to which any of them may become subject, under the Securities Act, the 1934 Act or other federal or state law, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder of Registerable Securities expressly for use in connection with such registration; and such Holder of Registerable Securities will reimburse any legal or other expenses reasonably incurred by any of them in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the indemnity agreement contained in this Section 6(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of such Holder of Registerable Securities, which consent shall not be unreasonably withheld; and provided, further, that the Investor shall be liable under this paragraph for only that amount of losses, claims, damages and liabilities as does not exceed the proceeds to such Investor as a result of the sale of Registerable Securities pursuant to such registration.

(c) Promptly after receipt by an indemnified party under this Section 6 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 6, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume control of the defense thereof with counsel mutually satisfactory to the parties; provided, however, that an indemnified party shall have the right to retain its own counsel, with the fees and expenses to be paid by the indemnifying party, if, in the reasonable opinion of counsel for the indemnifying party, representation of such indemnified party by the counsel retained by the indemnifying party, would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action shall relieve such indemnifying party of any liability to the indemnified party under this Section 6 only to the extent prejudicial to its ability to defend such action, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 6. The indemnification required by this Section

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6 shall be made by periodic payments of the amount thereof during the course of the investigation or defense, promptly as such expense, loss, damage or liability is incurred.

(d) To the extent any indemnification by an indemnifying party is prohibited or limited by law, the indemnifying party agrees to make the maximum contribution with respect to any amounts for which it would otherwise be liable under this Section 6 to the extent permitted by law, provided that (i) no contribution shall be made under circumstances where the maker would not have been liable for indemnification under the fault standards set forth in this Section 6, (ii) no seller of Registerable Securities guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any seller of Registerable Securities who was not guilty of such fraudulent

misrepresentation, and (iii) contribution by any seller of Registerable Securities shall be limited in amount to the net amount of proceeds received by such seller from the sale of such Registerable Securities.

7. Reports Under Securities Exchange Act of 1934. With a view to making available to the Holders of Registerable Securities the benefits of SEC Rule 144 promulgated under the Securities Act and any other rule or regulation of the SEC that may at any time permit the Investors to sell securities of the Company to the public without registration, the Company agrees to:

(a) make and keep public information available, as those terms are understood and defined in SEC Rule 144, at all times;

(b) file with the SEC in a timely manner all reports and other documents required of the Company under the Securities Act and the 1934 Act; and

(c) furnish to each Holder of Registerable Securities, so long as such Holder of Registerable Securities owns any Registerable Securities, forthwith upon request (i) a written statement by the Company that it has complied with the reporting requirements of SEC Rule 144, the Securities Act and the 1934 Act, (ii) a copy of the most recent annual or quarterly report of the Company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably requested in availing the Investors of any rule or regulation of the SEC which permits the selling of any such securities without registration.

8. Assignment of Registration Rights. The rights to have the Company register Registerable Securities pursuant to this Agreement may be assigned by the Holders of Registerable Securities, subject to the Holders of such Registerable Securities and such assignment being in compliance with the terms of this Agreement and any agreements incorporated herein, and subject to such assignment being in conformity with federal and state securities law, rules and regulations, unless exempt therefrom; to transferees or assignees, of such securities provided such transferee or assignee within a reasonable time after such transfer, furnishes the Company written notice of the name and address of such transferee or assignee and the securities with respect to which such registration rights are being assigned; provided, further, that such assignment shall be effective only if immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Securities Act. The term "Investor" as used in this Agreement shall include permitted assignees.

9. Miscellaneous.  
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(a) Notices required or permitted to be given hereunder shall be in writing and shall be deemed to be sufficiently given when personally delivered or sent by registered mail, return-receipt request, addressed (i) if to the Company at Cheung Laboratories, Inc. c/o Augustine Cheung, PhD., Chairman of the Board and Chief Executive

Office at 10220-I Old Columbia Road, Columbia, Maryland 21046-1705, and (ii) if to an Investor, at the address set forth under his name in the Subscription Agreement, or at such other address as each such party shall furnish by notice given in accordance with this Section 9(a).

(b) Failure of any party to exercise any right or remedy under this Agreement or otherwise, or delay by a party in exercising such right to remedy, will not operate as a waiver thereof. No waiver will be effective unless and until it is in writing and signed by the party giving the waiver.

