

FORM 10-KSB/A

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2000

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_ to \_\_\_

Commission File Number 0-27282  
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ATLANTIC TECHNOLOGY VENTURES, INC.  
(Exact name of issuer as specified in its charter)

Delaware 36-3898269  
-----  
(State or other jurisdiction (IRS Employer Identification No.)  
of incorporation or organization)

350 Fifth Avenue, Suite 5507, New York, New York  
-----  
10118 (Address of principal executive offices,  
including zip code)

(212) 267-2503  
-----  
(Issuer's telephone number)

Securities registered pursuant to Section 12(g) of the Exchange Act:

Units, each consisting of one share of Common Stock and one Redeemable Warrant

Common Stock, \$.001 par value  
Redeemable Warrants

Indicate by check mark whether the issuer (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 issuer 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-B is not contained herein, and will not be contained, to the best of issuer's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

The issuer's revenues for the fiscal year ended December 31, 2000 were \$5,358,946.

As of March 16, 2001 there were 6,458,424 outstanding shares of common stock, par value \$.001 per share.

The aggregate market value of the voting common stock of the issuer held by non-affiliates of the issuer on March 16, 2001 based on the closing price of the common stock as quoted by the Nasdaq SmallCap Market on such date was \$4,642,315.

Transitional Small Business Disclosure Format: Yes \_\_\_ No X

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

We are engaged in the business of developing and commercializing early-stage technologies. Specifically, we aim to do the following:

- o identify early biomedical, pharmaceutical, electronic infrastructure, software, communications or other technologies that we believe could be commercially viable;
- o acquire proprietary rights to these technologies, either by license or by acquiring an ownership interest;
- o fund research and development of these technologies; and
- o bring these technologies to market, either directly or by selling or licensing these technologies to other companies willing to make the necessary investment to conduct the next level of research or seek required regulatory approvals.

We have in the past focused on biomedical and pharmaceutical technologies. We are currently developing two such technologies that we believe may be useful in treating a variety of diseases, including cancer, infectious disease, pain, and inflammation. We are also entitled to royalties and other revenues in connection with commercialization of technology relating to cataract surgery.

We have, however, expanded our focus, and now seek to develop and commercialize a diverse portfolio of patented technologies. Consistent with this, last year we changed our name from "Atlantic Pharmaceuticals, Inc." to our current name, "Atlantic Technology Ventures, Inc." Our acquisition of an ownership interest in a company that is currently developing high-speed fiber-optic communication technologies represents our first investment in an electronic infrastructure technology.

CORPORATE STRUCTURE

We were incorporated in Delaware on May 18, 1993. Any technologies or rights to royalties or other revenues are held either by Atlantic or by our subsidiaries Optex Ophthalmologics, Inc., or "Optex," and Gemini Technologies, Inc., or "Gemini."

We seek to minimize administrative costs, thereby maximizing the capital available for research and development. We do so by providing a centralized management team that oversees the transition of products and technologies from the early development stage to commercialization. In addition, we budget and monitor funds and other resources among Atlantic and our subsidiaries, thereby providing flexibility to allocate resources among technologies based on the progress of individual technologies.

ATLANTIC AND ITS SUBSIDIARIES

Optex and the Catarex Technology

Our majority-owned (81.2%) subsidiary, Optex, is entitled to royalties and other revenues in connection with commercialization of Catarex technology. Bausch & Lomb, a multinational ophthalmics company, is developing this technology to overcome the limitations and deficiencies of traditional cataract extraction techniques. Optex had been the owner of this technology, and was developing it pursuant to a development agreement with Bausch & Lomb, but on March 2, 2001, Optex sold to Bausch & Lomb substantially all of its assets, including those related to the Catarex technology.

## Relationship with Bausch & Lomb

In May 1998, Optex entered into a development and licensing agreement pursuant to which it granted to Bausch & Lomb Surgical Incorporated, an affiliate of Bausch & Lomb, a worldwide license to its rights to the Catarex device. (For a description of the Catarex device, see "The Catarex Device and its Applications," below). Under this agreement, Bausch & Lomb was responsible for clinical testing, obtaining regulatory approval worldwide, and manufacturing and commercializing the Catarex device. In addition, Bausch & Lomb undertook to make milestone payments to Optex, as well as royalty payments on sales of the Catarex device, and was required to reimburse Optex for all of its costs, up to \$2.5 million, related to the initial phase of development of the Catarex device. Prior to amendment of this agreement in September 1999, reimbursements from Bausch & Lomb were treated as a reduction of expenses and totaled \$2,276,579 since the inception of the agreement.

In September 1999, Optex and Bausch & Lomb Surgical amended this agreement to expand Optex's role in development of the Catarex surgical device. In addition to the basic design work provided for in the original agreement, Optex was required to deliver to Bausch & Lomb within a stated period of time a number of Catarex devices for use in clinical trials, and was required to assist Bausch & Lomb in developing manufacturing processes for scale-up of manufacture of the Catarex device. Bausch & Lomb reimbursed Optex for all costs, including labor, professional services and materials, that Optex incurred in delivering these Catarex devices and performing manufacturing services, and paid Optex a profit component based upon certain of those costs. As of December 31, 2000, development revenue under the September 1999 amendment totaled \$6,251,798, with a net profit component of \$1,250,360.

Pursuant to an asset purchase agreement dated January 31, 2001, among Bausch & Lomb, a Bausch & Lomb affiliate, Atlantic, and Optex, on March 2, 2001, Optex sold to Bausch & Lomb substantially all its assets (mostly intangible assets with no book value), including all those related to the Catarex technology. Upon the sale, Atlantic and Optex have no further obligations to Bausch & Lomb. The purchase price was \$3 million paid at closing. Optex is also entitled to receive additional consideration, namely \$1 million, once Bausch & Lomb receives regulatory approval to market the Catarex device in Japan, royalties on net sales on the terms stated in the original development agreement dated May 14, 1998, between Bausch & Lomb and Optex, as amended, and minimum royalties of \$90,000, \$350,000, and \$750,000 for the first, second, and third years, respectively, starting on first commercial use of the Catarex device or January 1, 2004, whichever is earlier. Optex also has the option to repurchase the acquired assets from Bausch & Lomb if it ceases developing the Catarex technology at fair value. Upon the sale, Bausch & Lomb's development agreement with Optex was terminated. As of December 31, 2000, and including the \$3 million purchase price of Optex assets received on March 2, 2001, Bausch & Lomb payments to Optex have totaled \$14,028,377, of which \$6,750,360 was realized as net profit to Optex. Management believes that Bausch & Lomb will aggressively pursue commercialization of the assets purchased.

## Cataracts and Current Cataract-Removal Technology

One of the most common vision disorders is cataracts, or the clouding of the normally clear lens inside the eye. This results in increased glare, decreased vision, or both. Cataracts progressively degrade visual acuity, and restoring vision eventually requires that the affected lens be surgically extracted. Cataracts may exist at birth, may result from aging or may be caused by injury or disease. Cataract surgery is currently the most frequently performed therapeutic surgical procedure in the U.S. among persons over 65 years of age. Medicare pays \$3.4 billion a year for 1 million of the 1.3 million cataract procedures performed annually in the U.S. Each year approximately 3.6 million cataract surgeries are performed worldwide. According to the American Academy of Ophthalmology, the chances are 50% that a person between the ages of 52 and 64 will develop a cataract, and by age 75 almost everyone will develop a cataract. We anticipate that given the aging of the world population, the number of cataract removal procedures performed each year will increase in the near future.

Currently, there are two principal technologies that are widely used for cataract removal: extracapsular cataract extraction, or "ECCE," and phacoemulsification, or "phaco." Until relatively recently, most cataract procedures were done by means of ECCE, which is generally a simple and reliable procedure that can be used with cataracts of any density. The ECCE procedure requires direct surgical extraction of the entire lens nucleus in one step through an approximately 11 millimeter, or "mm," incision in the eye and an approximately 6mm opening in the lens capsule inside the eye. The residual cortical material (the softer material that surrounds the lens nucleus) is

then removed using a mechanical irrigation/aspiration device. Once the lens is completely removed, an intraocular synthetic polymer lens is inserted into the eye and placed in the remaining portion of the lens capsule.

Although it is an effective procedure, ECCE has a number of disadvantages, including the time required for surgery, post-operative recovery and visual rehabilitation.

In a phaco procedure, the surgeon uses an ultrasound-emitting handpiece to sculpt or carve the lens nucleus. An incision of approximately 3mm to 5mm is made in the eye and an opening of approximately 5mm is made in the lens capsule. As these incisions are smaller than those required in ECCE procedures, patients generally recover faster, and also experience better post-operative results, due to a reduction in astigmatism induced by wound healing. Phaco, however, also has disadvantages. For one, performing a phaco procedure successfully requires considerable skill and much training. Also, the ultrasound energy used in, and stray fragments of the lens nucleus resulting from, a phaco procedure can damage the cells that line the inner layer of the cornea, which in turn can cause them to degenerate.

#### The Catarex Device and its Applications

The Catarex device removes the lens nucleus and cortex in a single step through a small incision in the eye while leaving the lens capsule functionally intact. The Catarex device is inserted into the eye through an incision of less than 3mm and advanced into the lens capsule through a less than 1.5mm incision. Once positioned within the lens capsule, the device is activated and the lens nucleus and cortex are removed in a matter of minutes through the action of fluid vortex forces drawing the lens material to the device, where it is mechanically emulsified and aspirated. A synthetic lens would then be placed in the capsule; given the limitations of currently available intraocular lenses, the incision in the lens capsule would need to be slightly enlarged.

We believe that the Catarex device has several advantages over existing technologies that should facilitate it being accepted by the ophthalmic community:

- o If successfully developed, Catarex would allow the entire cataract, including the lens nucleus and cortex, to be removed through incisions in the eye and lens capsule that would be smaller than the incisions required in either ECCE or phaco procedures. We anticipate that this would reduce operating time and the trauma associated with operating, which in turn would speed recovery.
- o Speedier patient recovery would reduce the costs involved in cataract surgery, an important consideration in this era of managed care and cost containment.
- o We expect that cataract extraction using the Catarex device will leave the anterior lens capsule of the lens functionally intact, which would shield from damage the cells that line the inner surface of the cornea.
- o We expect that surgeons will find the Catarex device easier to master than phaco extraction, as the operating principles of the device eliminate the need for the skill-intensive sculpting required in the phaco procedure.
- o Studies have indicated that the Catarex device can be used on cataracts of all degrees of hardness.
- o Leaving the lens capsule functionally intact would permit the insertion of liquid polymer lenses, once they are developed. Liquid polymer lenses are lenses made of injectable substances that can be used to refill the original lens capsule. The use of injectable lenses in conjunction with lens extraction using the Catarex device could result in the Catarex device being used not only in cataract surgery, but also to treat all refractive errors, including myopia (nearsightedness), hyperopia (farsightedness) and presbyopia (the loss of near vision that occurs with age).

#### CT-3 Technology

Atlantic is developing CT-3, a synthetic derivative of the major active ingredient in marijuana, for use in the treatment of inflammation and pain and other indications.

## Background

There has been much publicity regarding whether patients are adequately treated for acute and chronic pain. This is due, in part, to the significant side effects of the more common drugs used to treat pain.

Acute pain encompasses such medical conditions as post-operative pain, as well as pain from acute injuries. Chronic pain covers a broad range of conditions, including headaches, cancer pain, arthritis pain, low back pain, neuropathic pain, and psychogenic pain. Although difficult to quantify, it is estimated that roughly 130 million people suffer from chronic pain in the U.S. alone, with about 3 million new diagnoses of chronic pain per year.

The single biggest cause of chronic pain is arthritis. An estimated 40 million people in the U.S. suffer from arthritis, as do an equal number in Europe. Osteoarthritis is the more common form, and 60% of its victims are women. Half of those suffering from osteoarthritis are under the age of 65. The number of people with osteoarthritis is expected to double by 2020 as the number of elderly people continues to grow.

A more debilitating form of arthritis is rheumatoid arthritis, affecting about 2.5 million people. Chronic pain and inflammation management are critical in this patient segment. Cancer pain is another market, with about 1 million new diagnoses of cancer per year, a majority of them requiring pain management.

Other causes of chronic pain are fibromyalgia (a connective tissue disorder causing pain affecting approximately 5 million people), and peripheral neuropathy.

Currently available analgesic (anti-pain) and anti-inflammatory drugs include narcotics, non-narcotic analgesics, corticosteroids and nonsteroidal anti-inflammatory drugs, or "NSAIDs." Although highly effective as analgesics, the usefulness of narcotics is limited by significant adverse effects, including their potential to cause addiction. In contrast, non-narcotic analgesics are safer but, due to their low potency, have limited usefulness in cases of severe chronic pain. Use of corticosteroids, which are highly effective as anti-inflammatory agents, is limited by their potentially significant side effects. Traditional NSAIDs, such as aspirin, ibuprofen and indomethacin, are generally safer than corticosteroids for long-term use, but they too can cause significant side effects when used chronically. While the newer NSAIDs categorized as COX-2 inhibitors, for example Celebrex (developed by G.D. Searle & Co.) and Vioxx (developed by Merck & Co.), are potentially less prone to cause ulcers than are traditional NSAIDs, they do not appear to be more effective for the relief of pain or inflammation.

