

INTRABIOTICS PHARMACEUTICALS INC /DE

Form DEF 14A

March 03, 2003

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SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934
[Amendment No. ___]

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material under Rule 14a-12

IntraBiotics Pharmaceuticals, Inc.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

- Fee paid previously by written preliminary materials.
- Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid: _____

2) Form Schedule

or Registration
Statement
No.:

3)Filing
Party:

4)Date
Filed:



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INTRABIOTICS PHARMACEUTICALS, INC.

P.O. Box 1720
Mountain View, CA 94042

**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
To Be Held on April 3, 2003**

To the Stockholders of IntraBiotics Pharmaceuticals, Inc.:

NOTICE IS HEREBY GIVEN that a Special Meeting of Stockholders of IntraBiotics Pharmaceuticals, Inc., a Delaware corporation (the Company), will be held on Thursday, April 3, 2003 at 8:00 a.m. local time at the offices of Cooley Godward LLP, located at 3175 Hanover Street, Palo Alto, California 94304, for the following purposes:

1. To approve amendments to the Company's amended and restated certificate of incorporation to effect a reverse stock split of the Company's Common Stock, pursuant to which any whole number of outstanding shares between, and including, eight and twelve would be combined into one share of Common Stock and to authorize the Company's Board of Directors to select and file one such amendment.
 2. To approve and ratify the sale and issuance, in a private placement, of up to 350 shares of Series A Convertible Preferred Stock (the Series A Stock), and warrants to purchase approximately such number of shares of Common Stock equal to 50% of the aggregate purchase price for the Series A Stock divided by the effective conversion price of the Series A Stock.
 3. To approve an amendment to the Company's 2000 Equity Incentive Plan to increase the aggregate number of shares of Common Stock authorized for issuance under such plan by 1,900,000 shares, and to increase the maximum number of shares that may be granted to any individual in any calendar year.
 4. To approve an amendment to the Company's certificate of incorporation to increase the authorized number of shares of Common Stock from 70,000,000 to 100,000,000 shares.
 5. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.
- The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

The Board of Directors has fixed the close of business on February 25, 2003, as the record date for the determination of stockholders entitled to notice of and to vote at this Special Meeting and at any adjournment or postponement thereof.

By Order of the Board of Directors

ROBERT L. JONES
Secretary

Mountain View, California
March 3, 2003

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ALL STOCKHOLDERS ARE CORDIALLY INVITED TO ATTEND THE MEETING IN PERSON. WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY AS PROMPTLY AS POSSIBLE IN ORDER TO ENSURE YOUR REPRESENTATION AT THE MEETING, OR YOU MAY VOTE YOUR SHARES ON THE INTERNET OR BY TELEPHONE BY FOLLOWING THE INSTRUCTIONS ON YOUR PROXY. IF YOUR SHARES ARE HELD OF RECORD BY A BROKER, BANK OR OTHER NOMINEE, YOU MAY BE ABLE TO VOTE ON THE INTERNET OR BY TELEPHONE BY FOLLOWING THE INSTRUCTIONS PROVIDED WITH YOUR VOTING FORM. A RETURN ENVELOPE (WHICH IS POSTAGE PREPAID IF MAILED IN THE UNITED STATES) IS ENCLOSED FOR THAT PURPOSE. EVEN IF YOU HAVE GIVEN YOUR PROXY, YOU MAY STILL VOTE IN PERSON IF YOU ATTEND THE MEETING. PLEASE NOTE, HOWEVER, THAT IF YOUR SHARES ARE HELD OF RECORD BY A BROKER, BANK OR OTHER NOMINEE AND YOU WISH TO VOTE AT THE MEETING, YOU MUST OBTAIN FROM THE RECORD HOLDER A PROXY ISSUED IN YOUR NAME.

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INTRABIOTICS PHARMACEUTICALS, INC.

P.O. Box 1720
Mountain View, CA 94042

**PROXY STATEMENT
FOR THE SPECIAL MEETING OF STOCKHOLDERS**

April 3, 2003

INFORMATION CONCERNING SOLICITATION AND VOTING

General

The enclosed proxy is solicited on behalf of the Board of Directors of IntraBiotics Pharmaceuticals, Inc., a Delaware corporation (IntraBiotics or the Company), for use at the Special Meeting of Stockholders to be held on Thursday, April 3, 2003, at 8:00 a.m. local time (the Special Meeting), or at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Special Meeting. The Special Meeting will be held at the offices of Cooley Godward LLP, located at 3175 Hanover Street, Palo Alto, California 94304. The Company intends to mail this proxy statement and accompanying proxy card on or about March 3, 2003 to all stockholders entitled to vote at the Special Meeting.

Solicitation

The Company will bear the entire cost of solicitation of proxies, including preparation, assembly, printing and mailing of this proxy statement, the proxy card and any additional information furnished to stockholders. Copies of solicitation materials will be furnished to banks, brokerage houses, fiduciaries and custodians holding in their names shares of Common Stock beneficially owned by others to forward to such beneficial owners. The Company may reimburse persons representing beneficial owners of Common Stock for their costs of forwarding solicitation materials to such beneficial owners. Original solicitation of proxies by mail may be supplemented by telephone, telegram or personal solicitation by directors, officers or other regular employees of the Company or at the Company's request, by Georgeson Shareholder Communications, a professional proxy solicitor. No additional compensation will be paid to directors, officers or other regular employees for such services, but Georgeson Shareholder Communications will be paid its customary fee, estimated to be \$12,500 plus reasonable approved out-of-pocket expenses, for its solicitation services.

Voting Rights and Outstanding Shares

Only holders of record of Common Stock at the close of business on February 25, 2003 will be entitled to notice of and to vote at the Special Meeting. At the close of business on February 25, 2003 the Company had outstanding and entitled to vote 39,231,351 shares of Common Stock. Each holder of record of Common Stock on such date will be entitled to one vote for each share held on all matters to be voted upon at the Special Meeting.

A quorum of stockholders is necessary to hold a valid meeting. A quorum will be present if at least a majority of the outstanding shares are represented by votes at the meeting or by proxy. Votes will be counted by the inspector of election appointed for the meeting, who will separately count For and Against votes, abstentions and broker non-votes. (A broker non-vote occurs when a nominee holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power

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with respect to that proposal and has not received instructions with respect to that proposal from the beneficial owner (despite voting on at least one other proposal for which it does have discretionary authority or for which it has received instructions.) Abstentions will be counted towards the vote total for each proposal, and will have the same effect as Against votes. Broker non-votes have no effect and will not be counted towards the vote total for any proposal except Proposal 1 and Proposal 4. For Proposal 1 and Proposal 4, broker non-votes will have the same effect as Against votes.

Voting Via the Internet or By Telephone

Stockholders may grant a proxy to vote their shares by means of the telephone or on the Internet. The law of Delaware, under which the Company is incorporated, specifically permits electronically transmitted proxies, provided that each such proxy contains or is submitted with information from which the inspectors of election can determine that such proxy was authorized by the stockholder.

The telephone and Internet voting procedures below are designed to authenticate stockholders' identities, to allow stockholders to grant a proxy to vote their shares and to confirm that stockholders' instructions have been recorded properly. Stockholders granting a proxy to vote via the Internet should understand that there may be costs associated with electronic access, such as usage charges from Internet access providers and telephone companies, that must be borne by the stockholder.

For Shares Registered in the Name of a Broker or Bank

Most beneficial owners whose stock is held in street name receive instruction for granting proxies from their banks, brokers or other agents, rather than the Company's proxy card.