(c) The Agreement shall be enforced, governed and construed in all respects in accordance with the laws of the State of Maryland, as such laws are applied by Maryland courts to agreements entered into and to be performed in Maryland by and between residents of Maryland. In the event that any provision of this Agreement is invalid or unenforceable under any applicable statute or rule of law, then such provision shall be deemed inoperative to the extent that it may conflict therewith and shall be deemed modified to conform with such statute or rule of law. Any provision hereof which may prove invalid or unenforceable under any law shall not affect the validity or enforceability of any other provision hereof.

(d) The Company will not, after the date of this Agreement, enter into any agreement with respect to its securities which is inconsistent with the rights granted to the Holders of Registerable Securities in this Agreement or otherwise conflicts with the provisions hereof.

(e) The provisions of this Agreement, including the provisions of this sentence, may not be amended, modified or supplemented, and waivers or consents to departures from the provisions hereof may not be given unless the Company has obtained the written consent of holders of at least a majority of shares of the Registerable Securities. Notwithstanding the foregoing, a waiver or consent to departure from the provisions hereof with respect to a matter which relates exclusively to the rights of Holders of Registerable Securities whose securities are being sold pursuant to a Registration Statement and which does not directly or indirectly affect the rights of other Holders of Registerable Securities may be given by the holders of a majority of the shares of the Registerable Securities being sold by such holders, provided that the provisions of this sentence may not be amended, modified, or supplemented except in accordance with the provisions of the immediately preceding sentence.

(f) Subject to Section 8 hereof, this Agreement shall inure to the benefit of and be binding upon the successors and permitted assigns of each of the parties, including without limitation and without the need for an express assignment, subsequent holders of Registerable Securities.

(g) This Agreement may be executed in any number of counterparts and by the parties hereto in separate counterparts and by facsimile signatures, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute one and the same agreement.

(h) This Agreement is intended by the parties as a final expression of their agreement and intended to be a complete and exclusive statement of the agreement and understanding of the parties hereto in respect of the subject matter contained herein. There are no restrictions, promises, warranties or undertakings, other than those set forth or referred to herein with respect to the registration rights granted by the Company with respect to the securities sold in connection with the Offering. This Agreement supersedes all prior agreements and understanding between the parties with respect to such subject matters.

Dated this \_\_\_\_ day of \_\_\_\_\_ 19\_\_\_\_.

INVESTOR: CHEUNG LABORATORIES, INC.

\_\_\_\_\_  
Signature

By: \_\_\_\_\_

\_\_\_\_\_  
Printed Name

Title: \_\_\_\_\_

Form of Registration Rights Agreement

THIS REGISTRATION RIGHTS AGREEMENT (this "Agreement") is made by Celsion Corporation, a Maryland corporation (the "Company"), for the benefit of the undersigned investor (the "Investor"; collectively, the "Investors"). This Agreement shall become effective upon acceptance and closing in respect of the related subscription for the Units being offered by the Company, each Unit consisting of 40,000 shares of Common Stock of the Company, par value \$0.01 per share (the "Common Stock"), and a Warrant (the "Warrant") to purchase (i) 20,000 shares of the Common Stock at an Exercise Price of \$0.50 per share, and (ii) 20,000 shares of the Common Stock at an Exercise Price of \$1.00 per share.

R E C I T A L S

A. The Investor desires to purchase from the Company, and the Company desires to issue and sell to the Investor, up to an aggregate of \$1,000,000 of Units, each Unit consisting of 40,000 shares of Common Stock and a Warrant to purchase 40,000 shares of the Common Stock, as described in the Private Placement Memorandum dated September 10, 1998, as amended November 12, 1998, together with the Exhibits attached thereto (the "Offering Memorandum").

B. As partial inducement for the Investor to purchase the Securities, the Company hereby undertakes to use its best effort to register under the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder (the "Securities Act"), the Securities upon the terms and subject to the conditions set forth herein.

The Company and the Investor hereby agree as follows:

1. Definitions. For the purposes of this Agreement:

(a) The terms "register," "registered" and "registration" refer to a registration effected by preparing and filing a registration statement or statements or similar documents in compliance with the Securities Act and pursuant to Rule 415 under the Securities Act or any successor rule providing for offering securities on a continuous basis ("Rule 415"), and the declaration or ordering of effectiveness of such registration statement or document by the Securities and Exchange Commission (the "SEC").