Although a major focus of pharmaceutical research for many years has been the development of safe, powerful anti-inflammatory and analgesic drugs with minimal adverse side effects, no such universally safe and efficacious drug has been developed. A variety of compounds are in preclinical and early clinical development, but it is not evident that an acceptable combination of efficacy and safety has yet been achieved.

In addition to the many pharmacological products, various alternative treatments have been utilized due to the continued need for additional types of pain management. The FDA estimated that there are approximately 9-12 million visits per year for acupuncture treatment of chronic pain. In addition, various herbs and nutritional supplements claim to relieve pain. Modified diets and various relaxation techniques have been utilized by some patients, seeking relief from their pain. Other devices, such as implanted opioid pumps, are marketed for chronic pain. This indicates that there is a continued need for alternative treatments to relieve pain.

## The CT-3 Technology and Its Applications

We have proprietary rights to a group of compounds, one of which is currently designated "CT-3." CT-3 is a synthetic derivative of (DELTA)<sup>9</sup> tetrahydrocannabinol (THC), the major active ingredient of marijuana. It was designed to maximize the potent efficacious medicinal properties of marijuana without producing its undesirable psychotropic side effects. Based upon the broad anti-inflammatory and analgesic properties exhibited in preclinical studies, we believe that this group of compounds may be useful in the treatment of inflammation and pain, as well as several other indications, including musculoskeletal disorders, neurological disorders, cancer, glaucoma, and gastrointestinal disorders. We also believe, based on preclinical studies and an initial phase I human clinical trial, that this group of compounds has a reduced potential for side effects.

Animal studies have shown that CT-3 lacks the ulcer causing side effects of NSAIDs. Animal studies using dosages significantly higher than the anticipated therapeutic dose of CT-3 have indicated a lack of central nervous system side effects (psychoactivity), and we believe that CT-3 provides anti-inflammatory and analgesic effects without the psychoactive effects of THC. Also, a clinical trial designed to measure the safety and pharmacokinetics of CT-3 resulted in no clinically relevant-adverse events and no evidence of marijuana-like psychoactivity. Several in vitro studies have indicated that CT-3 acts by inhibiting and reducing the release or synthesis of several different mediators of inflammation including cytokines, metalloproteinases, leukotrienes, and cyclooxygenases. In addition, tests in an in vivo model of rheumatoid arthritis have shown CT-3 to have significant anti-inflammatory effects, including the potential to reduce the amount of joint destruction caused by rheumatism. Subsequent studies have substantiated these findings and have demonstrated that CT-3 can minimize the effects of adjuvant-induced arthritis in rats. We also believe that it is not yet known whether this compound is more clinically effective than traditional NSAIDs, corticosteroids, COX-2 inhibitors and the variety of potential competitor compounds in late preclinical and early clinical development. The preliminary data therefore suggest that CT-3 appears to have significant potential for therapeutic benefit in the treatment of chronic pain and inflammation that potentially lacks the major side effects of traditional anti-inflammatory drugs and analgesics.

#### Research and Development Activities

Atlantic is developing CT-3 as the lead compound in the series of patented compounds. CT-3 has been tested in a Phase I clinical trial and in many pre-clinical in vitro and in vivo studies to profile its potential activity and to evaluate its usefulness in treating medical conditions. This evaluation process started with a focus on analgesic and anti-inflammatory processes and has been broadened to include musculoskeletal disorders, neurological disorders, gastrointestinal disorders, psychiatric disorders, glaucoma, and cancer.

In 2000 we successfully filed an investigational new drug (IND) application with the FDA for CT-3 and signed a contract with Aster Clinical Research Center in Paris, France, to conduct the Phase I clinical trial. The clinical trial was designed to measure the safety and pharmacokinetics of CT-3 in human subjects. As expected, the Phase I clinical trial was successfully completed and showed that CT-3 was safe. There occurred no clinically-relevant adverse events and no evidence of marijuana-like psychoactivity was found.

After completing the Phase I clinical trial, we increased our efforts to sublicense CT-3 to suitable strategic partners to assist in clinical development, regulatory approval filing, manufacturing and marketing of CT-3. We anticipate that by the fourth quarter of 2001 we will have found a corporate partner to continue the clinical development of CT-3. In addition, we are considering conducting a Phase II clinical trial ourselves. Since CT-3 appears to possess a wide range of therapeutic activity, we are carefully choosing an indication that we feel CT-3 would be most efficacious for and one that will strategically allow us to increase the licensing value of CT-3 in the most timely and cost effective manner.

In addition, in the fourth quarter of 2000, the U.S. Patent and Trademark Office issued us a new US patent 6,162,829 that covers the use of analogs of CT-3 as analgesic or anti-inflammatory agents.

#### Competition

The market for the treatment of chronic pain and inflammation is large and highly competitive. Several multinational pharmaceutical companies currently have many popular products in this market and many companies have active research programs to identify and develop more potent and safer anti-inflammatory and analgesic agents. One notable area of research is in the development of "COX-2 inhibitors," which are claimed to be safer to the stomach than available NSAIDs. (COX-2 inhibition is not considered a significant contributor to the mechanism of action of CT-3; in vitro studies have shown very weak COX-2 inhibition.) Two COX-2 inhibitor compounds have recently received FDA approval and several others are in various stages of clinical development. We believe that the potential advantages of CT-3 make it worth developing, and that if we succeed, CT-3 could become a significant new agent in the treatment of pain and inflammation.



## Proprietary Rights

We have an exclusive worldwide license to four U.S. patents and corresponding foreign applications covering a group of compounds, including CT-3. The licensor is Dr. Sumner Burstein, a professor at the University of Massachusetts. This license extends until the expiration of the underlying patent rights. The primary U.S. patent expires in 2012 and the new analog patent 6,162,829 expires in 2017. We have the right under this license to sublicense our rights under the license. The license requires that we pay royalties to Dr. Burstein based on sales of products and processes incorporating technology licensed under the license, as well as a percentage of any income derived from any sublicense of the licensed technology. Furthermore, pursuant to the terms of the license, we must satisfy certain other terms and conditions in order to retain the license rights. If we fail to comply with certain terms of the license, our license rights under the license could be terminated.

## Gemini and the 2-5A Antisense Technology

On August 14, 2000, Gemini Technologies, Inc., our subsidiary, was awarded a Small Business Innovation Research (SBIR) Phase II grant to continue its research on antisense enhancing technology by the National Institute for Allergy and Infectious Diseases (NIAID), a unit of the National Institutes of Health (NIH). The grant, which totals approximately \$750,000, will be used to fund a pre-clinical efficacy study using aerosolized 2-5A antisense compound for the inhibition of respiratory syncytial virus (RSV) in monkeys. It also will provide funds for the toxicological and pharmacological studies needed to file an investigational new drug (IND) application with the FDA to begin clinical studies in humans.

This research is intended to build upon research previously published in the Proceedings of the National Academy of Sciences (PNAS) Vol. 95, July 1998, that documented the compound's effectiveness against a broad spectrum of RSV strains. Data collected to date indicate that the molecule to be tested has 130 times greater in vitro potency than Ribavarin (Virazole), one of two FDA-approved treatments for RSV infections (the other treatment is a monoclonal antibody recommended for use in high-risk infants only). This molecule has also been shown to be stable against degradative enzymes, and is capable of being absorbed into lung tissue when administered in a droplet formulation.

## Our Diversification Strategy

Early in 2000 we adopted a broader approach in selecting technologies to develop. Consistent with this approach, effective March 21, 2000, Atlantic's name was changed from "Atlantic Pharmaceuticals, Inc." to its current name.

This broader approach is reflected in our acquisition on May 12, 2000, of an ownership interest in TeraComm Research, Inc., a privately-held company that is currently developing next-generation fiber optic communications technologies, namely a high-speed fiber-optic transceiver.

The purchase price for our ownership interest was \$5 million in cash, 200,000 shares of our common stock and a warrant to purchase 200,000 shares of our common stock. TeraComm issued us 1,400 shares of its Series A preferred stock representing a 35% ownership interest. Taking into account the cash purchase price and the value of the common stock at the signing of the letter of intent, we valued this deal at \$6,795,000. We are accounting for the investment in TeraComm in accordance with the equity method of accounting for investments since we have the ability to exert significant influence over TeraComm, including through our Board representation and other involvement with management of TeraComm.

TeraComm is developing a fiberoptic transmitter that uses a high-temperature superconductor (HTS) material to switch a laser beam on and off with a high-speed electronic digital signal. HTS materials have zero electrical resistance at low temperatures (< 70 K), and also can have very high optical reflectance in their superconducting state while they can transmit light in their normal (non-superconducting) state. TeraComm discovered that a small electric current in an HTS material could switch the material between states, and do so very quickly - in less than a millionth millionth of a second. Because the HTS optical switch works best at far infrared

wavelengths and these optical waves are too large to send through an optical fiber, the TeraComm invention employs an optical wavelength converter to change the waves to the band that is just right for the fiber.

Thus far, TeraComm has successfully developed methods of producing effective HTS thin-films with metal electrodes, has successfully demonstrated control of optical transmission in HTS films using electric current, and has been awarded patents covering implementation of this technology for fiberoptic telecommunications. TeraComm has not yet achieved the technical milestone that it needs to achieve for further progress in developing their technology. TeraComm has informed us that it is seeking to raise additional funding to continue its development program and achieve this technical milestone.

Due to our need to preserve our cash resources and due to our uncertainty regarding TeraComm's plans for developing its technology, we ultimately paid only \$1 million of the \$5 million cash portion of the purchase price. As a consequence, we were required to surrender to TeraComm a number of our shares of TeraComm's preferred stock, which had the effect of reducing to 14.4% our actual ownership interest. However, Atlantic continues to hold one seat on the Board of Directors and therefore continues to have the ability to exert significant influence.

On May 23, 2000, we announced our appointment of Walter L. Glomb, Jr., as Vice President. Mr. Glomb is responsible for supporting our investment in TeraComm and identifying complimentary electronic infrastructure and communication technologies for us to develop. Mr. Glomb is based in our new office in Vernon, Connecticut, in the center of the major cluster of photonics companies that stretches from Boston to New Jersey. Atlantic's new strategy focuses on our developing strategic partnerships with early-stage companies, and we feel that this region promises to be a rich source of such partnerships.

#### EMPLOYEES

We currently have six employees.

#### FORWARD-LOOKING STATEMENTS

The statements contained in this Annual Report on Form 10-KSB/A that are not historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding the expectations, beliefs, intentions or strategies regarding the future. We intend that all forward-looking statements be subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect our views as of the date they are made with respect to future events and financial performance, but are subject to many risks and uncertainties, which could cause actual results to differ materially from any future results expressed or implied by such forward-looking statements. Examples of such risks and uncertainties include the risks detailed below. We do not undertake to update any forward-looking statements.

#### RECENT DEVELOPMENTS

##### Sale of Optex Assets

On March 2, 2001, Optex Ophthalmologics, Inc., our 81.2%-owned subsidiary, sold substantially all of its assets (mostly intangible assets with no book value), including those related to the Catarex technology, to Bausch & Lomb Incorporated for an initial payment of \$3 million and ongoing royalty payment obligations upon product commercialization. For further details, see "Description of Business--Atlantic and Its Subsidiaries--Optex and the Catarex Technology."

##### Repurchase of Series B Preferred Stock

On March 9, 2001, we repurchased from BH Capital Investments, L.P. and Excalibur Limited Partnership, for an aggregate purchase price of \$617,067, all 165,518 shares of our Series B convertible preferred stock held by the investors. On December 4, 2000, we repurchased 482,758 shares of Series B preferred stock. Our repurchase of the remaining shares of Series B preferred stock and termination of our obligations under the purchase agreement with the investors represent the last in a series of transactions relating to that purchase agreement. For further

details, see "Market for Common Equity and Related Stockholder Matters--Recent Sales of Unregistered Securities," as well as our Quarterly Report on Form 10-QSB for the quarter ended September 30, 2000, and our Current Reports on Form 8-K filed with the SEC on December 11, 2000, December 29, 2000, January 24, 2001, January 30, 2001, and March 14, 2001.

#### Common Stock Purchase Agreement with Fusion Capital Fund II, LLC

On March 16, 2001, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC pursuant to which Fusion Capital agreed to purchase up to \$6.0 million of our common stock over a 30-month period, subject to a 6-month extension or earlier termination at our discretion. The selling price of the shares will be equal to the lesser of (1) \$20.00 or (2) a price based upon the future market price of the common stock, without any fixed discount to the market price. For further details, see our registration statement on Form S-3 filed with the SEC on March 25, 2001. However, Nasdaq delisting would constitute an event of default under the purchase agreement with Fusion Capital, and Fusion Capital would no longer be obligated to purchase our common stock.

#### Risk of Delisting

We risk being delisted from the Nasdaq SmallCap Market. March 20, 2001, marked the thirtieth consecutive business day that the minimum bid price of our common stock was less than \$1.00. This constitutes a failure on our part to meet Nasdaq's continued inclusion requirement for minimum bid price. On March 22, 2001, Nasdaq notified us of this failure, and we have a period of 90 calendar days from that notice to comply with the continued inclusion standard for minimum bid price. We can do so by meeting the standard for a minimum of 10 consecutive business days during the 90 day compliance period.