A number of brokers and banks are participating in a program provided through ADP Investor Communication Services that offers the means to grant proxies to vote shares by means of the telephone and Internet. If your shares are held in an account with a broker or bank participating in the ADP Investor Communications Services program, you may grant a proxy to vote those shares telephonically by calling the telephone number shown on the instruction form received from your broker or bank, or via the Internet at ADP Investor Communication Services' web site at <http://www.proxyvote.com>.

General Information for All Shares Voted Via the Internet or By Telephone

Votes submitted via the Internet or by telephone must be received by 11:59 p.m., Eastern Time on April 2, 2003. Submitting your proxy via the Internet or by telephone will not affect your right to vote in person should you decide to attend the Special Meeting.

Revocability of Proxies

Any person giving a proxy pursuant to this solicitation has the power to revoke it at any time before it is voted. It may be revoked by filing with the Secretary of the Company at the Company's principal executive office, P.O. Box 1720, Mountain View, California 94042, a written notice of revocation or a duly executed proxy bearing a later date, or it may be revoked by attending the meeting and voting in person. Attendance at the meeting will not, by itself, revoke a proxy.

Stockholder Proposals

The deadline for submitting a stockholder proposal for inclusion in the Company's proxy statement and form of proxy for the Company's 2003 annual meeting of stockholders pursuant to Rule 14a-8 of the Securities and Exchange Commission was December 26, 2002. Stockholders wishing to submit proposals or director nominations that are not to be included in such proxy statement and proxy must do so not later than the close of business on March 7, 2003, nor earlier than the close of business on February 6, 2003. Stockholders are also advised to review the Company's Bylaws, which contain additional requirements with respect to advance notice of stockholder proposals and director nominations.

Inquiries

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Stockholders may direct any questions regarding solicitation and voting to Georgeson Shareholder Communications by calling (866) 216-0457.

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PROPOSAL 1

AMENDMENTS TO AMENDED AND RESTATED

CERTIFICATE OF INCORPORATION TO EFFECT A REVERSE STOCK SPLIT

Overview

The Board of Directors of the Company (the Board) has unanimously approved proposed amendments to the Company's certificate of incorporation to effect a reverse stock split of all outstanding shares of the Company's Common Stock at an exchange ratio ranging from one-to-eight to one-to-twelve. The Board has recommended that these proposed amendments be presented to the stockholders of the Company for approval. You are now being asked to vote upon these amendments to the Company's certificate of incorporation to effect this reverse stock split whereby a number of outstanding shares of Common Stock between and including eight and twelve, such number consisting only of whole shares, will be combined into one share of Common Stock. Upon receiving stockholder approval, the Board will have the sole discretion pursuant to Section 242(c) of the Delaware General Corporation Law to elect, as it determines to be in the best interests of IntraBiotics and its stockholders, whether or not to effect a reverse stock split, and if so, the number of shares of Common Stock between and including eight and twelve which will be combined into one share of Common Stock, at any time before the first anniversary of this special meeting of stockholders. The Board believes that stockholder approval of these amendments granting the Board this discretion, rather than approval of a specified exchange ratio, provides the Board with maximum flexibility to react to then-current market conditions and, therefore, is in the best interests of IntraBiotics and its stockholders.

The text of the forms of proposed amendments to the Company's certificate of incorporation is attached to this proxy statement as Appendix A. By approving these amendments, stockholders will approve a series of amendments to the certificate of incorporation pursuant to which any whole number of outstanding shares between and including eight and twelve would be combined into one share of Common Stock, and authorize the Board to file only one such amendment, as determined by the Board in the manner described herein, and to abandon each amendment not selected by the Board. The Board may also elect not to do any reverse split.

If approved by the stockholders, and following such approval the Board determines that effecting a reverse stock split is in the best interests of IntraBiotics and its stockholders, the reverse stock split will become effective upon filing one such amendment with the Secretary of State of the State of Delaware. The amendment filed thereby will contain the number of shares selected by the Board within the limits set forth in this proposal to be combined into one share of Common Stock.

If the Board elects to effect a reverse stock split following stockholder approval, the number of issued and outstanding shares of Common Stock would be reduced in accordance with an exchange ratio determined by the Board within the limits set forth in this proposal. Except for adjustments that may result from the treatment of fractional shares as described below, each stockholder will hold the same percentage of outstanding Common Stock immediately following the reverse stock split as such stockholder held immediately prior to the reverse stock split. Currently, IntraBiotics is authorized to issue up to a total of 75,000,000 shares of capital stock, consisting of 5,000,000 shares of Preferred Stock and 70,000,000 shares of Common Stock. This amendment would not change the number of total authorized shares of our capital stock. Thus, immediately following the reverse stock split, the total number of authorized shares of capital stock would remain at 75,000,000, consisting of 5,000,000 shares of Preferred Stock and 70,000,000 shares of Common Stock. Subject to approval by the Company's stockholders at this meeting, in the event the reverse stock split is not approved, the Board may elect to increase the authorized number of shares of Common Stock as described in Proposal 4. The par value of the Preferred Stock and Common Stock would remain unchanged at \$0.001 per share.

In addition to the 39,225,824 shares of Common Stock outstanding at December 31, 2002, the Board has reserved 12,867,376 shares for issuance upon exercise of options and rights granted under the Company's stock option and stock purchase plans (including the increases subsequently approved by the Board and/or subject to stockholder approval as described in Proposal 3), and up to approximately 750,000 shares of Common Stock which may be issued upon exercise of warrants. In addition, on February 5, 2003, the Company entered

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into agreements to issue shares of Series A Convertible Preferred Stock, convertible into the Company's Common Stock, and Warrants to purchase Common Stock to certain investors in a private placement, subject to approval of the Company's stockholders at this meeting, as described in Proposal 2. Except as described above, at present the Board has no other plans to issue the additional shares of Common Stock.

Reasons for the Reverse Stock Split

The Board believes that a reverse stock split may be desirable for a number of reasons. First, the Board believes that a reverse stock split may allow the Company to avoid having the Common Stock delisted from the Nasdaq National Market. Second, the Board believes that a reverse stock split could improve the marketability and liquidity of the Common Stock.

The Common Stock is quoted on the Nasdaq National Market. In order for the Common Stock to continue to be quoted on the Nasdaq National Market, the Company must satisfy certain listing maintenance standards established by Nasdaq. Among other things, if the closing bid price of the Common Stock is under \$1.00 per share for 30 consecutive trading days and does not thereafter reach \$1.00 per share or higher for a minimum of ten consecutive trading days during the 90 calendar days following notification by Nasdaq, Nasdaq may delist the Common Stock from trading on the Nasdaq National Market. If the Common Stock were to be delisted, and the Common Stock does not qualify for trading on the Nasdaq SmallCap Market, the Common Stock would trade on the OTC Bulletin Board or in the pink sheets maintained by the National Quotation Bureau, Inc. Such alternative markets are generally considered to be less efficient than, and not as broad as, the Nasdaq National Market.

On November 12, 2002, the Company received a letter from Nasdaq advising that the Common Stock had not met Nasdaq's minimum bid price requirement for 30 consecutive trading days and that, if the Company was unable to demonstrate compliance with this requirement during the 90 calendar days ending February 10, 2003, the Common Stock would be delisted at that time. While Nasdaq has proposed an extension for its current grace periods and compliance for the minimum bid price requirement, it is unknown whether these rules will be adopted or the extended grace periods would be sufficient for the Company to regain compliance.