(b) The term "Registerable Securities" means (i) the Common Stock, including the Common Stock issued upon exercise of the Warrants, and (ii) any common stock of the Company issued as (or issuable upon the conversion or exercise of any convertible security, warrant, right or other security which is issued as) a dividend or other distribution with respect to, or in exchange for or in replacement of any Unit,

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Common Stock or Warrant, excluding in all cases, however, any Registerable Securities sold by a holder of such Registerable Securities in a transaction in which its registration rights under this Agreement are not assigned.

(c) The Investor and assignees with registration rights assigned to them pursuant to Section 8 of this Agreement may be referred to herein collectively as "Holders" of Registerable Securities and each may be referred to herein as a "Holder" of Registerable Securities.

2. Piggyback Registration. (a) On an unlimited number of occasions until December 31, 2000, and subject to the terms of this Agreement, in the event the Company decides to register any of its Common Stock (either for its own account or the account of a security holder or holders) on an SEC form (other than S-4 or S-8 or successor forms) that would be suitable for a registration involving Registerable Securities, the Company will: (x) promptly give each Holder of Registerable Securities written notice thereof (which shall include a list of jurisdictions in which the Company intends to qualify such securities under the applicable Blue Sky or other state securities laws) and (y) include in such registration (and in any related qualification under the Blue Sky laws or other state securities laws), and in any underwriting involved therein, all the Registerable Securities within twenty (20) days after delivery of such written notice from the Company. Nothing contained in this Section 2 shall limit the ability of the Company to withdraw a Registration Statement it has filed either before or after effectiveness.

(b) If the registration of which the Company gives notice pursuant to Section 2(a) is for a registered public offering involving an underwriting, the Company shall so advise the Holders of Registerable Securities as part of the written notice given pursuant to Section 2(a) hereof. In such event, the right of any Holder of Registerable Securities to registration shall be conditioned upon such underwriting and the inclusion of such Holders' Registerable Securities in such underwriting to the extent provided in this Section 2. All Holders of Registerable Securities proposing to distribute their securities through such an underwriting shall (together with the Company and the other holders distributing their securities through such underwriting) enter into an underwriting agreement with the Underwriter's representative for such offering; provided that such holders shall have no right to participate in the selection of the underwriters for an offering pursuant to this Section 2.

(c) In the event the Underwriters' representative advises the Holders of Registerable Securities seeking registration of Registerable Securities



pursuant to this Section 2 in writing that market factors (including, without limitation, the aggregate number of shares of Common Stock requested to be registered, the general condition of the market, and the status of the persons proposing to sell securities pursuant to this registration) require a limitation of the number of shares to be underwritten, the Underwriter's representative may exclude some or all Registerable Securities from such registration and underwriting. In such event, the Underwriters' representative shall so advise all Holders of Registerable Securities of the number of shares of Registerable Securities that may be included in such registration and underwriting (if any), and the number of shares of Registerable Securities that may be included in such

registration and underwriting (if any) shall be allocated among all holders seeking registration in proportion, as nearly as practicable, to the number of shares proposed to be included in the registration by the Holder. The number of shares of Registerable Securities to be included in such underwriting shall not be reduced unless all other securities (other than those sold by the Company) are similarly limited from the underwriting. No Registerable Securities or other securities excluded from the underwriting by reason of this Section 2 shall be included in such Registration Statement.

3. Obligations of the Company. When required under this Agreement to effect the registration of the Registerable Securities, the Company shall, as expeditiously as reasonably possible, use good faith efforts to:

(a) Prepare and file with the SEC a registration statement or statements or similar documents (the "Registration Statement") with respect to all Registerable Securities. The Company shall use good faith efforts to keep such Registration Statement effective pursuant to Rule 415 at all times until the earlier of (i) December 31, 2001, or (ii) the date on which all Investors can sell any of the Registerable Securities pursuant to Rule 144 of the Securities Act without restriction under Rule 144(e) thereof.

(b) Prepare and file with the SEC such amendments (including post-effective amendments) and supplements to the Registration Statement and the prospectus used in connection with the Registration Statement as may be necessary to keep the Registration Statement effective at all times until the earlier of (i) December 31, 2001, or (ii) the date on which all Investors can sell their respective shares of Registerable Securities pursuant to Rule 144 of the Securities Act without restriction under Rule 144(e) thereof, and to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by the Registration Statement.

(c) Furnish promptly to the Holders of Registerable Securities such numbers of copies of a prospectus, including a preliminary prospectus, and all amendments and supplements thereto, in conformity with the requirements of the Securities Act, and such other documents as the Holders of Registerable Securities may reasonably request in order to facilitate the disposition of Registerable Securities.