In addition, the consolidated financial statements included with this Annual Report show that on December 31, 2000, our net tangible assets were less than \$2 million. Consequently, we expect to receive a deficiency notice from Nasdaq notifying us that we have ten days to submit a plan to achieve and sustain long-term compliance with all applicable listing criteria. If Nasdaq is not satisfied with the plan that we submit or if we do not submit a plan, we will then receive a staff determination from Nasdaq. Upon receipt of the staff determination, we will have seven days to appeal the staff determination and request a hearing before Nasdaq's Listing Qualifications Panel (the "panel"), and such request will generally stay the delisting pending a determination by the panel (called a "panel decision"). Failure to request a hearing within seven calendar days will result in automatic delisting.

For more details regarding delisting and its significance, see "Risk Factors--Our Securities."

#### RISK FACTORS

Investing in our common stock is very risky, and you should be able to bear losing your entire investment. You should carefully consider the risks presented by the following factors.

##### Our Financial Condition and Need for Substantial Additional Funding

Because we have not completed developing any of our products or generated any product sales, we expect to incur significant operating losses over the next several years and our ability to generate profits in the future is uncertain.

All of our technologies are in the research and development stage, which requires substantial expenditures. Our operating loss from inception consists of milestone payments and development revenue, including a profit component, by Bausch & Lomb in connection with development of the Catarex device, and a government grant. In March 2001, we received \$2.4 million of net proceeds from the sale of substantially all of the assets of Optex Ophthalmologics, Inc., our 81.2%-owned subsidiary. We do not expect to generate any additional revenues in the near future. We expect to incur significant operating losses over the next several years, primarily due to continued and expanded research and development programs, including preclinical studies and clinical trials for our products and technologies under development, as well as costs incurred in identifying and possibly acquiring additional technologies.

If we do not obtain additional funding, our ability to develop our technologies will be impeded.

We will need substantial additional funds to develop our technologies. We will seek those funds through public or private equity or debt financings, through collaborative arrangements or from other sources (including exercise of the warrants we have issued giving the holder the right to purchase shares of our capital stock for a stated exercise price). Funding may not, however, be available on acceptable terms, if at all. Additionally, if our common stock is delisted from Nasdaq, we may find it still more difficult to obtain additional funding. Furthermore, pursuant to the common stock purchase agreement with Fusion Capital, and until its termination, we have agreed not to issue any variable-priced equity or variable-priced equity-like securities unless we have obtained Fusion Capital's prior written consent. This may further impede our ability to raise additional funding.

As of December 31, 2000, we had a cash and cash equivalents balance of \$2,663,583. We anticipate that our current resources will be sufficient to finance our currently anticipated needs for operating and capital expenditures for at least the next twelve months (See also Management's Discussion and Analysis).

#### Our Operations

To develop our technologies, we may need to enter into collaborative agreements with others. Such agreements could limit our control.

We do not have the resources to directly conduct full clinical development, obtain regulatory approvals, or manufacture or commercialize any of our proposed products, and we have no current plans to acquire such resources. Therefore, we depend upon others to carry out such activities. As a result, we anticipate that we may enter into collaborative agreements with third parties able to contribute to developing our technologies. Such agreements may limit our control over any or all aspects of development of our technologies.

We are in the early stages of developing our technologies and may not succeed in developing commercially viable products.

To be profitable, we must, alone or with others, successfully commercialize our technologies. They are, however, in early stages of development, will require significant further research, development and testing, and are subject to the risks of failure inherent in the development of products based on innovative or novel technologies. They are also rigorously regulated by the federal government, particularly the U.S. Food and Drug Administration, or "FDA," and by comparable agencies in state and local jurisdictions and in foreign countries. Each of the following is possible with respect to any one of our products:

- o that we will not be able to maintain our current research and development schedules;
- o that, in the case of one of our pharmaceutical technologies, we will not be able to enter into human clinical trials because of scientific, governmental or financial reasons, or that we will encounter problems in clinical trials that will cause us to delay or suspend development of one of the technologies;
- o that the product will be found to be ineffective or unsafe;
- o that government regulation will delay or prevent the product's marketing for a considerable period of time and impose costly procedures upon our activities;
- o that the FDA or other regulatory agencies will not approve a given product or will not do so on a timely basis;
- o that the FDA or other regulatory agencies may not approve the process or facilities by which a given product is manufactured;
- o that our dependence on others to manufacture our products may adversely affect our ability to develop and deliver the products on a timely and competitive basis;
- o that, if we are required to manufacture our own products, we will be subject to similar risks regarding delays or difficulties encountered in manufacturing the products, will require substantial additional capital, and may be unable to manufacture the products successfully or in a cost-effective manner;

- o that the FDA's policies may change and additional government regulations and policies may be instituted, both of which could prevent or delay regulatory approval of our potential products; or
- o that we will be unable to obtain, or will be delayed in obtaining, approval of a product in other countries, because the approval process varies from country to country and the time needed to secure approval may be longer or shorter than that required for FDA approval.

Similarly, it is possible that, for the following reasons, we may be unable to commercialize, or receive royalties from the sale of, any given technology, even if it is shown to be effective:

- o if it is uneconomical;
- o if, in the case of one of our pharmaceutical technologies or the Catarex device, it is not eligible for third-party reimbursement from government or private insurers;
- o if others hold proprietary rights that preclude us from commercializing it;
- o if others have brought to market equivalent or superior products;
- o if others have superior resources to market similar products or technologies;
- o if government regulation imposes limitations on the indicated uses of a product, or later discovery of previously unknown problems with a product results in added restrictions on the product or results in the product being withdrawn from the market; or
- o if it has undesirable or unintended side effects that prevent or limit its commercial use.

Our ability to compete will suffer if we are unable to protect our patent rights and trade secrets or if we infringe the proprietary rights of third parties.

Our success will depend to a large extent on our ability to obtain U.S. and foreign patent protection for drug candidates and processes, preserve trade secrets and operate without infringing the proprietary rights of third parties.

To obtain a patent on an invention, one must be the first to invent it or the first to file a patent application for it. We cannot be sure that the inventors of subject matter covered by patents and patent applications that we own or license were the first to invent, or the first to file patent applications for, those inventions. Furthermore, patents we own or license may be challenged, infringed upon, invalidated, found to be unenforceable, or circumvented by others, and our rights under any issued patents may not provide sufficient protection against competing drugs or otherwise cover commercially valuable drugs or processes.

We seek to protect trade secrets and other unpatented proprietary information, in part by means of confidentiality agreements with our collaborators, employees, and consultants. If any of these agreements is breached, we may be without adequate remedies. Also, our trade secrets may become known or be independently developed by competitors.

Because we carry only a limited amount of product liability insurance, product liability claims brought against us could adversely affect our business.

If we develop and commercialize any products, through third-party arrangements or otherwise, we may be exposed to product liability claims. Some of our license agreements require us to obtain product liability insurance when we begin clinical testing or commercialization of our proposed products and to indemnify our licensors against product liability claims brought against them as a result of the products developed by us. We may not be able to obtain such insurance at all or in sufficient amounts to protect us against such liability or at a reasonable cost.

Any breach by us of environmental regulations could result in our incurring significant costs.

Federal, state and local laws, rules, regulations and policies govern our use, generation, manufacture, storage, air emission, effluent discharge, handling and disposal of certain materials and wastes. Although we

believe that we have complied with these laws and regulations in all material respects and have not been required to take any action to correct any noncompliance, we may be required to incur significant costs to comply with environmental and health and safety regulations in the future. In addition, our research and development activities involve the controlled use of hazardous materials and we cannot eliminate the risk of accidental contamination or injury from these materials, although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by state and federal regulations. In the event of an accident, we could be held liable for any resulting damages and we do not have insurance to cover this contingency.

#### Our Securities

We risk being delisted from Nasdaq, and the resulting market illiquidity could adversely affect our ability to raise funds.

Although our common stock, redeemable warrants and the units offered in our initial public offering are quoted on the Nasdaq SmallCap Market, continued inclusion of those securities on Nasdaq will require the following:

- o that we maintain at least \$2,000,000 in net tangible assets;
- o that the minimum bid price for the common stock be at least \$1.00 per share;
- o that the public float consist of at least 500,000 shares of common stock, valued in the aggregate at more than \$1,000,000;
- o that the common stock have at least two active market makers;
- o that the common stock be held by at least 300 holders; and
- o that we adhere to certain corporate governance requirements.

If we are unable to satisfy any of these maintenance requirements, our securities may be delisted from Nasdaq.

With regard to our minimum bid price, March 20, 2001, marked the thirtieth consecutive business day that the minimum bid price of our common stock was less than \$1.00. This constituted a failure on our part to meet Nasdaq's continued inclusion requirement for minimum bid price. On March 22, 2001, Nasdaq notified us of this failure, and we had a period of 90 calendar days from that notice to comply with the continued inclusion standard for minimum bid price. To do so, we would have had to meet that standard for a minimum of 10 consecutive business days during the 90-day compliance period.

In addition, the financial statements included with this Annual Report show that on December 31, 2000, our net tangible assets were less than \$2 million. Consequently, we expect to receive a deficiency notice from Nasdaq notifying us that we have ten days to submit a plan to achieve and sustain long-term compliance with all applicable listing criteria. If Nasdaq is not satisfied with the plan that we submit or if we do not submit a plan, we will then receive a staff determination from Nasdaq. Upon receipt of the staff determination, we will have seven days to appeal the staff determination and request a hearing before Nasdaq's Listing Qualifications Panel (the "panel"), and such request will generally stay the delisting pending a determination by the panel (called a "panel decision"). Failure to request a hearing within seven calendar days will result in automatic delisting.

If our securities are delisted, trading, if any, in the securities would thereafter be conducted in the over-the-counter market in the "pink sheets" or the National Association of Securities Dealers' "Electronic Bulletin Board." Consequently, the liquidity of our securities could be materially impaired, not only in the number of securities that could be bought and sold at a given price, but also through delays in the timing of transactions and reduction in security analysts' and the media's coverage of us, which could result in lower prices for our securities than might otherwise be attained and could also result in a larger spread between the bid and asked prices for our securities. In addition, if our securities are delisted it could materially and adversely affect our ability to raise funding.

In addition, if our securities are delisted from trading on Nasdaq and the trading price of our common stock is less than \$5.00 per share, our common stock will become a "penny stock." Broker-dealers who sell penny stocks must provide purchasers of these stocks with a standardized risk-disclosure document prepared by the SEC. This document provides information about penny stocks and the nature and level of risks involved in investing in the penny-stock market. A broker must also give a purchaser, orally or in writing, bid and offer quotations and information regarding broker and salesperson compensation, make a written determination that the penny stock is a suitable investment for the purchaser, and obtain the purchaser's written agreement to the purchase. In the event our securities are delisted, the penny stock rules may make it difficult for you to sell your shares of our stock. Because of the rules, there is less trading in penny stocks. Also, many brokers choose not to participate in penny stock transactions.

Because holders of our Series A preferred stock have rights superior to those of the holders of our common stock, in certain circumstances holders of our common stock may be adversely affected.

Holders of shares of our outstanding Series A preferred stock can convert each share into 3.27 shares of our common stock without paying us any cash. The conversion price of shares of Series A preferred stock is \$3.06 per share of common stock. Both the conversion rate and the conversion price may be adjusted in favor of holders of shares of Series A preferred stock upon certain triggering events. Accordingly, the number of shares of common stock that holders of shares of Series A preferred stock receive upon conversion may increase, which could adversely affect the prevailing market price of our securities.

In addition, each February 7 and August 7 we are obligated to pay dividends, in arrears, to the holders of shares of Series A preferred stock, and the dividends consist of 0.065 additional shares of Series A preferred stock for each outstanding share of Series A preferred stock. Our issuing additional shares of Series A preferred stock without payment of any cash to us could adversely affect the prevailing market price of our securities.

If we are liquidated, sold to or merged with another entity (and we are not the surviving entity after the merger), we will be obligated to pay holders of shares of Series A preferred stock a liquidation preference of \$13.00 per share before any payment is made to holders of shares of common stock. After payment of the liquidation preference, we might not have any assets remaining to pay the holders of shares of common stock. The liquidation preference could adversely affect the market price of our securities.

The holders of shares of Series A preferred stock have rights in addition to those summarily described. A complete description of the rights of the Series A preferred stock is contained in the certificate of designations of the Series A preferred stock filed with the Secretary of State of Delaware.

Given the limited trading volume of our shares, investors may experience delay in liquidating an investment in our securities.

Our securities are traded on the Nasdaq SmallCap Market and lack the liquidity of securities traded on the principal trading markets. Accordingly, an investor may find it impossible to promptly liquidate an investment in our securities. Also, the sale of a large block of our securities could depress the price of our securities to a greater degree than a company that typically has a higher volume of trading in its securities.

Because many factors may have a significant impact upon the market price of our common stock, the market price of our common stock may continue to be highly volatile.

The market price of our common stock has been highly volatile, and we expect that this will continue to be the case. Many factors, including announcements of technological innovations by us or other companies, regulatory matters, new or existing products or procedures, concerns about our financial position, operating results, government regulation, developments or disputes relating to agreements, patents or proprietary rights, may have a significant impact on the market price of our stock. In addition, the potential dilutive effects of future sales of shares of common stock by us and by stockholders, including Fusion Capital pursuant to this prospectus, and the subsequent sale of common stock by the holders of warrants and options could depress the market price of our securities.

Sale of shares of our common stock to Fusion Capital may cause dilution, and sale of those shares by Fusion Capital could cause the price of our common stock to decline.