The Board expects that a reverse stock split of the Common Stock will increase the market price of the Common Stock so that the Company is able to maintain compliance with the Nasdaq minimum bid price listing standard. However, the effect of a reverse split upon the market price of the Common Stock cannot be predicted with any certainty, and the history of similar stock split combinations for companies in like circumstances is varied. It is possible that the per share price of the Common Stock after the reverse split will not rise in proportion to the reduction in the number of shares of the Common Stock outstanding resulting from the reverse stock split, and there can be no assurance that the market price per post-reverse split share will either exceed or remain in excess of the \$1.00 minimum bid price for a sustained period of time. The market price of the Common Stock may vary based on other factors which are unrelated to the number of shares outstanding, including the Company's future performance. In addition, there can be no assurance that the Common Stock will not be delisted due to a failure to meet other continued listing requirements even if the market price per post-reverse split share of the Common Stock remains in excess of \$1.00. Notwithstanding the foregoing, the Board believes that the proposed reverse stock split, when implemented within the proposed exchange ratio range, will result in the market price of the Common Stock rising to the level necessary to satisfy the \$1.00 minimum bid price requirement.

The Board also believes that the increased market price of the Common Stock expected as a result of implementing a reverse stock split will improve the marketability and liquidity of the Common Stock and will encourage interest and trading in the Common Stock. Because of the trading volatility often associated with low-priced stocks, many brokerage houses and institutional investors have internal policies and practices that either prohibit them from investing in low-priced stocks or tend to discourage individual brokers from recommending low-priced stocks to their customers. Some of those policies and practices may function to make the processing of trades in low-priced stocks economically unattractive to brokers. Additionally, because brokers' commissions on low-priced stocks generally represent a higher percentage of the stock price than

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commissions on higher-priced stocks, the current average price per share of the Common Stock can result in individual stockholders paying transaction costs representing a higher percentage of their total share value than would be the case if the share price were substantially higher. It should be noted that the liquidity of the Common Stock may be adversely affected by the proposed reverse split given the reduced number of shares that would be outstanding after the reverse stock split. The Board anticipates, however, that the expected higher market price will reduce, to some extent, the negative effects on the liquidity and marketability of the Common Stock inherent in some of the policies and practices of institutional investors and brokerage houses described above.

The Board does not intend for this transaction to be the first step in a series of plans or proposals of a going private transaction within the meaning of Rule 13e-3 of the Securities Exchange Act of 1934, as amended.

Board Discretion to Implement the Reverse Stock Split

If the reverse stock split is approved by the Company's stockholders, it will be effected, if at all, only upon a determination by the Board that a reverse stock split (with an exchange ratio determined by the Board as described above) is in the best interests of IntraBiotics and its stockholders. Such determination shall be based upon certain factors, including meeting the listing requirements for the Nasdaq National Market, existing and expected marketability and liquidity of the Common Stock, prevailing market conditions and the likely effect on the market price of the Common Stock. In addition, the reverse stock split is a condition to closing the private placement of Series A Convertible Preferred Stock and Warrants to purchase Common Stock to certain investors as described in Proposal 2. In the event the Board determines not to proceed with the reverse stock split, the Company may be unable to complete the private placement. If the Board determines to effect the reverse stock split, the Board will consider certain factors in selecting the specific exchange ratio, including the overall market conditions at the time and the recent trading history of the Common Stock.

Notwithstanding approval of the reverse stock split by the stockholders, the Board may, in its sole discretion, abandon all of the proposed amendments and determine prior to the effectiveness of any filing with the Secretary of State of the State of Delaware not to effect the reverse stock split prior to the one year anniversary of this special meeting of stockholders, as permitted under Section 242(c) of the Delaware General Corporation Law. If the Board fails to implement any of the amendments prior to the one year anniversary of this special meeting of stockholders, stockholder approval again would be required prior to implementing any reverse stock split.

Effects of the Reverse Stock Split

After the effective date of the proposed reverse stock split, each stockholder will own a reduced number of shares of the Common Stock. However, the proposed reverse stock split will affect all of the Company's stockholders uniformly and will not affect any stockholder's percentage ownership interests, except to the extent that the reverse split results in any of the stockholders owning a fractional share as described below. Proportionate voting rights and other rights and preferences of the holders of Common Stock will not be affected by the proposed reverse stock split (other than as a result of the payment of cash in lieu of fractional shares). For example, a holder of 2% of the voting power of the outstanding shares of Common Stock immediately prior to reverse stock split would continue to hold 2% of the voting power of the outstanding shares of Common Stock immediately after the reverse stock split. The number of stockholders of record will not be affected by the proposed reverse stock split (except to the extent that any stockholder holds only a fractional share interest and receives cash for such interest after the proposed reverse stock split).

The following table reflects the approximate number of shares of our Common Stock that would be outstanding as a result of each proposed reverse stock split based on 39,225,824 shares of our Common Stock

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outstanding as of December 31, 2002, without accounting for fractional shares which will be cancelled and paid for in cash:

Proposed Reverse Stock Split Ratio	Approximate Shares of Common Stock to be Outstanding	Approximate Shares of Common Stock to be Authorized but Unissued*
one-for-eight	4,903,228	65,096,772
one-for-ten	3,922,582	66,077,418
one-for-twelve	3,268,818	66,731,182

* Depending upon the reverse stock split ratio, up to approximately 1,700,000 shares will be reserved for issuance pursuant to outstanding options or warrants and for future issuances under the Company's equity incentive plans. Other than as described in Proposals 2 and 3, the Company has no current plans to issue the additional available shares of its Common Stock.

Although the proposed reverse stock split will not affect the rights of stockholders or any stockholder's proportionate equity interest in IntraBiotics (subject to the treatment of fractional shares), the number of authorized shares of Common Stock will not be reduced. This will increase significantly the ability of the Board to issue authorized and unissued shares without further stockholder action. The issuance in the future of such additional authorized shares may have the effect of diluting the earnings per share and book value per share, as well as the stock ownership and voting rights, of the currently outstanding shares of Common Stock. The effective increase in the number of authorized but unissued shares of Common Stock may be construed as having an anti-takeover effect by permitting the issuance of shares to purchasers who might oppose a hostile takeover bid or oppose any efforts to amend or repeal certain provisions of the Company's certificate of incorporation or bylaws.

The proposed reverse stock split will reduce the number of shares of Common Stock available for issuance under the Company's 2000 Equity Incentive Plan (including the increase in the number of shares reserved under this plan as more fully described in Proposal 3, below), 2000 Employee Stock Purchase Plan, 2002 Non-Officer Equity Incentive Plan and Amended and Restated 1995 Stock Option Plan in proportion to the exchange ratio selected by the Board within the limits set forth in this proposal. There are also certain outstanding stock options and warrants to purchase shares of Common Stock. Under the terms of the outstanding stock options and warrants, the proposed reverse stock split will effect a reduction in the number of shares of Common Stock issuable upon exercise of such stock options and warrants in proportion to the exchange ratio of the reverse stock split and will effect a proportionate increase in the exercise price of such outstanding stock options and warrants. None of the rights currently accruing to holders of our Common Stock, options or warrants would be affected by the reverse stock split.

If the proposed reverse stock split is implemented, it will increase the number of stockholders of IntraBiotics who own odd lots of less than 100 shares of Common Stock. Brokerage commission and other costs of transactions in odd lots are generally higher than the costs of transactions of more than 100 shares of Common Stock.

The Common Stock is currently registered under Section 12(g) of the Securities Exchange Act of 1934, as amended, and the Company is subject to the periodic reporting and other requirements of the Exchange Act. The proposed reverse stock split will not affect the registration of the Common Stock under the Exchange Act. If the proposed reverse stock split is implemented, the Common Stock will continue to be reported on the Nasdaq National Market under the symbol IBPI (although Nasdaq would likely add the letter D to the end of the trading symbol for a period of 20 trading days to indicate that the reverse stock split has occurred).