(d) Register and qualify the securities covered by the Registration Statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Investors and prepare and file in those jurisdictions such amendments (including post-effective amendments) and supplements and to take such other actions as may be necessary to maintain such registration and qualification in effect at all times until the earlier of (i) December 31, 2001, or (ii) the date on which all Investors can sell their

respective shares of Registerable Securities pursuant to Rule 144 of the Securities Act without restriction under Rule 144(e) thereof, and to take all other actions necessary or advisable to enable the disposition of such securities in such jurisdictions, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions or to provide any undertaking or make any change in its charter or by-laws which the Board of Directors determines to be contrary to the best interest of the Company and its stockholders.

(e) In the event the holders of a majority in interest of the Registerable Securities select underwriters for the offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, including, without limitation, customary indemnification and contribution obligations, with the managing underwriter of such offering. The Investors shall also enter into and perform their customary obligations under any such agreement including, without limitation, customary indemnification and contribution obligations.

(f) Notify the Holders of Registerable Securities, at any time when a prospectus relating to Registerable Securities covered by the Registration Statement is required to be delivered under the Securities Act, of the happening of any event as a result of which the prospectus included in the Registration Statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing. The Company shall promptly amend or supplement the Registration Statement to correct any such untrue statement or omission.

(g) Notify the Holders of Registerable Securities of the issuance by the SEC of any stop order suspending the effectiveness of the Registration Statement or the initiation of any proceedings for the purposes. The Company will make every reasonable effort to prevent the issuance of any stop order and, if any stop order is issued, to obtain the lifting thereof at the earliest possible time.

(h) Permit a single firm of counsel designated as selling stockholders' counsel by the holders of a majority in interest of the Registerable Securities commencing at a reasonable period of time prior to their filing, to review the Registration Statement and all amendments and supplements thereto and shall not file any document in a form to which such counsel reasonably objects.

(i) Make generally available to its security holders as soon as practicable, but not later than ninety (90) days after the close of the period covered thereby, an earnings statement (in form complying with the provisions of Rule 158 under the Securities Act) covering a

12-month period beginning not later than the first day of the Company's fiscal quarter next following the effective date of the Registration Statement.

(j) At the request of the Holders of Registerable Securities, furnish to the underwriters on the date that Registerable Securities are delivered to the underwriters for sale in connection with a registration pursuant to this Agreement (i) an opinion, dated such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters, and (ii) a letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters.

(k) Make available for inspection by the Holders of Registerable Securities, any underwriters participating in the offering pursuant to the registration and the counsel, accountants or other agents retained by the Investors, all pertinent financial and other records, corporate documents and properties of the Company, and cause the Company's officers, directors and employees to supply all information reasonably requested by the Investors in connection with the registration.

(l) If the Common Stock is then listed on a national securities exchange, cause the Registerable Securities to be listed on such exchange. If the Common Stock is not then listed on a national securities exchange, use good faith efforts to facilitate the reporting of the Common Stock on NASDAQ.

(m) Provide a transfer agent and registrar, which may be a single entity, for the Registerable Securities not later than the effective date of the Registration Statement.

(n) Take all actions necessary to facilitate the timely preparation and delivery of certificates (not bearing any restrictive legend) representing the Registerable Securities to be sold pursuant to the Registration Statement and to enable such certificates to be in such denominations and registered in such names as the Holders of such Registerable Securities or any underwriters may reasonably request.

(o) Take all other reasonable actions necessary to expedite and facilitate disposition by the Investors of the Registerable Securities pursuant to the Registration Statement.

4. Furnish Information. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Agreement with respect to each Investor that such Investor shall furnish to the Company such

information regarding itself, the Registerable Securities held by it, and the intended method of disposition of such securities as shall be reasonably required to effect the registration of the Registerable Securities and shall execute such documents in connection with such registration as the Company may reasonably request.

5. Expenses of Registration. All expenses incurred in connection with registration, filings or qualifications pursuant to Sections 2 and 3 hereof, including, without limitation, all registration, listing, filing and qualification fees, printers and accounting fees, the fees and disbursements of counsel for the Company and the reasonable fees and disbursements of one counsel for the Investors shall be borne by the Company.