The purchase price for the common stock to be issued to Fusion Capital under the common stock purchase agreement will fluctuate based on the closing price of our common stock.

All shares registered in this offering will be freely tradeable. However, Fusion Capital has agreed that it will not sell or otherwise transfer the commitment shares until the earliest of termination of the common stock purchase agreement, our default under the agreement, or approximately 30 months from the date of the common stock purchase agreement. Fusion Capital may at any time sell none, some or all of the shares of common stock purchased from us. We expect that shares registered in this offering will be sold over a period of up to 30 months from the date of this prospectus. Depending upon market liquidity at the time, a sale of shares under this offering at any given time could cause the trading price of our common stock to decline. The sale of a substantial number of shares of our common stock under this offering, or anticipation of such sales, could make it more difficult for us to sell equity or equity related securities in the future at a time and at a price that it might otherwise wish to effect sales.

The existence of the agreement with Fusion Capital to purchase shares of our common stock could cause downward pressure on the market price of our common stock.

Both the actual dilution and the potential for dilution resulting from sales of our common stock to Fusion could cause holders to elect to sell their shares of our common stock, which could cause the trading price of our common stock to decrease. In addition, prospective investors anticipating the downward pressure on the price of the Atlantic common stock due to the shares available for sale by Fusion Capital could refrain from purchases or effect sales in anticipation of a decline of the market price.

#### ITEM 2. Description of Property

Through January 31, 2002, we have leased space for our executive office at 150 Broadway, Suite 1009, New York, New York 10038, for a monthly lease payment of \$967. On March 19, 2001, we moved into new offices at 350 Fifth Avenue, Suite 5507, New York, New York 10118. The lease for this space is for a term of two years and two and a half months with a monthly lease payment of \$6,645.

Optex's lease of spaces at 27452 Calle Arroyo, San Juan Capistrano, California 92675, was transferred to B&L as of April 1, 2001, as part of the sale to Bausch & Lomb of substantially all of Optex's assets.

Gemini's lease of space at 11000 Cedar Avenue, Cleveland, Ohio 44106 ended on October 30, 2000. The space is now under a month-to-month rental agreement with monthly payments of \$1,933. The new rental agreement will continue until Atlantic management makes a determination with regard to the 2-5A Antisense Technology.

To facilitate Atlantic's exploration of investment opportunities in fiber-optics, we are leasing space at One Executive Park East, 135 Bolton Road in the Town of Vernon, County of Tolland, Connecticut 06066. This lease is for a term of three years commencing May 17, 2000, with monthly lease payments of \$1,000 through May 14, 2001 and thereafter \$1,251 per month until May 14, 2003.

We believe that our existing facilities are adequate to meet our current requirements and that our insurance coverage adequately covers our interest in our leased spaces. We do not own any real property.

#### ITEM 3. LEGAL PROCEEDINGS

There are no current or pending legal proceedings to which Atlantic or any of its subsidiaries is a party or to which any of their properties is subject other than the following.



Claim for Arbitration Brought by Cleveland Clinic Foundation

Atlantic's subsidiary, Gemini, has an exclusive worldwide sublicense from the Cleveland Clinic Foundation to a U.S. patent and related patent applications, as well as corresponding foreign applications, relating to 2-5A chimeric antisense technology and its use for selective degradation of targeted RNA. On May 8, 2000, the Cleveland Clinic Foundation filed a claim for arbitration before the American Arbitration Association to terminate this sublicense, claiming that Gemini has breached the sublicense by failing to fulfill its obligations under the sublicense. Atlantic and the Cleveland Clinic Foundation are currently engaged in discussions aimed at settling this dispute. To that end, on April 5, 2001, the parties agreed to extend several arbitration deadlines pursuant to Rule 40 of the AAA Commercial Arbitration Rules.

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

None.

PART II

ITEM 5. Market for Common Equity and Related Stockholder Matters

Our common stock is listed on the Nasdaq SmallCap Market. The following table sets forth the high and low closing price for our common stock as quoted, in U.S. dollars, by Nasdaq during each quarter within the last two fiscal years:

Quarter Ended	High	Low
March 31, 1999	\$3.125	\$1.313
June 30, 1999	\$2.469	\$1.063
September 30, 1999	\$2.375	\$1.125
December 31, 1999	\$2.25	\$1.25
March 31, 2000	\$10.625	\$1.375
June 30, 2000	\$6.375	\$2.50
September 30, 2000	\$5.00	\$2.50
December 31, 2000	\$3.313	\$0.406

The number of holders of record of our common stock as of March 28, 2001 was 120. The number of beneficial stockholders of our common stock as of March 28, 2001 was 1,880.

We have not paid or declared any dividends on our common stock and we do not anticipate paying dividends on our common stock in the foreseeable future. The certificate of designations for our Series A preferred stock provides that we may not pay dividends on our common stock unless a special dividend is paid on our Series A preferred stock.

RECENT SALES OF UNREGISTERED SECURITIES

Issuance to Joseph Stephens & Company, Inc.

On January 4, 2000, we entered into a Financial Advisory and Consulting Agreement with Joseph Stevens & Company, Inc. ("Joseph Stevens"). In this agreement, we engaged Joseph Stevens to provide us with investment banking services from January 4, 2000 until January 4, 2001. As partial compensation for the services to be rendered by Joseph Stevens, we issued them three warrants, each warrant entitling Joseph Stevens to purchase 150,000 shares of our common stock.

The issuance of the warrants did not involve any public offering and therefore was exempt from the registration requirements of Section 5 of the Securities Act of 1933 (the "Act") pursuant to Section 4(2) of the Act.

The exercise price of each warrant is as follows:

Warrant Number	No. of Shares	Exercise Price
No. 1	150,000	\$2.50
No. 2	150,000	\$3.50
No. 3	150,000	\$4.50

Each warrant may only be exercised when the market price of a share of common stock is at least \$1.00 greater than the exercise price of that warrant. In connection with issuance of the warrants, Atlantic and Joseph Stevens entered into a letter agreement granting Joseph Stevens registration rights in respect of the shares of common stock issuable upon exercise of the warrants.

Issuance to TeraComm Research, Inc.

On May 12, 2000, we acquired shares of preferred stock representing a 35% ownership interest in TeraComm Research, Inc. ("TeraComm"), a privately-held company that is developing next-generation high-speed fiberoptic communications technologies. The purchase price for this ownership interest was \$5,000,000 in cash, 200,000 shares of our common stock, and a warrant to purchase a further 200,000 shares of our common stock. The warrants have a term of three years and are exercisable at \$8.975 per share of common stock, but only if the market price of our common stock is \$30 or more. We are accounting for the investment in TeraComm in accordance with the equity method of accounting for investments since we have the ability to exert significant influence over TeraComm, including through our Board representation.

The issuance of the common stock and warrants did not involve any public offering and therefore was exempt from the registration requirements of Section 5 of the Securities Act of 1933 (the "Act") pursuant to Section 4(2) of the Act.

On July 18, 2000, Atlantic and TeraComm amended the purchase agreement. In the amendment, the parties agreed that the \$4,000,000 balance of the \$5,000,000 cash component of the purchase price would not be due until TeraComm achieved a specified milestone. Within ten days after TeraComm achieved that milestone, we were required to pay TeraComm \$1,000,000 and thereafter make to TeraComm three payments of \$1,000,000 at three-month intervals. If we failed to make any of these payments, TeraComm's only recourse would be reducing proportionately our ownership interest. Our failure to make the first \$1,000,000 payment by midnight at the end of December 30, 2000 (whether or not TeraComm has reached the milestone) would at the option of TeraComm be deemed to constitute failure by us to timely make that payment.

When we failed to make the first \$1,000,000 payment by midnight at the end of December 30, 2000, we were deemed to have surrendered to TeraComm a proportion of our TeraComm shares equal to the proportion of the dollar value of the purchase price for our TeraComm shares (\$6,795,000) that was represented by the unpaid \$4,000,000 of the cash portion of the purchase price. This had the effect of reducing to 14.4% our actual ownership interest in TeraComm. However, Atlantic continues to hold one seat on the Board of Directors and therefore continues to have the ability to exert significant influence.

Issuance to BH Capital Investments, L.P. and Excalibur Limited Partnership

On September 28, 2000, pursuant to a convertible preferred stock and warrants purchase agreement (the "purchase agreement"), we issued to BH Capital Investments, L.P. and Excalibur Limited Partnership (together, the "Investors") for a purchase price of \$2,000,000, 689,656 shares of our Series B convertible preferred stock (the "Series B preferred stock") and warrants to purchase 134,000 shares of our common stock. Half of the shares of Series B preferred stock (344,828 shares) and warrants to purchase half of the shares of common stock (67,000 shares) were held in escrow, along with half of the purchase price.

On December 4, 2000, Atlantic and the Investors entered into a stock repurchase agreement (the "stock repurchase agreement") pursuant to which we repurchased from the Investors for \$500,000 137,930 shares of Series B preferred stock, and agreed to the release from escrow to the Investors of the \$1,000,000 purchase price of the 344,828 shares of Series B preferred stock held in escrow. We also allowed the Investors to keep all of the warrants

issued under the purchase agreement and issued to the Investors warrants to purchase a further 20,000 shares of our common stock at the same exercise price.

The issuance of the shares of Series B preferred stock and warrants did not involve any public offering and therefore was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

The warrants are exercisable at the fixed exercise price or 110% of the market price 180 days after the date of issuance, whichever is lower. Pursuant to a second amendment to the purchase agreement, executed on January 9, 2001, the fixed exercise price of the warrants was lowered from \$3.19, the fixed exercise price upon their issuance, to \$1.00, the market price of our common stock at the time of the renegotiations. Each warrant may be exercised any time during the five years from the date of granting. The warrants may not be exercised if doing so would result in our issuing a number of shares of common stock in excess of the limit imposed by the rules of the Nasdaq SmallCap Market.

Holder of shares of our outstanding Series B preferred stock can convert each share into shares of common stock without paying Atlantic any cash. The conversion price per share of the Series B preferred stock was also amended by the second amendment to the purchase agreement. The conversion price per share of Series B preferred stock on any given day is the lower of (1) \$1.00 or (2) 90% of the average of the two lowest closing bid prices on the principal market of the common stock out of the fifteen trading days immediately prior to conversion, but the conversion price will be reduced by an additional 5% if the common stock is not listed on either the Nasdaq SmallCap Market or Nasdaq National Market as of that date, and in no event will the conversion price be lower than the floor price (\$0.50 for the conversion of a share of Series B preferred stock effected on or before March 28, 2002). The conversion price may be adjusted in favor of holders of shares of Series B preferred stock upon certain triggering events. The conversion rate is determined by dividing the original price of the Series B preferred stock by the conversion price in effect at the time of conversion; but before any adjustment is required upon the occurrence of any such triggering events, the conversion price will be equal to the original price of the Series B preferred stock.

On March 9, 2001, Atlantic and the Investors entered into stock repurchase agreement no. 2. Pursuant to stock repurchase agreement no. 2, we repurchased from the Investors, for an aggregate purchase price of \$617,067, all 165,518 shares of our Series B preferred stock held by the Investors. The repurchase price represented 125% of the purchase price originally paid by the investors for the repurchased shares, as well as an amount equal to the annual dividend on the Series B preferred stock at a rate per share of 8% of the original purchase price. The repurchased shares constitute all remaining outstanding shares of Series B preferred stock; we have cancelled those shares.

#### Issuance to Dian Griesel

On March 8, 2001, Atlantic entered into an agreement with The Investor Relations Group, Inc., or "IRG," under which IRG will provide Atlantic investor relations services. Pursuant to this agreement Atlantic issued to Dian Griesel warrants to purchase 120,000 shares of its common stock. The term of the warrants is five years and the exercise price of the warrants is \$0.875, and they will vest in 5,000 share monthly increments over a 24 month period. In addition, should Atlantic's stock price reach \$2.50, Atlantic will grant Ms. Griesel an additional 50,000 warrants. Should Atlantic's stock price reach \$5.00, Atlantic will grant Ms. Griesel a further 50,000 warrants. As a result, Atlantic recorded compensation expense relating to these stock warrants of \$11,971 for the three month period ended March 31, 2001 and will remeasure the compensation expense at the end of each reporting period until the final measurement date is reached in 24 months.

The issuance of the warrants did not involve any public offering and therefore was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion includes "forward-looking" statements that reflect our current views with respect to future events and financial performance. We use words such as we "expect," "anticipate," "believe," and "intend" and similar expressions to identify forward-looking statements. Investors should be aware that actual results may differ materially from our expressed expectations because of risks and uncertainties inherent in future events, particularly those risks identified in the "Risk Factors" section of this Annual Report, and should not unduly rely on these forward looking statements.

OVERVIEW

We were incorporated in Delaware on May 18, 1993, and commenced operations on July 13, 1993. We are engaged in the development of biomedical and pharmaceutical products and technologies. We have rights to two technologies which we believe may be useful in the treatment of a variety of diseases, including cancer, infectious disease, and pain and inflammation, and we are entitled to royalties and other revenues in connection with a third technology, relating to the treatment of ophthalmic disorders. Our existing products and technologies under development are each held either by us or our subsidiaries. We have been unprofitable since inception and expect to incur substantial additional operating losses over the next several years. The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this Form 10 - KSB/A.