Effective Date

The proposed reverse stock split would become effective as of 5:00 p.m. Eastern time on the date of filing of a certificate of amendment to the Company's certificate of incorporation with the office of the Secretary of State of the State of Delaware. Except as explained below with respect to fractional shares, on the effective date, shares of Common Stock issued and outstanding immediately prior thereto will be combined and

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converted, automatically and without any action on the part of the stockholders, into new shares of Common Stock in accordance with reverse stock split ratio determined by the Board within the limits set forth in this proposal.

Payment for Fractional Shares

No fractional shares of Common Stock will be issued as a result of the proposed reverse stock split. Instead, stockholders who otherwise would be entitled to receive fractional shares, upon surrender to the exchange agent of such certificates representing such fractional shares, will be entitled to receive cash in an amount equal to the product obtained by multiplying (i) the closing sales price of the Common Stock on the effective date as reported on the Nasdaq National Market by (ii) the number of shares of Common Stock held by such stockholder that would otherwise have been exchanged for such fractional share interest.

Exchange of Stock Certificates

As soon as practicable after the effective date, stockholders will be notified that the reverse split has been effected. The Company's transfer agent will act as exchange agent for purposes of implementing the exchange of stock certificates. Such person is referred to as the exchange agent. Holders of pre-reverse split shares will be asked to surrender to the exchange agent certificates representing pre-reverse split shares in exchange for certificates representing post-reverse split shares in accordance with the procedures to be set forth in a letter of transmittal to be sent by the Company. No new certificates will be issued to a stockholder until such stockholder has surrendered such stockholder's outstanding certificate(s) together with the properly completed and executed letter of transmittal to the exchange agent. **Stockholders should not destroy any stock certificate and should not submit any certificates until requested to do so.**

Accounting Consequences

The par value per share of Common Stock would remain unchanged at \$0.001 per share after the reverse stock split. As a result, on the effective date of the reverse split, the stated capital on the Company's balance sheet attributable to the Common Stock will be reduced proportionally, based on the exchange ratio of the reverse stock split, from its present amount, and the additional paid-in capital account will be credited with the amount by which the stated capital is reduced. The per share Common Stock net income or loss and net book value will be increased because there will be fewer shares of Common Stock outstanding. It is not anticipated that any other accounting consequences would arise as a result of the reverse stock split.

No Appraisal Rights

Under the Delaware General Corporation Law, the Company's stockholders are not entitled to dissenter's rights with respect to the proposed amendments to the Company's charter to effect the reverse split and the Company will not independently provide the stockholders with any such right.

Material Federal U.S. Income Tax Consequences of the Reverse Stock Split

The following is a summary of important tax considerations of the proposed reverse stock split. It addresses only stockholders who hold the pre-reverse split shares and post-reverse split shares as capital assets. It does not purport to be complete and does not address stockholders subject to special rules, such as financial institutions, tax-exempt organizations, insurance companies, dealers in securities, mutual funds, foreign stockholders, stockholders who hold the pre-reverse split shares as part of a straddle, hedge, or conversion transaction, stockholders who hold the pre-reverse split shares as qualified small business stock within the meaning of Section 1202 of the Internal Revenue Code of 1986, as amended (the Code), stockholders who are subject to the alternative minimum tax provisions of the Code, and stockholders who acquired their pre-reverse split shares pursuant to the exercise of employee stock options or otherwise as compensation. This summary is based upon current law, which may change, possibly even retroactively. It does not address tax considerations under state, local, foreign, and other laws. Furthermore, the Company has not obtained a ruling

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from the Internal Revenue Service or an opinion of legal or tax counsel with respect to the consequences of the reverse stock split. **Each stockholder is advised to consult his or her tax advisor as to his or her own situation.**

The reverse stock split is intended to constitute a reorganization within the meaning of Section 368 of the Code. Assuming the reverse split qualifies as a reorganization, a stockholder generally will not recognize gain or loss on the reverse stock split, except to the extent of cash, if any, received in lieu of a fractional share interest in the post-reverse split shares. The aggregate tax basis of the post-reverse split shares received will be equal to the aggregate tax basis of the pre-reverse split shares exchanged therefor (excluding any portion of the holder's basis allocated to fractional shares), and the holding period of the post-reverse split shares received will include the holding period of the pre-reverse split shares exchanged.

A holder of the pre-reverse split shares who receives cash will generally recognize gain or loss equal to the difference between the portion of the tax basis of the pre-reverse split shares allocated to the fractional share interest and the cash received. Such gain or loss will be a capital gain or loss and will be short term if the pre-reverse split shares were held for one year or less and long term if held more than one year.

No gain or loss will be recognized by the Company as a result of the reverse stock split.

Required Vote

The affirmative vote of the holders of a majority of the shares of the Common Stock outstanding on the record date will be required to approve these amendments to the Company's amended and restated certificate of incorporation. As a result, abstentions and broker non-votes will have the same effect as negative votes.

**The Board of Directors Recommends
a Vote in Favor of Proposal 1.**

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PROPOSAL 2

APPROVAL AND RATIFICATION OF THE

PRIVATE PLACEMENT PROPOSAL

Overview

On February 3, 2003, the Board of Directors unanimously approved the sale and issuance, in a private placement, of a newly created Series A Convertible Preferred Stock, par value \$0.001 per share (the Series A Stock), and warrants to purchase Common Stock of the Company (the Warrants) to certain investors. Pursuant to a series of individual Preferred Stock and Warrant Purchase Agreements, dated as of February 5, 2003 and amended as of February 11, 2003 (collectively referred to as the Purchase Agreements), and subject to approval of the Company's stockholders, the Company agreed to issue to the investors, and the investors agreed to purchase from the Company, for an aggregate gross purchase price of approximately \$3.5 million, (i) a total of up to 350 shares of Series A Stock and (ii) Warrants to purchase the number of shares of Common Stock as determined pursuant to the formula described below.

The Series A Stock is convertible into shares of Common Stock at a conversion price (the Conversion Price) equal to 92% of the Closing Price. The Closing Price is equal to the lesser of (i) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the date of the Purchase Agreements and (ii) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the issuance of the Series A Stock. The Warrants are exercisable at the Closing Price for a number of shares of Common Stock equal to 50% of the Investors' aggregate purchase price for Series A Stock divided by the Conversion Price. If certain changes occur to the Company's capitalization, such as a stock split, stock dividend of the Common Stock or other capital reorganization, then the Conversion Price will be adjusted appropriately.

The primary purpose of completing the private placement is to provide funds to allow the Company to conduct and complete a clinical trial of iseganan HCl for the prevention of ventilator-associated pneumonia (the VAP Clinical Trial) as well as for other general corporate purposes and working capital. The net proceeds from the proposed private placement will enhance the Company's liquidity, strengthen its balance sheet and, the Company believes, facilitate the completion of the VAP Clinical Trial.

Tang Capital Partners, LP (Tang Capital) is the lead investor in this private placement and an existing holder of approximately 3% of the Company's Common Stock outstanding as of December 31, 2002. Certain other institutional investors will also purchase shares in this private placement (collectively, the Investors). In addition, Ernest Mario, Ph.D., Chairman of the Company's Board of Directors, is participating in the private placement as more fully described below. At the request of the Investors, certain of the Company's stockholders, who are affiliates of the Company, entered into stockholder agreements (collectively referred to as the Stockholder Agreements) with the Investors that require these stockholders to vote their shares of the Company's capital stock in favor of the approval of the private placement.