6. Indemnification. In the event any Registerable Securities are included in a Registration Statement:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Investor, the directors, employees, agents and the officers of the Company, each person who signs the Registration Statement, and each person, if any, who controls any of them, any underwriter (as defined in the Securities Act) for such Holders of Registerable Securities and each person, if any, who controls any such underwriter within the meaning of the Securities Act or the Securities Exchange Act of 1934, as amended (the "1934 Act"), against any losses, claims, damages, expenses or liabilities (or actions or proceedings, whether commenced or threatened, in respect thereof) arising out of or based upon any of the following statements, omissions or violations (collectively, a "Violation"): (i) any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading, or (iii) any violation or alleged violation by the Company of the Securities Act, the 1934 Act, any state securities laws or any rule or regulation promulgated under the Securities Act, the 1934 Act or any state securities laws; and the Company will reimburse the Investors and each such underwriter or controlling person, promptly as such expenses are incurred, for any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability, action or proceeding; provided, however, that the indemnity agreement contained in this Section 6(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Company, which consent shall not be unreasonably withheld, nor shall the Company be liable in any such case for any such loss, claim, damage, liability, or action to the extent that it arises out of or is based upon a Violation which occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by the Investors or any such underwriter or controlling person, as the case may be. Such indemnity shall remain in

full force and effect regardless of any investigation made by or on behalf of the Investors or any such underwriter or controlling person and shall survive the transfer of the Registerable Securities by the Holders of Registerable Securities.

(b) To the extent permitted by law, each Holder of Registerable Securities, severally and not jointly, will indemnify and hold harmless the Company, each of its directors, each of its officers who have signed the Registration Statement, each person, if any, who controls the Company within the meaning of the Securities Act or the 1934 Act, any underwriter and any other stockholder selling securities pursuant to the Registration Statement of any of its directors or officers or any person who controls such holder or underwriter, against any losses, claims, damages or liabilities (joint or several) to which any of them may become subject, under the Securities Act, the 1934 Act or other federal or state law, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder of Registerable Securities expressly for use in connection with such registration; and such Holder of Registerable Securities will reimburse any legal or other expenses reasonably incurred by any of them in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the indemnity agreement contained in this Section 6(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of such Holder of Registerable Securities, which consent shall not be unreasonably withheld; and provided, further, that the Investor shall be liable under this paragraph for only that amount of losses, claims, damages and liabilities as does not exceed the proceeds to such Investor as a result of the sale of Registerable Securities pursuant to such registration.

(c) Promptly after receipt by an indemnified party under this Section 6 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 6, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume control of the defense thereof with counsel mutually satisfactory to the parties; provided, however, that an indemnified party shall have the right to retain its own counsel, with the fees and expenses to be paid by the indemnifying party, if, in the reasonable opinion of counsel for the indemnifying party, representation of such indemnified party by the counsel retained by the indemnifying party, would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any

such action shall relieve such indemnifying party of any liability to the indemnified party under this Section 6 only to the extent prejudicial to its ability to defend such action, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 6. The indemnification required by this Section 6 shall be made by periodic payments of the amount thereof during the course of the investigation or defense, promptly as such expense, loss, damage or liability is incurred.

(d) To the extent any indemnification by an indemnifying party is prohibited or limited by law, the indemnifying party agrees to make the maximum contribution with respect to any amounts for which it would otherwise be liable under this Section 6 to the extent permitted by law, provided that (i) no contribution shall be made under circumstances where the maker would not have been liable for indemnification under the fault standards set forth in this Section 6, (ii) no seller of Registerable Securities guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any seller of Registerable Securities who was not guilty of such fraudulent misrepresentation, and (iii) contribution by any seller of Registerable Securities shall be limited in amount to the net amount of proceeds received by such seller from the sale of such Registerable Securities.

7. Reports Under Securities Exchange Act of 1934. With a view to making available to the Holders of Registerable Securities the benefits of SEC Rule 144 promulgated under the Securities Act and any other rule or regulation of the SEC that may at any time permit the Investors to sell securities of the Company to the public without registration, the Company agrees to:

(a) make and keep public information available, as those terms are understood and defined in SEC Rule 144, at all times;

(b) file with the SEC in a timely manner all reports and other documents required of the Company under the Securities Act and the 1934 Act; and

(c) furnish to each Holder of Registerable Securities, so long as such Holder of Registerable Securities owns any Registerable Securities, forthwith upon request (i) a written statement by the Company that it has complied with the reporting requirements of SEC Rule 144, the Securities Act and the 1934 Act, (ii) a copy of the most recent annual or quarterly report of the Company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably requested in availing the Investors of any rule or regulation of the SEC which permits the selling of any such securities without registration.