Results of Operations

From the commencement of operations through December 31, 2000, we have generated \$9,118,457 of revenue.

2000 Versus 1999

In accordance with a development agreement as amended in September 1999, Bausch & Lomb Surgical paid our subsidiary, Optex, for developing its Catarex technology, plus a profit component. For the year ended December 31, 2000, this agreement provided \$5,169,288 of development revenue, and the related cost of development revenue was \$4,135,430. For the year ended December 31, 1999, this agreement provided \$1,082,510 of development revenue, and the related cost of development revenue was \$866,008 which solely represented the activity for the fourth quarter of 1999. On March 2, 2001, Optex sold substantially all of its assets, including those related to the Catarex technology, to Bausch & Lomb. As described below, the development agreement was terminated and we will no longer receive development revenue under that agreement.

Research and development expenditures consist primarily of costs associated with research and development personnel; the cost of operating our research and development laboratories; payments made under our license agreements, sponsored research agreements, research agreements with institutes, and consultants' agreements with its licensors, scientific collaborators, and research institutes; and costs related to patent filings and maintenance. For the year ended December 31, 2000, our research and development expense was \$1,130,345 as compared to \$1,091,291 for the year ended December 31, 1999. The 1999 expense is presented net of nine months of Bausch & Lomb reimbursements of \$1,044,708 received prior to the September 1999 amendment described in the preceding paragraph. This increase was due to increased expenditures for the year on certain development projects, including the costs associated with the completion of a successful Phase I study for our CT-3 compound during 2000.

During 2000, we made an investment in TeraComm Research, Inc., accounted for under the equity method of accounting, of \$1,000,000 cash as well as common stock and a warrant to purchase common stock, together valued at \$1,800,000. Of the \$2,800,000 purchase price, we expensed \$2,653,382 as acquired in-process research and development, as no capitalizable intangible assets are present at TeraComm, as its product development activity is in the very early stages and has no alternative future use at this time. The TeraComm investment is accounted for

in accordance with the equity method of accounting for investments as we continue to have the ability to exert significant influence over TeraComm through our Board seat and other involvement with management.

General and administrative expenses consist primarily of expenses associated with corporate operations, legal, finance and accounting, human resources and other general operating costs. For the year ended December 31, 2000, our general and administrative expense was \$2,235,535 as compared to \$1,941,425, which is net of Bausch & Lomb reimbursements of \$184,360 for the year ended December 31, 1999 received prior to the September 1999 amendment. This increase was due to costs incurred in hiring and relocating executives, an increase in payroll costs over last year, and an increase in fees for professional services attributable to legal filings and due diligence relating to fundraising efforts and certain investments.

In 2000, we had \$1,020,128 of expense associated with warrants issued to Joseph Stevens & Company as partial compensation for investment banking services provided by Joseph Stevens & Company during 2000. Compensation expense relating to these investment banking services represents a general and administrative expense.

For the year ended December 31, 2000, our interest and other income was \$92,670 compared to \$292,630 for the year ended December 31, 1999. This decrease was primarily due to a decline in our cash reserves, which resulted in decreased interest income. For the year ended December 31, 2000, our share of losses of TeraComm amounted to \$79,274.

Net loss applicable to common shares for the year ended December 31, 2000, was \$6,847,749 as compared to a net loss applicable to common shares of \$2,760,881 for the year ended December 31, 1999. This increase in net loss applicable to common shares is primarily attributable to acquired in-process research and development expense relating to our investment in TeraComm of \$2,653,382. In the year ended December 31, 2000, we recorded compensation expense of \$1,020,865 relating to stock warrants issued to Joseph Stevens & Co. which did not exist during 1999. Net loss applicable to common shares in 2000 also included a dividend paid upon the repurchase of the outstanding Series B preferred stock of \$233,757 which was not paid in 1999. We also issued preferred stock dividends on our Series A preferred stock for which the estimated fair value of \$811,514 and \$314,366 was included in the net loss applicable to common shares for the years ended December 2000 and 1999, respectively. The increase in the estimated fair value of these dividends as compared to the prior year is partially a reflection of an increase in our stock price. Going forward, with the termination of our agreement with Bausch & Lomb, described below, we will no longer have the revenue or profits associated with that agreement available to us. For the year ended December 31, 2000, we received \$5,169,288 in development revenue from Bausch & Lomb as compared with \$1,082,510 in 1999.

#### 1999 Versus 1998

During 1999, Optex's development agreement with Bausch & Lomb was amended to include a profit component. Fees earned from the date of the amendment are presented in our financial statements as development revenue. Prior to amendment of this agreement in September 1999, reimbursements from Bausch & Lomb, which represented pass-through expenses, were treated as a reduction of expenses and totaled \$2,276,579 since the inception of the agreement. Reimbursements made under the agreement in 1999 reduced our research and development expenses by \$1,044,708 and general and administrative expenses by \$184,360. Net general and administrative expenses for the year ended December 31, 1999, were \$1,941,425 as compared to \$2,668,508 for the corresponding period in 1998. This decrease was primarily attributable to a general reduction in corporate overhead associated with reduced corporate staffing, patent prosecution fees, advertising, and travel expenses.

Research and development expenses, including license fees, were \$1,091,291 for the year ended December 31, 1999, as compared to \$3,036,355 for the corresponding period in 1998. These amounts are net of reimbursements from Bausch & Lomb of \$1,044,708 in 1999 and \$899,936 in 1998. The decrease in research and development expenses in 1999 was attributable to reduced research and development activities for all of our technologies, except for the Catarex technology being developed by Optex, with respect to which increased development work was offset by higher reimbursement from Bausch & Lomb. Termination of the license agreement between Channel and the Trustees of the University of Pennsylvania contributed to reduced research and development activities.

Interest income in 1999 was \$292,630 compared to \$451,335 in 1998. The decrease was attributable to reduced investment amounts.

Net loss applicable to common shares for the year ended December 31, 1999, was \$2,760,881 as compared to a net loss applicable to common shares of \$4,381,779 for the year ended December 31, 1998. This decrease in net loss is primarily attributable to an imputed preferred stock dividend on our Series A preferred stock of 1,628,251 in 1998 compared to a preferred stock dividend on our Series A preferred stock of \$314,366 in 1999. In addition, research and development expenses decreased by \$1,945,064 from 1998 to 1999 and general and administrative expenses decreased by \$727,083 from 1998 to 1999 as a result of our efforts to scale back on these expenses in 1999. This decrease in expenses is partially offset by \$2,500,000 of license revenue which was recognized in 1998 from our agreement with Bausch and Lomb. This is compared with total revenue net of cost of development for 1999 of \$293,571 in 1999 subsequent to the September 1999 amendment with Bausch & Lomb.

#### LIQUIDITY AND CAPITAL RESOURCES

From inception to December 31, 2001, we incurred an accumulated deficit of \$24,826,334, and we expect to continue to incur additional losses through the year ending December 21, 2000 and for the foreseeable future. The loss has been incurred through primarily research and development activities related to our various technologies under our control.

In May 1998, Optex entered into a development and licensing agreement pursuant to which it granted to Bausch & Lomb Surgical Incorporated, an affiliate of Bausch & Lomb, a worldwide license to its rights to the Catarex device. In September 1999, Optex and Bausch & Lomb Surgical amended this agreement to expand Optex's role in development of the Catarex surgical device. During 2000, we recorded development revenue from the amended agreement in the amount of \$5,169,288.

Pursuant to an asset purchase agreement dated January 31, 2001, among Bausch & Lomb, a Bausch & Lomb affiliate, Atlantic, and Optex, on March 2, 2001, Optex sold to Bausch & Lomb substantially all its assets (mostly intangible assets with no book value), including all those related to the Catarex technology. Upon the sale, Atlantic and Optex have no further obligations to Bausch & Lomb. The purchase price was \$3 million paid at closing (approximately \$564,000 of which was distributed to the minority shareholders). In addition, Optex is entitled to receive additional consideration, namely \$1 million once Bausch & Lomb receives regulatory approval to market the Catarex device in Japan, royalties on net sales on the terms stated in the original development agreement dated May 14, 1998, between Bausch & Lomb and Optex, as amended, and minimum royalties of \$90,000, \$350,000, and \$750,000 for the first, second, and third years, respectively, starting on first commercial use of the Catarex device or January 1, 2004, whichever is earlier. Optex also has the option to repurchase the acquired assets from Bausch & Lomb if it ceases developing the Catarex technology at fair value. Upon the sale of Optex assets, Bausch & Lomb's development agreement with Optex was terminated. Upon the closing of the asset purchase agreement, Optex agreed to forgo future contingent payments in exchange for the receipt of a one-time \$3 million payment and the same potential for future royalties.

On September 28, 2000, pursuant to a convertible preferred stock and warrants purchase agreement (the purchase agreement), we issued to BH Capital Investments, L.P. and Excalibur Limited Partnership (together, the Investors) for a purchase price of \$2,000,000, 689,656 shares of our Series B convertible preferred stock (the Series B preferred stock) and warrants to purchase 134,000 shares of our common stock. Half of the shares of Series B preferred stock (344,828 shares) and warrants to purchase half of the shares of common stock (67,000 shares) were held in escrow, along with half of the purchase price.

On December 4, 2000, Atlantic and the Investors entered into a stock repurchase agreement (the stock repurchase agreement) pursuant to which we repurchased from the Investors for \$500,000 137,930 shares of Series B preferred stock, and agreed to the release from escrow to the Investors of the \$1,000,000 purchase price of the 344,828 shares of Series B preferred stock held in escrow. We also allowed the Investors to keep all of the warrants issued under the purchase agreement and issued to the Investors warrants to purchase a further 20,000 shares of our common stock at the same exercise price. On January 19, 2001, 41,380 shares of Series B preferred stock were converted by the Investors into 236,422 shares of our common stock. On March 9, 2001, Atlantic and the Investors

entered into a second stock repurchase agreement (stock repurchase agreement no. 2). Pursuant to stock repurchase agreement no. 2, we repurchased from the Investors, for an aggregate purchase price of \$617,067, all 165,518 shares of our Series B preferred stock held by the Investors. The repurchase price represented 125% of the purchase price originally paid by the investors for the repurchased shares, as well as an amount equal to the annual dividend on the Series B preferred stock at a rate per share of 8% of the original purchase price. The repurchased shares constitute all remaining outstanding shares of Series B preferred stock; we have cancelled those shares.

On May 12, 2000, we acquired shares of preferred stock representing a 35% ownership interest in TeraComm Research, Inc. ("TeraComm"), a privately held company that is developing next-generation high-speed fiber optic communications technologies. The purchase price for this ownership interest was \$5,000,000 in cash, 200,000 shares of our common stock, and a warrant to purchase a further 200,000 shares of our common stock. Of the \$5,000,000 cash portion of the purchase price, we paid \$1,000,000. We are accounting for the investment in TeraComm in accordance with the equity method of accounting for investments since we have the ability to exert significant influence over TeraComm, including through our Board representation.

On July 18, 2000, Atlantic and TeraComm amended the purchase agreement. In the amendment, the parties agreed that the \$4,000,000 balance of the \$5,000,000 cash component of the purchase price would not be due until TeraComm achieved a specified milestone. Within ten days after TeraComm achieved that milestone, we were required to pay TeraComm \$1,000,000 and thereafter make to TeraComm three payments of \$1,000,000 at three-month intervals. If we failed to make any of these payments, TeraComm's only recourse would be reducing proportionately our ownership interest. Our failure to make the first \$1,000,000 payment by midnight at the end of December 30, 2000 (whether or not TeraComm has reached the milestone) would at the option of TeraComm be deemed to constitute failure by us to timely make that payment.

When we failed to make this first \$1,000,000 payment, we were deemed to have surrendered to TeraComm a proportion of our TeraComm shares equal to the proportion of the dollar value of the purchase price for our TeraComm shares (\$6,795,000) that was represented by the unpaid \$4,000,000 of the cash portion of the purchase price. This had the effect of reducing to 14.4% our actual ownership interest in TeraComm. However, Atlantic continues to hold one seat on the Board of Directors, and therefore continues to have the ability to exert significant influence.

On March 16, 2001, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC pursuant to which Fusion Capital agreed to purchase up to \$6.0 million of our common stock over a 30-month period, subject to a 6-month extension or earlier termination at our discretion. The selling price of the shares will be equal to the lesser of (1) \$20.00 or (2) a price based upon the future market price of the common stock, without any fixed discount to the market price. For further details, see our registration statement on Form S-3 filed with the SEC on March 25, 2001. However, Nasdaq delisting would constitute an event of default under the purchase agreement with Fusion Capital, and Fusion Capital would no longer be obligated to purchase our common stock.

Our available working capital and capital requirements will depend upon numerous factors, including progress of our research and development programs; our progress in and the cost of ongoing and planned preclinical and clinical testing; the timing and cost of obtaining regulatory approvals; the cost of filing, prosecuting, defending, and enforcing patent claims and other intellectual property rights; competing technological and market developments; changes in our existing collaborative and licensing relationships; the resources that we devote to developing manufacturing and commercializing capabilities; technological advances; status of competitors; our ability to establish collaborative arrangements with other organizations; and our need to purchase additional capital equipment.