If the Company's stockholders do not approve this proposal, the Series A Stock and Warrants will only be issued in such amounts and subject to such conditions that would permit the issuance under the Nasdaq Marketplace Rules without the stockholder approval. This includes, among other things, the limitation on the number of shares that the Company could issue or that would be deemed issuable in connection with the private placement, which would be no more than 19.9% percent of the Company's Common Stock outstanding on the date of the Purchase Agreements. In addition, Dr. Mario will not be able to participate in the private placement. This would result in lower proceeds to the Company from the transaction. Management believes that if the stockholders do not authorize the proposed private placement, the amount of the proceeds will not be sufficient to complete the VAP Clinical Trial, and it may be difficult to obtain alternative sources of financing on a timely basis or at all. Even if the Company is able to timely obtain such an alternative source of financing, there can be no assurance that the terms will be as favorable as the terms of the private placement with the Investors, or acceptable at all.

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Reasons for Stockholder Approval

The Company is seeking stockholder approval and ratification of the issuance of the Series A Stock and the Warrants pursuant to the Purchase Agreements (including any securities of the Company issued as dividends, pursuant to any adjustments or otherwise in respect of the Series A Stock or the Warrants in accordance with the terms thereof) in order to ensure compliance with Rule 4350 of the Nasdaq Marketplace Rules (Nasdaq Rule 4350). Stockholder approval of the private placement is not otherwise required as a matter of Delaware law or other applicable laws or rules or by the Company s certificate of incorporation or bylaws.

The Company s Common Stock is listed on the Nasdaq National Market. Nasdaq Rule 4350 requires stockholder approval prior to the issuance of securities under certain circumstances, including in connection with a transaction involving the sale or issuance by the Company of Common Stock, or securities convertible into or exercisable for Common Stock at a price below the book value or market value, where the amount of the stock being issued is equal to 20% or more of the issuer s Common Stock outstanding prior to issuance of the preferred stock or 20% or more of the issuer s voting power outstanding before such issuance. In addition, Nasdaq Rule 4350 requires stockholder approval in connection with the issuance of securities that could result in a change of control of an issuer. Finally, Nasdaq Rule 4350 also requires stockholder approval in connection with certain issuances of securities to officers or directors of the Company at a price below the book value or market value. As of December 31, 2002, the book value of the Common Stock was \$0.39 per share and the closing market price reported on Nasdaq National Market on February 5, 2003 was \$0.23.

The Common Stock issuable upon conversion of the Series A Stock and exercise of the Warrants to be purchased by the Investors would exceed 20% of the total Common Stock outstanding and the voting power of the Series A Stock to be purchased by the Investors exceeds 20% of the voting power outstanding. The Series A Stock is being issued at a stated price of \$10,000.00 per share and is convertible at the election of the holder in into shares of Common Stock at the Conversion Price, as defined above. Because the Conversion Price is equal to 92% of the lesser of (i) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the date of the Purchase Agreements and (ii) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the issuance of the Series A Stock, the Company is unable to determine prior to issuance whether the price is below market value as defined by Nasdaq. In addition, the Series A Stock also accrues dividends that are payable in Common Stock on a quarterly basis. Finally, the Warrants will be exercisable for shares of Common Stock at an exercise price equal to the Conversion Price, which, as noted above, may be less than market value as defined by Nasdaq. Accordingly, the Company is seeking stockholder approval to ensure compliance with this aspect of the Nasdaq Rule 4350.

Further, Nasdaq Rule 4350 requires stockholder approval in connection with the issuance of securities that could result in a change of control of an issuer. While the rule currently does not specifically define when a change in control of an issuer may be deemed to occur, Nasdaq suggests in its proposed rules that a change of control would occur, subject to certain limited exceptions, if after a transaction, a person or an entity will hold 20% or greater of the issuer s then outstanding capital stock. For the purposes of calculating the holding of such person or entity, Nasdaq would take into account, in addition to all of the shares of capital stock received by such person or entity in the transaction, all of the shares held by such person or entity unrelated to the transaction and would assume the conversion of any convertible securities and exercise of any options or warrants held by such person or entity. The Company believes that the issuance of the Series A Stock and the Warrants to Tang Capital may constitute a change in control of the Company solely for the purpose of Nasdaq Rule 4350 calculations, and the Company is seeking stockholder approval to ensure compliance with the rule.

Nasdaq Rule 4350 also requires stockholder approval in connection with arrangements pursuant to which securities may be acquired by officers or directors of the issuer at a price below book or market value. Pursuant to the Purchase Agreements, the Company will issue 50 shares of Series A Stock and Warrants to purchase up to the proportionate number of shares of Common Stock in this private placement to Dr. Mario, Chairman of the Company s Board of Directors, for an aggregate purchase price of \$500,000. The Company is seeking

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stockholder approval to ensure compliance with the rule and allow Dr. Mario's participation in the private placement.

Reasons for the Proposed Private Placement

The Board of Directors decided to pursue the proposed private placement following an evaluation and review of the Company's financial condition, funding requirements and prospects in light of its business strategy. Management believes the proposed private placement will result in more long-term value for the Company's stockholders as it is expected to allow the Company to conduct and complete the VAP Clinical Trial and will provide greater financial flexibility.

Summary of Terms

The following is a summary of the provisions of the Purchase Agreements between the Company and the Investors as well as the rights and preferences of the Series A Stock and Warrants and the terms of the Stockholder Agreements. Each summary is qualified in its entirety by the form of Purchase Agreement attached as Appendix B, the form of Certificate of Designation attached as Appendix C, the form of Warrant attached as Appendix D and the form of Stockholder Agreement attached as Appendix E, each incorporated herein.

Purchase Agreements

Pursuant to the Purchase Agreements, the Company has agreed to issue and sell a total of up to 350 shares of Series A Stock to the Investors at a purchase price of \$10,000 per share. Simultaneously with the issuance of Series A Stock, the Company has also agreed to issue to the Investors warrants to purchase an aggregate number of shares of Common Stock equal to 50% of the Investor's aggregate purchase price for Series A Stock divided by the Conversion Price. The closing of the transactions (the Closing) contemplated by the Purchase Agreements will occur on the tenth business day following the date upon which the reverse stock split becomes effective, subject to stockholder approval as described above in Proposal 1 and certain other closing conditions. If the Company's stockholders do not approve this proposal, the Purchase Agreements provide that Series A Stock and Warrants will only be issued in such amounts and subject to such conditions that would permit the issuance under the Nasdaq Rule 4350 without stockholder approval. This includes, among other things, the limitation on the number of shares and warrant that the Company could issue in the private placement.

Representations, Warranties and Covenants. The Purchase Agreements contain representations and warranties relating to the Company's organization and qualification, capitalization, authorization and enforceability of the Purchase Agreements, the issuance and sale of the Series A Stock and Warrants, the Company's filings with the SEC, intellectual property, financial statements, regulatory compliance and other matters common in transactions of this kind. The Purchase Agreements also contain covenants by the Company to use its reasonable best efforts to effect the transactions contemplated by the Purchase Agreements, notify the Investors of certain developments, maintain listing of the Company's Common Stock on the Nasdaq National Market, timely deliver shares of Common Stock issuable upon conversion of the Series A Stock or exercise of the Warrants, and other similar covenants common in transactions of this kind. The Company also agreed not to incur indebtedness (other than payables in the ordinary course of business) in excess of \$500,000 in the aggregate and not to engage in any additional equity financings without the approval of the Board of Directors, including the Tang Representatives, as defined in the Corporate Governance subsection below. In addition, the reverse stock split as described in Proposal 1 is a condition to closing the private placement.