8. Assignment of Registration Rights. The rights to have the Company register Registerable Securities pursuant to this Agreement may be assigned by

the Holders of Registerable Securities, subject to the Holders of such Registerable Securities and such assignment being in compliance with the terms of this Agreement and any agreements incorporated herein, and subject to such assignment being in conformity with federal and state securities law, rules and regulations, unless exempt therefrom, to transferees or assignees, of such securities, provided, however, that such transferee or assignee within a reasonable time after such transfer, furnishes the Company written notice of the name and address of such transferee or assignee and the securities with respect to which such registration rights are being assigned; and provided, further, that such assignment shall be effective only if immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Securities Act. The term "Investor" as used in this Agreement shall include permitted assignees.

9. Miscellaneous.  
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(a) Notices required or permitted to be given hereunder shall be in writing and shall be deemed to be sufficiently given when personally delivered or sent by registered mail, return-receipt request, addressed (i) if to the Company, at Celsion Corporation, 10220-I Old Columbia Road, Columbia, MD 21046-1705, Attention: Augustine Cheung, PhD., Chairman of the Board and Chief Executive Office, and (ii) if to an Investor, at the address set forth under his name in the associated Subscription Agreement, or at such other address as each such party shall furnish by notice given in accordance with this Section 9(a).

(b) Failure of any party to exercise any right or remedy under this Agreement or otherwise, or delay by a party in exercising such right to remedy, will not operate as a waiver thereof. No waiver will be effective unless and until it is in writing and signed by the party giving the waiver.

(c) This Agreement shall be enforced, governed and construed in all respects in accordance with the laws of the State of Maryland, as such laws are applied by Maryland courts to agreements entered into and to be performed in Maryland by and between residents of Maryland. In the event that any provision of this Agreement is invalid or unenforceable under any applicable statute or rule of law, then such provision shall be deemed inoperative to the extent that it may conflict therewith and shall be deemed modified to conform with such statute or rule of law. Any provision hereof which may prove invalid or unenforceable under any law shall not affect the validity or enforceability of any other provision hereof.

(d) The Company will not, after the date of this Agreement, enter into any agreement with respect to its securities which is inconsistent with the rights granted to the Holders of Registerable Securities in this Agreement or otherwise conflicts with the provisions hereof.

(e) The provisions of this Agreement, including the provisions of this sentence, may not be amended, modified or supplemented, and waivers or consents to departures from the provisions hereof may not be given unless the Company has obtained the written consent of holders of at least a majority of shares of the Registerable Securities. Notwithstanding the foregoing, a waiver or consent to departure from the provisions hereof with respect to a matter which relates



exclusively to the rights of Holders of Registerable Securities whose securities are being sold pursuant to a Registration Statement and which does not directly or indirectly affect the rights of other Holders of Registerable Securities may be given by the holders of a majority of the shares of the Registerable Securities being sold by such holders, provided that the provisions of this sentence may not be amended, modified, or supplemented except in accordance with the provisions of the immediately preceding sentence.

(f) Subject to Section 8 hereof, this Agreement shall inure to the benefit of and be binding upon the successors and permitted assigns of each of the parties, including without limitation and without the need for an express assignment, subsequent holders of Registerable Securities.

(g) This Agreement may be executed in any number of counterparts and by the parties hereto in separate counterparts and by facsimile signatures, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute one and the same agreement.

(h) This Agreement is intended by the parties as a final expression of their agreement and intended to be a complete and exclusive statement of the agreement and understanding of the parties hereto in respect of the subject matter contained herein. There are no restrictions, promises, warranties or undertakings, other than those set forth or referred to herein with respect to the registration rights granted by the Company with respect to the Registerable Securities. This Agreement supersedes all prior agreements and understanding between the parties with respect to such subject matters.

Dated: December 1, 1998

CELSION CORPORATION

By: \_\_\_\_\_  
Name: Augustine Y. Cheung  
Title: Chairman of the Board

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Name:

CONSENT OF INDEPENDENT AUDITORS

We hereby consent to the inclusion in Form 10-K for fiscal year ended September 30, 1998 of our report dated November 18, 1998 relating to the financial statements of Celsion Corporation.

Stegman & Company

December 28, 1998  
Baltimore, Maryland

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