At December 31, 2000, we had \$2,663,583 in cash and cash equivalents and working capital of \$798,726. We anticipate that our current resources, together with \$2.4 million in net proceeds from the Bausch & Lomb asset purchase agreement, less \$617,067 used to repurchase the remaining shares of our Series B preferred stock (see above), will be sufficient to finance our currently anticipated needs for operating and capital expenditures for at least the next twelve months. In addition, we will attempt to generate additional capital through a combination of collaborative agreements, strategic alliances, and equity and debt financing. However, we can give no assurance that we will be able to obtain additional capital through these sources or upon terms acceptable to us.



We have the following short term and long term liquidity needs. Our cash utilized for operations for the next year is expected to be approximately \$200,000 per month. Currently, these expected operating expenses include approximately \$70,000 per month for research and pre-clinical development expenses and approximately \$130,000 for general and administrative expenses. Based on our cash position of \$2,663,583 at December 31, 2000, we will either have to raise additional funds within the next twelve months to fund our current spending requirements or we will have to reduce or eliminate the planned levels of development activities. Since we do not have significant fixed cash commitments, we have the option of significantly cutting or delaying our development activities as may be necessary.

We are at risk of being delisted from the Nasdaq SmallCap Market. As of March 20, 2001, we had the thirtieth consecutive business day that the minimum bid price of our common stock was less than \$1.00. This constituted a failure on our part to meet Nasdaq's continued inclusion requirement for minimum bid price. On March 22, 2001, Nasdaq notified us of this failure, and we have a period of 90 calendar days from that notice to comply with the continued inclusion standard for minimum bid price. We can do so by meeting the standard for a minimum of 10 consecutive business days during the 90 day compliance period.

In addition, the consolidated financial statements included within this Annual Report show that on December 31, 2000, our net tangible assets were less than \$2 million. Consequently, we expect to receive a deficiency notice from Nasdaq notifying us that we have ten days to submit a plan to achieve and sustain long-term compliance with all applicable listing criteria. If Nasdaq is not satisfied with the plan that we submit or if we do not submit a plan, we will then receive a staff determination from Nasdaq. Upon receipt of the staff determination, we will have seven days to appeal the staff determination and request a hearing before Nasdaq's Listing Qualifications Panel (the "panel"), and such a request will generally stay the delisting pending a determination by the panel (called a "panel decision"). Failure to request a hearing within seven calendar days will result in automatic delisting. In addition, if our securities were delisted, it could materially and adversely affect our ability to raise additional funding.

#### RECENTLY ISSUED ACCOUNTING STANDARDS

On January 1, 2001, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - an amendment of SFAS No. 133" and SFAS No. 133, "Accounting for Certain Derivative Instruments and Certain Hedging Activities". SFAS No. 138 amends the accounting and reporting standards of SFAS No. 133 for certain derivative instruments and certain hedging activities. SFAS No. 133 requires a company to recognize all derivative instruments as assets and liabilities in its balance sheet and measure them at fair value. The adoption of these statements did not have a material impact on our consolidated financial position, results of operations or cash flows, as we are currently not party to any derivative instruments.

#### ITEM 7. CONSOLIDATED FINANCIAL STATEMENTS

For a list of the consolidated financial statements filed as part of this report, see the Index to Consolidated Financial Statements at page 39.

#### ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

INFORMATION CONCERNING DIRECTORS AND EXECUTIVE OFFICERS

A. Joseph Rudick, M.D., 44, has been a director of Atlantic since May 1999 and Chief Executive Officer since April 10, 2000. He was also the President of Atlantic from May 1999 until April 3, 2000 and was a founder of Atlantic and two of its majority-owned subsidiaries, Optex and Channel. Dr. Rudick served as a business consultant to Atlantic from January 1997 until November 1998. From June 1994 until November 1998, Dr. Rudick was a Vice President of Paramount Capital, Inc. ("Paramount"), an investment bank specializing in the biotechnology and biopharmaceutical industries. Since 1988, he has been a Partner of Associate Ophthalmologists P.C., a private ophthalmology practice located in New York, and from 1993 to 1998 he served as a director of Healthdesk Corporation, a publicly-traded medical information company of which he was a co-founder. Dr. Rudick earned a B.A. in Chemistry from Williams College in 1979 and an M.D. from the University of Pennsylvania in 1983.

Steve H. Kanzer, C.P.A., Esq., 37, has been a director of Atlantic since its inception in 1993. Mr. Kanzer currently is a member of the Audit Committee and the Compensation Committee. Since December 1997, Mr. Kanzer has been Chief Executive Officer of a biotechnology holding company, Corporate Technology Development, Inc., based in Miami. From 1992 until December 1998, Mr. Kanzer was a founder and Senior Managing Director of Paramount, and Senior Managing Director--Head of Venture Capital of Paramount Capital Investments, LLC ("Paramount Investments"), a biotechnology and biopharmaceutical venture capital and merchant banking firm that is associated with Paramount. From 1993 until June 1998, Mr. Kanzer was a founder and a member of the board of directors of Boston Life Sciences, Inc., a publicly-traded pharmaceutical research and development company. Mr. Kanzer is a founder and Chairman of the Board of Discovery Laboratories, Inc., and a member of the board of directors of Endorex Corp., two publicly-traded pharmaceutical research and development companies. Prior to joining Paramount, Mr. Kanzer was an attorney with Skadden, Arps, Slate, Meagher & Flom LLP in New York, New York from September 1988 to October 1991. He received his J.D. from New York University School of Law in 1988 and a B.B.A. in Accounting from Baruch College in 1985. In his capacity as employee and director of other companies in the venture capital field, Mr. Kanzer is not required to present to Atlantic opportunities that arise outside the scope of his duties as a director of Atlantic.

Frederic P. Zotos, Esq., 35, has been a director of Atlantic since May 1999 and President of Atlantic since April 3, 2000. From June 1999 until April 2000, Mr. Zotos was Director of Due Diligence and Internal Legal Counsel of Licent Capital, LLC, an intellectual property royalty finance company located in Jericho, New York. From September 1998 until June 1999, Mr. Zotos practiced as an independent patent attorney and technology licensing consultant in Cohasset, Massachusetts. From December 1996 until August 1998, Mr. Zotos was Assistant to the President and Patent Counsel of Competitive Technologies, Inc., a publicly-traded technology licensing agency located in Fairfield, Connecticut. From July 1994 until November 1996, Mr. Zotos was an Intellectual Property Associate of Pepe & Hazard, a general practice law firm located in Hartford, Connecticut. He is Co-Chair of the Fairfield-Westchester and Chair of the New York City Chapters of the Licensing Executive Society, and a member of its Financial Markets Committee. Mr. Zotos is a registered patent attorney with the United States Patent and Trademark Office, and is also registered to practice law in Massachusetts and Connecticut. He earned a B.S. in Mechanical Engineering from Northeastern University in 1987, a joint J.D. and M.B.A. degree from Northeastern University in 1993, and successfully completed an M.S. in Electrical Engineering Prerequisite Program from Northeastern University in 1994.

Nicholas J. Rossettos, C.P.A., 35, has been Chief Financial Officer since April 2000. Mr. Rossettos' most recent position was as Manager of Finance for Centerwatch, a pharmaceutical trade publisher headquartered in Boston, MA that is a wholly owned subsidiary of Thomson CP headquartered in Toronto, Canada. Prior to that, he was Director of Finance and Administration for EnviroBusiness, Inc., an environmental and technical management-consulting firm headquartered in Cambridge, MA. He holds an A.B. in Economics from Princeton University and a M.S. in Accounting and M.B.A. from Northeastern University.

Peter O. Kliem, 62, has been a Director of Atlantic since March 21, 2000 and is a member of the Compensation Committee. Mr. Kliem is a co-founder, President and COO of Enanta Pharmaceuticals, a Boston based biotechnology start-up. Prior to this start-up, he worked with Polaroid Corporation for 36 years, most recently in the positions of Senior Vice President, Business Development, Senior VP, Electronic Imaging and Senior VP and Director of Research & Development. During his tenure with Polaroid, he initiated and executed major strategic alliances with corporations in the U.S., Europe, and the Far East. Mr. Kliem also introduced a broad range of innovative products such as printers, lasers, CCD and CID imaging, fiber optics, flat panel display, magnetic/optical storage and medical diagnostic products in complex technological environments. He serves as trustee and vice president of the Boston Biomedical Research Institute and served as Chairman of PB Diagnostics. He is a member of the board of directors of the privately held company, Corporate Technology Development, Inc. In addition, he served as Industry Advisor to TVM-Techno Venture Management. Mr. Kliem earned his M.S. in chemistry from Northeastern University.

There are no family relationships among the executive officers or directors of Atlantic.

#### SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires Atlantic's officers, directors and persons who are the beneficial owners of more than 10% of the common stock to file initial reports of ownership and reports of changes in ownership of the common stock with the SEC. Officers, directors and beneficial owners of more than 10% of the common stock are required by SEC regulations to furnish Atlantic with copies of all Section 16(a) forms they file.

Each of Atlantic's directors and executive officers was late in filing the forms required by Section 16(a) of the Exchange Act during fiscal year 2000.

#### ITEM 10. EXECUTIVE COMPENSATION

##### COMPENSATION OF EXECUTIVE OFFICERS

Pursuant to our 1995 stock option plan, on April 12, 2000, Dr. Rudick was granted options for 100,000 shares of common stock at an exercise price of \$4.1875. Additionally, on April 12, 2000, Dr. Rudick was granted options for 25,000 shares of common stock at an exercise price of \$4.1875 in connection with his promotion to Chief Executive Officer. During the 2000 fiscal year, options for 50,000 shares of common stock that had been granted to Dr. Rudick on August 9, 1999, were rescinded in order to correct for the grant to Dr. Rudick during the 1999 fiscal year of options for 37,000 shares of common stock above the amount permitted by our stock option plan for that fiscal year. Pursuant to the 1995 stock option plan, on April 12, 2000, Frederic Zotos was granted options for 100,000 shares of common stock at an exercise price of \$4.1875. Additionally, on April 12, 2000, Frederic Zotos was granted options for 150,000 shares of common stock at an exercise price of \$4.1875 in connection with his promotion to President. On April 12, 2000, Nicholas Rossettos was granted options for 50,000 shares of common stock at an exercise price of \$4.1875 in connection with his promotion to Chief Financial Officer.

The following table sets forth, for the last three fiscal years, the compensation earned for services rendered in all capacities by our chief executive officer and the other highest-paid executive officers serving as such at the end of 2000 whose compensation for that fiscal year was in excess of \$100,000. The individuals named in the table will be hereinafter referred to as the "Named Officers." No other executive officer of Atlantic received compensation in excess of \$100,000 during fiscal year 2000. No executive officer who would otherwise have been included in this table on the basis of 2000 salary and bonus resigned or terminated employment during that year.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation	All Other Compensation (\$)
		Salary(\$)	Bonus(\$)	Other Annual Compensation (\$)	Awards	
					Securities Underlying Options/SARs(#)	
A. Joseph Rudick, M.D.(1) Chief Executive Officer	2000	123,750	111,174	0	25,000	84,674(2)
	1999	0	23,502	0	87,000(3)	81,523(4)
	1998	0	0	0	10,000	0
Frederic P. Zotos, Esq. (5) President	2000	131,250	50,000	10,000(6)	250,000	14,750(7)
	1999	0	0	0	37,000	2,600(8)
	1998	0	0	0	0	0
Nicholas J. Rossettos, C.P.A.(9) Chief Financial Officer, Treasurer and Secretary	2000	91,146	25,000	10,000(10)	50,000	0
	1999	0	0	0	0	0
	1998	0	0	0	0	0

- (1) Dr. Rudick became Chief Executive Officer of Atlantic on April 10, 2000.
- (2) Represents \$86,174 paid to Dr. Rudick in recognition of his role in negotiating an amendment to Optex's contract with Bausch & Lomb (see Item 12 below for a more detailed explanation), less \$1,500 returned to Atlantic by him due to mistaken overpayment of director's fees for the 1999 fiscal year.
- (3) Excludes options for 50,000 shares of common stock granted to Dr. Rudick on August 9, 1999, but rescinded in the 2000 fiscal year to correct the grant to him in the 1999 fiscal year of options for 37,000 shares of common stock above the amount permitted by the stock option plan for that fiscal year.
- (4) Represents \$50,516 in fees paid to Dr. Rudick for consulting services rendered, \$7,500 in director's fees, of which \$1,500 was paid in error and therefore returned to Atlantic by him in 2000, and \$23,507 paid in recognition of his role in negotiating an amendment to Optex's contract with Bausch & Lomb (see Item 12 below for a more detailed explanation).
- (5) Mr. Zotos became President of Atlantic on April 3, 2000.
- (6) Represents matching contributions by Atlantic pursuant to Atlantic's SAR-SEP retirement plan.
- (7) Represents \$8,000 in fees paid for consulting services rendered and \$6,750 in director's fees.
- (8) Represents fees paid for consulting services rendered.
- (9) Mr. Rossettos became Chief Financial Officer of Atlantic on April 10, 2000.
- (10) Represents matching contributions by Atlantic pursuant to Atlantic's SAR-SEP retirement plan.

OPTIONS AND STOCK APPRECIATION RIGHTS

The following table contains information concerning the grant of stock options under the 1995 stock option plan and otherwise to the Named Officers during the 2000 fiscal year. Except as described in footnote (1) below, no stock appreciation rights were granted during the 2000 fiscal year.