Corporate Governance. Pursuant to the Purchase Agreements, the Company and the Investors agreed that, upon the Closing, Tang Capital will have the right to designate the two individuals who will serve as representatives of the Series A Stock on the Company's Board of Directors (the Tang Representatives), in accordance with the provisions of the Certificate of Designation. The Company further agreed to take such corporate actions as necessary to facilitate such appointment. In addition, the Company agreed, for so long as the Series A Stock remains outstanding, not to increase the size of the Board existing at the time of the

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Closing without the approval of the Board of Directors, including the Tang Representatives. If the private placement is not approved by the stockholders, the Series A Stock will only be entitled to one Board representative in compliance with the Nasdaq requirements.

Right of First Refusal. The Investors shall have the right in the event the Company proposes to offer equity securities to any person to purchase their pro rata portion of such shares. Such right of first refusal will be subject to certain customary exclusions, including for shares issued pursuant to any options or other stock awards granted to employees, directors or consultants of the Company, equipment leasing arrangements, debt financings or strategic financings that have been approved by the Board of Directors. The right of first refusal will terminate upon the earlier of (i) the automatic conversion of the Series A Stock held by the Investors into Common Stock (as described below) or (ii) a change in control of the Company.

Registration Rights. Pursuant to the Purchase Agreements, the Company has agreed to file with the SEC, at its expense, a registration statement related to the Common Stock issued or issuable upon the conversion of the Series A Stock or exercise of the Warrants within ten days after the Series A Stock and Warrants are issued. The Company has agreed to use its reasonable best efforts to have such registration statement declared effective by the SEC within 90 days after the registration statement is initially filed. The registration rights include other customary terms, including without limitation those related to registration expenses, indemnification and other similar provisions. If the Company fails to file the registration statement within ten days after the Series A Stock and Warrants are issued, then the Company must pay to each Investor 2.0% of the Investor's aggregate purchase price per month (on a pro-rated basis) until the registration statement is filed.

Other Penalties. If the Company fails to perform certain of the covenants, such as timely holding the stockholders' meeting to solicit approval of the private placement and timely delivery to the Investors of the shares of Common Stock issuable upon conversion of Series A Stock or exercise of the Warrants, then the Company must pay to each Investor 2.0% of the Investor's aggregate purchase price per month (on a pro-rated basis) until the covenant is performed.

If the Company fails to retain the services of Henry J. Fuchs, M.D., the Company's Chief Executive Officer, until the earlier to occur of (A) the unblinding and the public announcement of the results of the VAP Clinical Trial or (B) the second anniversary of the issuance of Series A Stock, then the Company must pay to each Investor a one-time payment equal to 15.0% of the Investor's aggregate purchase price for the Series A Stock. This penalty will not apply if Dr. Fuchs' departure from the Company is the result of his death, disability or family emergency or if the Company retains services of an executive officer to replace Dr. Fuchs within sixty (60) days of Dr. Fuchs' departure, for reasons other than his death, disability or family emergency, and such replacement is approved by the Board of Directors, including the Tang Representatives.

In the event that the Company's Common Stock is delisted from the Nasdaq National Market at any time prior to the exercise or the expiration of the Warrants, then the exercise price of the Warrants will be decreased by 50% without an associated increase in the number of shares of Common Stock issuable upon exercise of the Warrants. In that regard, under Nasdaq Rule 4450, the Company must maintain a minimum net worth of \$10.0 million. As of December 31, 2002, the Company's stockholders' equity was approximately \$15.5 million. The Company cannot anticipate when, without additional financings, it will have stockholders' equity of less than \$10.0 million. The Company expects stockholders' equity to decline as it continues to spend cash resources in pursuit of the VAP Clinical Trial and once the Company takes possession of an additional delivery of finished iseganan HCl and expenses \$2.4 million of pre-paid expense reflected on its December 31, 2002 balance sheet. As a result, the Company could fall out of compliance with Nasdaq's continued listing standard prior to its completion of VAP Clinical Trial. If this were to occur, Nasdaq could initiate a delisting procedure, and the Company may be unable to obtain additional financing in order to stay listed on the Nasdaq National Market.

Terms of the Series A Stock

The following summary of the rights and preferences of the Series A Stock is qualified in its entirety by the Certificate of Designation attached hereto as Appendix C and incorporated herein.

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Amount. The Company will designate a total of 350 shares of Series A Stock.

Dividends. The holders of Series A Stock will be entitled to receive cumulative dividends at the rate of eight percent (8%) per annum of the original per share price of the Series A Stock, prior to and in preference to any declaration or payment of a dividend to the holders of Common Stock. The dividends will be payable quarterly in shares of Common Stock, and the number of shares payable will be determined based on the average closing sale price of the Common Stock on the Nasdaq National Market or other market on which the Company's Common Stock is traded for each of the five (5) trading days immediately preceding the applicable dividend payment date. Until accrued and unpaid dividends on the Series A Stock are paid and set apart, no dividends or other distributions in respect of any other capital stock of the Company shall be declared.

Liquidation Rights. Upon liquidation, dissolution or winding up of the Company, the holders of Series A Stock shall be first entitled to receive, in preference to holders of Common Stock, an amount equal to the original per share price of the Series A Stock, plus accrued and unpaid dividends. In addition, the holders of Series A Stock could elect to treat as liquidation (A) the acquisition of the Company by another entity by means of any transaction or series of related transactions that have been approved by the Board of Directors, including any reorganization, merger or consolidation, other than with a wholly-owned subsidiary corporation or solely for the purposes of changing the domicile of the Company, or (B) a sale, transfer or disposition of all or substantially all of the shares or assets of the Company by a means of any transaction or series of related transactions that have been approved by the Board of Directors, except when the Company's stockholders as constituted immediately prior to such transaction will, immediately after such transaction hold at least fifty percent (50%) of the voting power of the surviving or acquiring entity.

Conversion at Option of Holder. Each share of Series A Stock is convertible, in whole or in part, into shares of Common Stock at any time at the option of the holder thereof at the Conversion Price. The Conversion Price is equal to ninety-two percent (92%) of the Closing Price, which, in turn, is equal to the lesser of (i) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the date of the Purchase Agreements and (ii) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the issuance of the Series A Stock.

Automatic Conversion. Each share of Series A Stock shall automatically be converted into shares of Common Stock, based on the Conversion Price (as adjusted for stock splits, dividends and the like), in the event that after the earlier to occur of (i) the unblinding and public announcement of the results of the VAP Clinical Trial or (ii) the second anniversary of the issuance of the Series A Stock, the closing sale price of the Common Stock on the Nasdaq National Market has traded at a price equal to or higher than four times the Closing Price for a period of 20 consecutive days, provided that the Common Stock has traded at such a level.

Voting Rights. The Series A Stock will generally vote together with the Common Stock and not as a separate class except as described below or as otherwise required by law. In accordance with Nasdaq voting rights policy, each share of Series A Stock shall have a number of votes equal to the number of shares of Common Stock which would have been issuable upon conversion of such shares of Series A on the date of signing of the Purchase Agreements if the Conversion Price was equal to the closing bid price of the Common Stock on the Nasdaq National market on the date of the Purchase Agreements. The number of votes will not be adjusted except for stock splits, dividends paid on the Common Stock and the like.

So long as at least 100 shares of Series A Stock remain outstanding, the holders of the Series A Stock will be entitled to elect two members of the Board of Directors of the Company at each meeting of the Company's stockholders for the election of directors. The remaining directors will be elected by the holders of Common Stock and Series A Stock, voting together as a single class. If the private placement is not approved by the stockholders, the Series A Stock will only be entitled to one Board representative in compliance with the Nasdaq requirements.