OPTION/SAR GRANTS IN LAST FISCAL YEAR

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 Individual Grants  
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Name	Number of Securities Underlying Options/SARs Granted(1)	% of Underlying Options/SARs Granted to Employees in Fiscal Year(2)	Exercise Price (\$/Share)(3)	Expiration Date
A. Joseph Rudick M.D.(4)	125,000	25%	\$4.1875	4/12/10
Frederic P. Zotos, Esq.	250,000	51%	\$4.1875	4/12/10
Nicholas J. Rossettos, CPA	50,000	10%	\$4.1875	4/12/10
Other Employees	20,000 50,000	4% 10%	\$4.1875 \$3.4375	4/12/10 5/15/10

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(1) Each option has a maximum term of ten years, subject to earlier termination in the event of the optionee's cessation of service with Atlantic. Dr. Rudick's options became exercisable as follows: (1) the first option for 100,000 shares of common stock, 25% on April 3, 2000 and 25% each of the first three anniversaries of the date of granting; (2) the second option for 25,000 shares of common stock, 25% upon granting and 25% each of the first three anniversaries of the date of granting. Mr. Zotos' options are exercisable as follows: (1) the first option for 100,000 shares of common stock, 25% upon granting and 25% each of the first three anniversaries of the date of granting; (2) the second option for 150,000 shares of common stock, 25% upon granting and 25% each of the first three anniversaries of the date of granting. Mr. Rossettos' options for 50,000 shares of common stock are exercisable as follows: 25% upon granting and 25% upon each of the first three anniversaries of the date of granting. Options for the remainder of the employees are exercisable as follows: (1) the option for 20,000 shares of common stock, 25% upon granting and 25% upon each of the first three anniversaries of the date of granting; (2) the option for 50,000 shares of common stock, 25% upon granting and 25% upon each of the first three anniversaries of the date of granting. Each option will become immediately exercisable in full upon an acquisition of Atlantic by merger or asset sale, unless the option is assumed by the successor entity. Each option includes a limited stock appreciation right pursuant to which the optionee may surrender the option, to the extent exercisable for vested shares, upon the successful completion of a hostile tender for securities possessing more than 50% of the combined voting power of Atlantic's outstanding voting securities. In return for the surrendered option, the optionee will receive a cash distribution per surrendered option share equal to the excess of (1) the highest price paid per share of common stock in that hostile tender offer over (2) the exercise price payable per share under the cancelled option.

(2) Calculated based on total option grants to employees of 495,000 shares of common stock during the 2000 fiscal year.

(3) The exercise price may be paid in cash or in shares of common stock (valued at fair market value on the exercise date) or through a cashless exercise procedure involving a same-day sale of the purchased shares. Atlantic may also finance the option exercise by loaning the optionee sufficient funds to pay the exercise price for the purchased shares and the federal and state income tax liability incurred by the optionee in connection with such exercise. The optionee may be permitted, subject to the approval of the Plan Administrator, to apply a portion of the shares purchased under the option (or to deliver existing shares of common stock) in satisfaction of such tax liability.

(4) Stock options for 50,000 shares granted to Dr. Rudick on August 9, 1999, would have vested upon the sale of Optex on January 31, 2001. These options were, however, rescinded during the 2000 fiscal year, in order to correct for the grant to Dr. Rudick in the 1999 fiscal year of options for 37,000 shares above the amount permitted by the 1995 stock option plan for that fiscal year.

OPTION EXERCISE AND HOLDINGS

The following table provides information with respect to the Named Officers concerning the exercisability of options during the 2000 fiscal year and unexercisable options held as of the end of the 2000 fiscal year. No stock appreciation rights were exercised during the 2000 fiscal year, and, except for the limited rights described in footnote (1) to the preceding table, no stock appreciation rights were outstanding at the end of that fiscal year.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR ("FY")  
AND FY-END OPTION VALUES

Name	Shares Acquired on Exercise	Value Realized (1)	No. of Securities Underlying Unexercised Options/SARs at FY-End (#)		Value of Unexercised In-the-Money Options/SARs at FY-End (Market price of shares at FY-End less exercise price) (\$)(2)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
A. Joseph Rudick, M.D.	0	-	94,361	127,639	0	0
Frederic P. Zotos	0	--	92,833	194,167	0	0
Nicholas J. Rossettos	0	--	12,500	37,500	0	0

(1) Equal to the fair market value of the purchased shares at the time of the option exercise over the exercise price paid for those shares.

(2) Based on the fair market value of Atlantic's common stock on December 31, 2000 of \$0.66 per share, the closing sales price per share on that date on the Nasdaq SmallCap Market.

LONG TERM INCENTIVE PLAN AWARDS

No long term incentive plan awards were made to a Named Officer during the last fiscal year.

COMPENSATION OF DIRECTORS

Non-employee directors are eligible to participate in an automatic stock option grant program pursuant to the 1995 stock option plan. Non-employee directors are granted an option for 10,000 shares of common stock upon their initial election or appointment to the board and an option for 2,000 shares of common stock on the date of each annual meeting of our stockholders for those non-employee directors continuing to serve after that meeting. On September 29, 2000, pursuant to the automatic stock option grant program, Atlantic granted each of Steve Kanzer and Peter Kliem options for 2,000 shares of common stock at an exercise price of \$3.1875 per share, the fair market value of our common stock on the date of grant. Additionally, on September 29, 2000, Peter Kliem was granted options for 25,000 shares of common stock at an exercise price of \$3.1875. On September 29, 2000, Steve Kanzer was granted options for 25,000 shares of common stock at an exercise price of \$3.1875. Peter Kliem was also granted options for 23,000 shares of common stock on April 6, 2000, at an exercise price of \$5.125 and options for 10,000 shares of common stock on March 21, 2000, at an exercise price of \$6.125.

The board agreed that effective October 21, 1999, each non-employee member of the board is to receive \$6,000 per year for his services as a director, payable semi-annually in arrears, plus \$1,500 for each board meeting attended in person, \$750 for each board meeting attended via telephone conference call and \$500 for each meeting of a committee of the board attended.

Board members are reimbursed for reasonable expenses incurred in connection with attending meetings of the board and of committees of the board.

EMPLOYMENT CONTRACTS AND TERMINATION OF EMPLOYMENT AND CHANGE OF CONTROL AGREEMENTS

Effective November 15, 1995, Shimshon Mizrachi became Controller of Atlantic and of each of Atlantic's subsidiaries pursuant to a letter agreement dated November 6, 1995. Mr. Mizrachi and his dependents were also eligible to receive paid medical and long-term disability insurance and such other health benefits as Atlantic made available to its other senior officers and directors. Effective January 7, 2000, Atlantic terminated the employment of Mr. Mizrachi and was obligated, pursuant to the letter agreement, to pay his salary for six months thereafter, subject to Mr. Mizrachi's duty to mitigate damages by seeking alternative employment.

Effective April 10, 2000, Dr. Rudick became Chief Executive Officer of Atlantic pursuant to an employment agreement dated as of the effective date. This agreement has a three-year term ending on April 10, 2003. Dr. Rudick reports to our board of directors. Dr. Rudick and his dependents are eligible to receive paid medical and long term disability insurance and such other health benefits as Atlantic makes available to other senior officers and directors.

Effective April 3, 2000, Mr. Zotos became President of Atlantic pursuant to an employment agreement dated as of the effective date. This agreement has a three-year term ending on April 2, 2003. As President, Mr. Zotos reports to the Chief Executive Officer. Mr. Zotos and his dependents are eligible to receive paid medical and long term disability insurance and such other health benefits as Atlantic makes available to other senior officers and directors.

Effective April 10, 2000, Mr. Rossettos became Chief Financial Officer of Atlantic pursuant to an employment agreement dated as of the effective date. This agreement has a three-year term ending on April 10, 2003. Mr. Rossettos reports to the President or Chief Executive Officer. Mr. Rossettos and his dependents are eligible to receive paid medical and long term disability insurance and such other health benefits as Atlantic makes available to other senior officers and directors.

The Compensation Committee has the discretion under the 1995 stock option plan to accelerate options granted to any officers in connection with a change in control of Atlantic or upon the subsequent termination of the officer's employment following the change of control.

ITEM 11. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information known to us with respect to the beneficial ownership of common stock as of March 30, 2001, by (1) all persons who are beneficial owners of 5% or more of our common stock, (2) each director and nominee, (3) the Named Officers in the Summary Compensation Table above, and (4) all directors and executive officers as a group. We do not know of any person who beneficially owns more than 5% of the Series A preferred stock and none of our directors or the Named Officers owns any shares of Series A preferred stock. Consequently, the following table does not contain information with respect to the Series A preferred stock.

The number of shares beneficially owned is determined under rules promulgated by the SEC, and the information is not necessarily indicative of beneficial ownership for any other purpose. Under those rules, beneficial ownership includes any shares as to which the individual has sole or shared voting power or investment power and also any shares which the individual has the right to acquire within 60 days of March 30, 2001, through the exercise or conversion of any stock option, convertible security, warrant or other right. Including those shares in the tables does not, however, constitute an admission that the named stockholder is a direct or indirect beneficial owner of those shares. Unless otherwise indicated, each person or entity named in the table has sole voting power and investment power (or shares that power with that person's spouse) with respect to all shares of capital stock listed as owned by that person or entity. The common stock represented here includes the common stock that the beneficial holders would directly possess if they converted all shares of Series A Preferred Stock held by them.

NAME AND ADDRESS -----	NUMBER OF SHARES -----	% OF TOTAL SHARES OUTSTANDING (1) -----
CERTAIN BENEFICIAL HOLDERS:		
Lindsay A. Rosenwald, M.D.(2) 787 Seventh Avenue New York, NY 10019	499,298	7.7%
VentureTek, L.P.(3) 40 Exchange Place 20th Floor New York, NY 10005	438,492	6.8%
MANAGEMENT:		
A. Joseph Rudick, M.D.(4)	130,333	2.0%
Frederic P. Zotos, Esq.(5)	158,666	2.5%
Steve H. Kanzer, C.P.A., Esq.(6)	60,000	1%
Peter O. Kliem(7)	38,500	*
Nicholas J. Rossettos, C.P.A.(8)	25,000	*
All current executive officers and directors as a group (5 persons)	412,499	6.4%

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\* Less than 1.0%

- (1) Percentage of beneficial ownership is calculated assuming 6,458,424 shares of common stock were outstanding on March 30, 2001.
- (2) Includes 344,508 shares of common stock and 154,410 shares of common stock issuable upon conversion of 47,202 shares of Series A preferred stock within 60 days of March 30, 2001. Also includes 190 shares of common stock held by June Street Corporation and 190 shares of common stock held by Huntington Street Corporation. Dr. Rosenwald is the sole proprietor of both June Street Corporation and Huntington Street Corporation.
- (3) The general partner of VentureTek, L.P. is Mr. C. David Selengut. Mr. Selengut may be considered a beneficial owner of shares owned by VentureTek, L.P. by virtue of his authority as general partner to vote and dispose of those shares. VentureTek, L.P. is a limited partnership, the limited partners of which include Dr. Rosenwald's wife and children, and sisters of Dr. Rosenwald's wife and children. Dr. Rosenwald disclaims beneficial ownership of those shares.
- (4) Represents options exercisable within 60 days of March 30, 2001. 50,000 shares of common stock are exercisable pursuant to stock options granted under the plan on April 12, 2000 for 100,000 shares, of which 25% or 25,000 shares were exercisable on April 3, 2000, then an additional 25% annually thereafter; an additional 12,500 shares are exercisable pursuant to stock options granted on April 12, 2000 for 25,000 shares, of which 25% or 6,250 were exercisable immediately, then an additional 25% annually thereafter;



an additional 25,000 shares are exercisable pursuant to stock options granted October 21, 1999, all of which were immediately exercisable; an additional 2,000 shares are exercisable pursuant to stock options granted on September 23, 1999, all of which were exercisable on September 23, 2000; an additional 25,000 shares are exercisable pursuant to stock options granted on August 9, 1999 for 50,000 shares, of which 25% or 12,500 were exercisable on issuance, then an additional 25% annually thereafter; an additional 6,666 shares are exercisable pursuant to stock options granted on May 28, 1999 for 10,000 shares, exercisable in three equal amounts starting one year from grant date; and an additional 9,167 shares are exercisable pursuant to stock options granted on August 7, 1998 for 10,000 shares, of which one third were exercisable after one year, with the remainder exercisable monthly (or 277.79 per month) over two years. Does not include 50,000 shares exercisable pursuant to stock options granted on August 9, 1999, all of which would have been exercisable upon the sale of Optex on January 31, 2001, because we rescinded this grant in the 2000 fiscal year in order to correct the grant of stock options to Dr. Rudick in the 1999 fiscal year above the amount permitted by the stock option plan for that year.