For so long as at least 100 shares of Series A Stock remain outstanding, consent of at least a majority of the then outstanding Series A Stock shall be required for (i) any action that amends the Company's

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Certificate of Incorporation (including the filing of a Certificate of Designation) so as to affect the rights, preferences or privileges of the Series A Stock adversely; (ii) any authorization or designation of a new class or series of stock which ranks senior to the Series A Stock in right of liquidation preference, voting or dividends or (iii) prior to the second anniversary of the issuance date of Series A Stock, any merger into or consolidation with any other corporation (other than a wholly-owned subsidiary corporation or for the purposes of changing the domicile of the Company) or the completion of any transaction or series of related transactions in which fifty percent (50%) or more of the voting power of the Corporation is transferred or any transfer or sale of all or substantially all of the assets of the Company.

Terms of the Warrants

The following description of the rights and preferences of the Warrants is qualified in its entirety by the form of Warrant attached hereto as Appendix D and incorporated herein. The Warrants will have a term of five years. The Warrants are exercisable at a price equal to the Closing Price, which is equal to the lesser of (i) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the date of the Purchase Agreements and (ii) the average of the closing sale prices of the Common Stock on the Nasdaq National Market for each of the five trading days immediately preceding the issuance of the Series A Stock. The Warrant will also include cashless exercise provisions.

If certain changes occur to the Company's capitalization, such as a stock split, stock dividend of the Common Stock or other capital reorganization, then the exercise price and number of shares issuable upon exercise of the Warrants will be adjusted appropriately.

In the event that the private placement is not approved by the stockholders, the Warrants will not be exercisable during the six months after issuance and the exercise price will be equal to the closing bid price of the Common Stock on the Nasdaq National Market on the date of the Purchase Agreements, in accordance with the Nasdaq requirements.

In the event that the Company's Common Stock is delisted from the Nasdaq National Market at any time prior to the exercise or the expiration of the Warrants, then the exercise price of the Warrants will be decreased by 50% without an associated increase in the number of shares of Common Stock issuable upon exercise of the Warrants.

Stockholder Agreements

The following description of the Stockholder Agreements is qualified in its entirety by the form of Stockholder Agreement attached hereto as Appendix E and incorporated herein. At the request of the Investors, certain of the Company's stockholders, who are affiliates of the Company, entered into Stockholder Agreements with the Investors that require these stockholders to vote their shares of the Company's capital stock in favor of the approval of the private placement. The Stockholder Agreements will terminate upon the earlier of the date immediately following the date of this meeting or the date of the completion of the private placement.

Impact of the Private Placement on Existing Stockholders

Factors. The holders of the Series A Stock will have certain rights which are senior to those of the holders of Common Stock. Stockholders should consider the following non-exclusive factors, among others, in determining whether to vote for the transaction:

The issuance of the Series A Stock, the ability of the holders of such shares to convert their shares into Common Stock, the issuance of shares of Common Stock upon exercise of the Warrants, and the conversion and exercise price adjustment provisions of the Warrants, respectively, may impact the trading patterns and adversely affect the market price of the Common Stock.

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The holders of Series A Stock will have a claim against the Company's assets senior to the holders of Common Stock in the event of the Company's liquidation or deemed liquidation, as described above, or bankruptcy.

The holders of Series A Stock will be entitled to receive certain dividends, payable in Common Stock, as described above. The payment of these dividends will take priority over the payment of dividends, if any, on the Company's Common Stock.

Stockholders are subject to the risk of substantial dilution to their interests which may result from the issuance of shares of Common Stock upon conversion of the Series A Stock or exercise of the Warrants. As a result of the issuance of such Common Stock, the current stockholders will own a smaller percentage of the outstanding Common Stock of the Company.

The holders of Series A Stock will have the right to elect two directors to the Company's Board of Directors and will have certain protective voting rights, as described above.

All shares of Common Stock issuable upon the conversion of Series A Stock or exercise of the Warrants will be entitled to certain registration rights. Consequently, if such shares are registered, such shares will be freely transferable without restriction under the Securities Act of 1933, as amended (but may be subject to the short-swing profit rules and other restrictions under the Exchange Act). Such free transferability could materially and adversely affect the market price of the Common Stock if a sufficient number of such shares are sold into the market. In addition, even if the shares of Common Stock are not registered, the Investors may be eligible to sell some of the Common Stock pursuant to Rule 144.

Appraisal Rights. Under Delaware law, stockholders are not entitled to appraisal rights with respect to the transaction.

Relationship of the Investors to Company

Ernest Mario, Ph.D. is Chairman of the Board of Directors and previously served as the Company's Chief Executive Officer from April 2002 to January 2003. Tang Capital currently holds approximately 1,251,900 shares of the Company's Common Stock, which represents approximately 3% of the Company's Common Stock outstanding as of December 31, 2002. Kevin Tang is the managing director of Tang Capital Management, LLC, which is the general partner of Tang Capital. Mr. Tang is the managing director of Tang Advisors, LLC, which previously served as a consultant to the Company in the first quarter of 2002. In addition, Mr. Tang exercises sole voting and investment power over the shares of Common Stock held of record by Tang Capital. Upon Closing, Mr. Tang is expected to be one of the representatives of the Series Stock on the Board of Directors of the Company. Some of the other Investors are also existing stockholders of the Company.

Required Vote

The affirmative vote of the stockholders having a majority of the voting power of all shares present in person or represented by proxy and entitled to vote at the meeting will be required to approve and ratify Proposal 2. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether this matter has been approved.

**The Board of Directors Recommends
a Vote in Favor of Proposal 2.**

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PROPOSAL 3

APPROVAL OF THE AMENDMENT TO THE 2000 EQUITY INCENTIVE PLAN

In March 2000, the Board adopted, and the stockholders subsequently approved, the Company's 2000 Equity Incentive Plan (the "Incentive Plan"). As of December 31, 2002, there were 6,430,940 shares of Common Stock reserved for issuance under the Incentive Plan. In addition, on each December 31 the number of shares of Common Stock reserved for issuance under the Incentive Plan automatically increases by the least of (i) 5% of the outstanding Common Stock, (ii) two million (2,000,000) shares or (iii) a lesser amount determined by the Board.

In November 2001 and November 2002, based on the Company's then existing strategic plans, the Board determined that the automatic increase in the share reserve scheduled to occur on December 31, 2001 and December 31, 2002, respectively, should not occur, and acted accordingly. As a result of the Board's actions in 2001 and 2002, the number of shares of Common Stock reserved for issuance under the Incentive Plan did not increase on either December 31, 2001 or December 31, 2002.

The strategic plans of the Company have changed substantially since November 2002. In November 2002, the Board was in the process of reviewing strategic alternatives including a sale of the Company and did not anticipate granting additional stock awards to current employees, consultants and directors of the Company. However, as a result of the Board's decision to pursue the VAP Clinical Trial, the Board now believes it is necessary to grant new stock awards to current employees and directors as incentives for those persons to remain in the service of the Company and to exert maximum efforts for the success of the Company.

The Board believes additional grants are appropriate because options to purchase approximately 7,431,009 shares, or 98% of all options outstanding as of December 31, 2002, have exercise prices substantially in excess of the current trading price for the Common Stock. Accordingly, the Board adopted an amendment to the Incentive Plan, described below, in order to effect a cancellation of existing options and grant of new options at an exercise price equal to the current fair market value of the Common Stock. In addition, the Board believes that in order to retain the services of new employees and directors, it will be necessary to grant such persons stock awards under the Incentive Plan. Therefore, on February 3, 2003 and February 11, 2003, the Board amended the Incentive Plan, subject to stockholder approval, to increase the number of shares of Common Stock authorized for issuance under the Incentive Plan by one million nine hundred thousand (1,900,000) shares. This number represents the number of shares of Common Stock that is slightly lower than the number that would have been added to the share reserve under the Incentive Plan automatically on December 31, 2002, had the Board not taken its actions to prevent such increase. The Board adopted this amendment in order to ensure that the Company can continue to grant stock awards at levels determined appropriate by the Board.

As of December 31, 2002 stock awards covering an aggregate of 5,508,763 shares of the Company's Common Stock were outstanding under the Incentive Plan. Only 922,177 shares of Common Stock (plus any shares that might in the future be returned to the Incentive Plan as a result of cancellations or expiration of awards) remained available for future grant under the Incentive Plan.

Currently, no employee may be granted options under the Incentive Plan covering more than one million five hundred thousand (1,500,000) shares of Common Stock during any calendar year (the "Section 162(m) Limitation"). On February 3, 2003, the Board amended the Incentive Plan, subject to stockholder approval, to increase the Section 162(m) Limitation to three million (3,000,000) shares of Common Stock.

On January 27, 2003, the Board approved, and on February 6, 2003, the Company completed an Option Cancellation and Regrant Program, whereby all optionholders, including the Company's employees, officers and directors, could elect to have their existing, outstanding options cancelled in exchange for new options to purchase the same number of shares, subject to some exceptions, which were granted immediately following the cancellation of the existing options. The new options have an exercise price equal to the fair market value of the stock on the date of grant, in accordance with the terms of the Company's option plans, and have a five

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(5) year term. In accordance with past practice, new options granted to employees vest monthly over four years beginning one month after the date of grant. New options granted to non-employee directors of the Company vest in full on the first anniversary after the date of grant, which is consistent with vesting schedule for stock options previously granted to non-employee directors. Subject to obtaining stockholder approval of this Proposal 3, the new options were granted under the Incentive Plan and the Company's 2002 Non-Officer Equity Incentive Plan.

Ordinarily, when a stock option is granted to an employee, or to a member of a company's board of directors, with an exercise price that is equal to or greater than the fair market value of the underlying common stock on the date of grant and a time-based vesting schedule, the granting company will not be required to recognize a charge to its earnings for financial accounting purposes with respect to such grant because the grant is subject to fixed award accounting.

Since December 15, 1998, the Financial Accounting Standards Board has taken the position that a direct or indirect repricing of compensatory stock options will convert those options into variable awards for financial accounting purposes. The Company's Option Cancellation and Regrant Program is considered a repricing of compensatory stock options; therefore, the new options granted under the program will be subject to variable award accounting for financial accounting purposes. If an option is treated as a variable award, the compensatory charge to earnings associated with that option will not be finally fixed until the time that the option is exercised, forfeited or expires unexercised. If, at the time the compensatory charge to earnings for the new options is fixed, the fair market value of the Common Stock subject to the new options is greater than the exercise price of the new options (*i.e.*, there is a spread), the Company will be required to recognize a charge to earnings equal to such spread. In addition, a tentative charge to earnings is calculated and adjusted quarterly to reflect fluctuations in the value of the Common Stock subject to the new options until the new options are exercised, forfeited or expire unexercised. Due to this treatment, the Company's Option Cancellation and Regrant Program could have a significant adverse and unpredictable impact on the Company's reported earnings.

Required Vote

Stockholders are requested in this Proposal 3 to approve the amendments to the Incentive Plan. The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the meeting will be required to approve the amendments to the Incentive Plan. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether this matter has been approved.

The Board of Directors Recommends a Vote in Favor of Proposal 3.

The essential features of the Incentive Plan are outlined below:

General

The Incentive Plan provides for the grant of incentive stock options, nonstatutory stock options, stock bonuses and restricted stock purchase awards (collectively awards). Incentive stock options granted under the Incentive Plan are intended to qualify as incentive stock options within the meaning of Section 422 of the Code. Nonstatutory stock options granted under the Incentive Plan are not intended to qualify as incentive stock options under the Code. See Federal Income Tax Information for a discussion of the tax treatment of awards.

Purpose

The Board adopted the Incentive Plan to provide a means by which employees, directors and consultants of the Company and its affiliates may be given an opportunity to purchase stock in the Company, to assist in retaining the services of such persons, to secure and retain the services of persons capable of filling such

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positions and to provide incentives for such persons to exert maximum efforts for the success of the Company and its affiliates. All of the approximately 20 employees, directors and consultants of the Company and its affiliates are eligible to participate in the Incentive Plan.

Administration

The Board administers the Incentive Plan. Subject to the provisions of the Incentive Plan, the Board has the power to construe and interpret the Incentive Plan and to determine the persons to whom and the dates on which awards will be granted, the number of shares of Common Stock to be subject to each award, the time or times during the term of each award within which all or a portion of such award may be exercised, the exercise price, the type of consideration and other terms of the award. In addition, the Board has the power to reduce the exercise price of any outstanding option under the Incentive Plan; cancel any outstanding option and grant in substitution therefor a new option, a stock bonus, the right to acquire restricted stock and/or cash; or take any other action that is treated as a repricing under generally accepted accounting principles.

The Board has the power to delegate administration of the Incentive Plan to a committee composed of at least one member of the Board. In the discretion of the Board, a committee may consist solely of two or more outside directors in accordance with Section 162(m) of the Code or solely of two or more non-employee directors in accordance with Rule 16b-3 of the Exchange Act. The Board has delegated administration of the Incentive Plan to the Compensation Committee of the Board. As used herein with respect to the Incentive Plan, the Board refers to any committee the Board appoints as well as to the Board itself.

The regulations under Section 162(m) of the Code require that the directors who serve as members of the committee must be outside directors. The Incentive Plan provides that, in the Board's discretion, directors serving on the committee may be outside directors within the meaning of Section 162(m). This limitation would exclude from the committee directors who are (i) current employees of the Company or an affiliate, (ii) former employees of the Company or an affiliate receiving compensation for past services (other than benefits under a tax-qualified pension plan), (iii) current and former officers of the Company or an affiliate, (iv) directors currently receiving direct or indirect remuneration from the Company or an affiliate in any capacity (other than as a director), and (v) any other person who is otherwise not considered an outside director for purposes of Section 162(m).

Stock Subject to the Incentive Plan

Subject to this Proposal, an aggregate of 8,330,940 shares of Common Stock is reserved for issuance under the Incentive Plan. In addition, on each December 31 the number of shares of Common Stock reserved for issuance under the Incentive Plan shall continue to be increased automatically by the least of (i) 5% of the outstanding Common Stock, (ii) two million (2,000,000) shares or (iii) a lesser amount determined by the Board. If awards granted under the Incentive Plan expire or otherwise terminate without being exercised, the shares of Common Stock not acquired pursuant to such awards again become available for issuance under the Incentive Plan. If the Company reacquires unvested stock issued under the Incentive Plan, the reacquired stock will not become available for issuance again under the Incentive Plan.

Eligibility

Incentive stock options may be granted under the Incentive Plan only to employees (including officers) of the Company and its affiliates. Employees (including officers), directors, and consultants of the Company and its affiliates are eligible to receive all other types of awards under the Incentive Plan.

No incentive stock option may be granted under the Incentive Plan to any person who, at the time of the grant, owns (or is deemed to own) stock possessing more than 10% of the total combined voting power of the Company or any affiliate of the Company, unless the exercise price is at least 110% of the fair market value of the stock subject to the option on the date of grant and the term of the option does not exceed five years from the date of grant. In addition, the aggregate fair market value, determined at the time of grant, of the shares of Common Stock with respect to which incentive stock options are exercisable for the first time by a participant