- (5) Represents options exercisable within 60 days of March 30, 2001. 50,000 shares of common stock are exercisable pursuant to stock options granted on April 12, 2000 for 100,000 shares, of which 25% or 25,000 shares were exercisable on issuance, then an additional 25% annually thereafter; an additional 75,000 shares are exercisable pursuant to stock options granted on April 12, 2000 for 150,000, of which 25% or 37,500 were exercisable on issuance, then an additional 25% annually thereafter; an additional 25,000 shares are exercisable pursuant to stock options granted October 21, 1999, all of which were immediately exercisable; an additional 2,000 shares are exercisable pursuant to stock options granted September 23, 1999 for 2,000 shares, all of which were exercisable after one year; and an additional 6,666 shares are exercisable pursuant to stock options granted May 28, 1999 for 10,000 shares, exercisable in three equal annual amounts exercisable starting one year from grant date.
- (6) Represents options exercisable within 60 days of March 30, 2001. 25,000 shares are exercisable pursuant to stock options granted on February 29, 2000, all of which were immediately exercisable; an additional 2,000 shares are exercisable pursuant to stock options granted on September 29, 2000, all of which were immediately exercisable; an additional 25,000 shares are exercisable pursuant to stock options granted on October 21, 1999, all of which were immediately exercisable; an additional 2,000 shares are exercisable pursuant to stock options granted September 23, 1999, all of which were exercisable on September 23, 2000; an additional 2,000 shares are exercisable pursuant to stock options granted August 28, 1998; an additional 2,000 shares are exercisable pursuant to stock options granted on June 17, 1997; and an additional 2,000 shares are exercisable pursuant to stock options granted on July 24, 1996.
- (7) Represents options exercisable within 60 days of March 30, 2000. 25,000 shares of common stock are exercisable pursuant to stock options granted September 29, 2000, all of which were immediately exercisable; an additional 2,000 shares are exercisable pursuant to stock options granted September 29, 2000, all of which were immediately exercisable; and an additional 11,500 shares are exercisable pursuant to stock options for 23,000 shares granted on April 6, 2000, of which 25% or 5,570 were exercisable on issuance, and then an additional 25% annually thereafter.
- (8) Represents options exercisable within 60 days of March 30, 2001. 25,000 shares of common stock are exercisable pursuant to stock options for 50,000 shares granted April 4, 2000, of which 25% or 12,500 were exercisable on issuance, and then an additional 25% annually thereafter.

#### ITEM 12. Certain Relationships and Related Transactions

In recognition of his role in negotiating an amendment to Optex's contract with Bausch & Lomb (see "Business--Optex Ophthalmologics, Inc."), Atlantic agreed to pay to Dr. Rudick, Atlantic's President, an amount equal to \$141,012. This amount will be paid in 18 monthly installments (\$7,834 per month), which commenced October 1999, out of the profit component of Bausch & Lomb's payments to Optex. Under this arrangement, Dr. Rudick received in 1999 a total of \$23,507 covering 3 monthly installments and in 2000 a total of \$86,174 covering 11 monthly installments. The remaining four installments will be paid in 2001. We felt it was appropriate to enter into this arrangement, given that the deal struck with Bausch & Lomb was considerably more advantageous to us than the deal tentatively agreed to by us prior to Dr. Rudick's joining the board and becoming President, and given also that in 2000 Dr. Rudick spent more time on Atlantic matters than Atlantic had any right to expect, given that Dr. Rudick's compensation was initially limited to consulting fees of \$6,000 a month.

On January 4, 2000, we entered into a Financial Advisory and Consulting Agreement with Joseph Stevens & Company, Inc. In this agreement, we engaged Joseph Stevens to provide us with investment banking services from January 4, 2000 until January 4, 2001. As partial compensation for the services to be rendered by Joseph Stevens, we issued them three warrants, each warrant entitling Joseph Stevens to purchase 150,000 shares of our common stock. The exercise price and exercise period of each warrant is as follows:

Warrant Number	No. of Shares	Exercise Price	Exercise Period
No.1	150,000	\$2.50	1/4/00 through 1/4/05
No.2	150,000	\$3.50	1/4/01 through 1/4/06 (subject to vesting in equal monthly increments from 1/4/00-1/4/01)
No.3	150,000	\$4.50	1/4/02 through 1/4/07 (subject to vesting in equal monthly increments from 1/4/00-1/4/01)

In addition, each warrant may only be exercised when the market price of a share of common stock is at least \$1.00 greater than the exercise price of that warrant. In connection with issuance of the warrants, Atlantic and Joseph Stevens entered into a letter agreement granting Joseph Stevens registration rights in respect of the shares of common stock issuable upon exercise of the warrants.

Pursuant to Atlantic's restated certificate of incorporation and bylaws, Atlantic enters into indemnification agreements with each of its directors and executive officers.

All transactions between Atlantic and its officers, directors, principal stockholders and their affiliates are approved by a majority of the board of directors, including a majority of the independent and disinterested outside directors on the board of directors. We believe that all of the transactions set forth above were made on terms no less favorable to us than could have been obtained from unaffiliated third parties.

ITEM 13. Exhibits List, and Reports on Form 8-K

#### EXHIBITS

The Following documents are referenced or included in this report.

Exhibit No.	Description
3.1(1)	Certificate of Incorporation of Atlantic, as amended to date.
3.2(1)	Bylaws of Atlantic, as amended to date.
3.3(5)	Certificate of Designations of Series A Convertible Preferred Stock.
3.4(6)	Certificate of Increase of Series A Convertible Preferred Stock.

- 3.5(9) Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock of Atlantic, filed on September 28, 2000.
- 3.6(9) Certificate of Amendment of the Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock of Atlantic, filed on November 17, 2000.
- 3.7(10) Certificate of Amendment of the Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock of Atlantic, filed on January 9, 2001.
- 3.8(10) Certificate of Amendment of the Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock of Atlantic, filed on January 19, 2001.
- 4.2(1) Form of Unit certificate.
- 4.3(1) Specimen Common Stock certificate.
- 4.4(1) Form of Redeemable Warrant certificate.
- 4.5(1) Form of Redeemable Warrant Agreement by and between Atlantic and Continental Stock Transfer & Trust Company.
- 4.6(1) Form of Underwriter's Warrant certificate.
- 4.7(1) Form of Underwriter's Warrant Agreement by and between Atlantic and Joseph Stevens & Company, L.P.
- 4.8(1) Form of Subscription Agreement by and between Atlantic and the Selling Stockholders.
- 4.9(1) Form of Bridge Note.
- 4.10(1) Form of Bridge Warrant.
- 4.11(2) Investors' Rights Agreement by and among Atlantic, Dreyfus Growth and Value Funds, Inc. and Premier Strategic Growth Fund.
- 4.12(2) Common Stock Purchase Agreement by and among Atlantic, Dreyfus Growth and Value Funds, Inc. and Premier Strategic Growth Fund.
- 10.2(1) Employment Agreement dated July 7, 1995, between Atlantic and Jon D. Lindjord.
- 10.3(1) Employment Agreement dated September 21, 1995, between Atlantic and Dr. Stephen R. Miller.
- 10.4(1) Employment Agreement dated September 21, 1995, between Atlantic and Margaret A. Schalk.
- 10.5(1) Letter Agreement dated August 31, 1995, between Atlantic and Dr. H. Lawrence Shaw.
- 10.6(1) Consulting Agreement dated January 1, 1994, between Atlantic and John K. A. Prendergast.
- 10.8(1) Investors' Rights Agreement dated July 1995, between Atlantic, Dr. Lindsay A. Rosenwald and VentureTek, L.P.
- 10.9(1) License and Assignment Agreement dated March 25, 1994, between Optex Ophthalmologics, Inc., certain inventors and NeoMedix Corporation, as amended.

- 10.10(1) License Agreement dated May 5, 1994, between Gemini Gene Therapies, Inc. and the Cleveland Clinic Foundation.
- 10.11(1)+ License Agreement dated June 16, 1994, between Channel Therapeutics, Inc., the University of Pennsylvania and certain inventors, as amended.
- 10.12(1)+ License Agreement dated March 28, 1994, between Channel Therapeutics, Inc. and Dr. Sumner Burstein.
- 10.13(1) Form of Financial Advisory and Consulting Agreement by and between Atlantic and Joseph Stevens & Company, L.P.
- 10.14(1) Employment Agreement dated November 3, 1995, between Atlantic and Shimshon Mizrahi.
- 10.15(3) Financial Advisory Agreement between Atlantic and Paramount dated September 4, 1996 (effective date of April 15, 1996).
- 10.16(3) Financial agreement between Atlantic, Paramount and UI USA dated June 23, 1996.
- 10.17(3) Consultancy agreement between Atlantic and Dr. Yuichi Iwaki dated July 31, 1996.
- 10.18(3) 1995 stock option plan, as amended.
- 10.19(3) Warrant issued to an employee of Paramount Capital, LLC to purchase 25,000 shares of Common Stock of Atlantic.
- 10.20(3) Warrant issued to an employee of Paramount Capital, LLC to purchase 25,000 shares of Common Stock of Atlantic.
- 10.21(3) Warrant issued to an employee of Paramount Capital, LLC to purchase 12,500 shares of Common Stock of Atlantic.
- 10.22(4) Letter Agreement between Atlantic and Paramount Capital, Inc. dated February 26, 1997.
- 10.23(4) Agreement and Plan of Reorganization by and among Atlantic, Channel Therapeutics, Inc. and New Channel, Inc. dated February 20, 1997.
- 10.24(4) Warrant issued to John Prendergast to purchase 37,500 shares of Atlantic's Common Stock.
- 10.25(4) Warrant issued to Dian Griesel to purchase 24,000 shares of Atlantic's Common Stock.
- 10.26(7) Amendment No.1 to Development & License Agreement by and between Optex and Bausch & Lomb Surgical, Inc. dated September 16, 1999.
- 10.27(8) Financial Advisory and Consulting Agreement by and between Atlantic and Joseph Stevens & Company, Inc. dated January 4, 2000.
- 10.28(8) Warrant No.1 issued to Joseph Stevens & Company, Inc. to purchase 150,000 shares of Atlantic's Common Stock exercisable January 4, 2000.
- 10.29(8) Warrant No.2 issued to Joseph Stevens & Company, Inc. to purchase 150,000 shares of Atlantic's Common Stock exercisable January 4, 2001.
- 10.30(8) Warrant No.3 issued to Joseph Stevens & Company, Inc. to purchase 150,000 shares of Atlantic's Common Stock exercisable January 4, 2002.

- 10.31(9) Preferred Stock Purchase Agreement dated May 12, 2000, between Atlantic and TeraComm Research, Inc.
- 10.32(9) Warrant Certificate issued May 12, 2000, by Atlantic to TeraComm Research, Inc.
- 10.33(9) Stockholders Agreement dated May 12, 2000, among TeraComm Research, Inc., the common stockholders of TeraComm, and Atlantic.
- 10.34(9) Registration Rights Agreement dated May 12, 2000, between Atlantic and TeraComm Research, Inc. with respect to shares of TeraComm preferred stock issued to Atlantic.
- 10.35(9) Registration Rights Agreement dated May 12, 2000, between Atlantic and TeraComm Research, Inc. with respect to shares of Atlantic common stock issued to TeraComm.
- 10.36(9) Employment Agreement dated as of April 10, 2000, between Atlantic and A. Joseph Rudick.
- 10.37(9) Employment Agreement dated as of April 3, 2000, between Atlantic and Frederic P. Zotos.
- 10.38(9) Employment Agreement dated as of April 10, 2000, between Atlantic and Nicholas J. Rossettos, as amended.
- 10.39(9) Employment Agreement dated as of May 15, 2000, between Atlantic and Walter Glomb.
- 10.40(9) Employment Agreement dated as of April 18, 2000, between Atlantic and Kelly Harris.
- 10.41(10) Amendment dated as of July 18, 2000, to the Preferred Stock Purchase Agreement dated May 12, 2000, between Atlantic and TeraComm Research, Inc.
- 10.42(10) Convertible Preferred Stock and Warrants Purchase Agreement dated September 28, 2000, among Atlantic, BH Capital Investments, L.P. and Excalibur Limited Partnership.
- 10.43(10) Registration Rights Agreement dated September 28, 2000 among Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership.
- 10.44(10) Escrow Agreement dated September 28, 2000 among Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership.
- 10.45(10) Form of Stock Purchase Warrants issued on September 28, 2000 to BH Capital Investments, L.P., exercisable for shares of common stock of Atlantic.
- 10.46(10) Form of Stock Purchase Warrants issued on September 28, 2000 to Excalibur Limited Partnership, exercisable for shares of common stock of Atlantic.
- 10.47(10) Amendment No. 1, dated October 31, 2000, to Convertible Preferred Stock and Warrants Purchase Agreement dated September 28, 2000, among Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership.
- 10.48(12) Stock Repurchase Agreement, dated December 4, 2000, among Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership.
- 10.49 Letter Agreement, dated December 28, 2000, among Atlantic and BH Capital Investments, L.P., and Excalibur Limited Partnership. (filed herewith).

- 10.50(11) Amendment No. 2, dated January 9, 2001, to Convertible Preferred Stock and Warrants Purchase Agreement dated September 28, 2000, among Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership.
- 10.51 Amendment No. 1, dated January 9, 2001, to Registration Rights Agreement dated September 28, 2000, among Atlantic and BH Capital Investments, L.P. and Excalibur Limited Partnership. (filed herewith).
- 10.52(11) Amendment No. 3, dated January 19, 2001, to Convertible Preferred Stock and Warrants Purchase Agreement dated September 28, 2000, among Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership.
- 10.53 Letter Agreement, dated January 25, 2001, among Atlantic and BH Capital Investments, L.P., and Excalibur Limited Partnership. (filed herewith).
- 10.54(13) Stock Repurchase Agreement No. 2, dated March 9, 2001, among Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership.
- 21.1(1) Subsidiaries of Atlantic.
- 23.1 Consent of KPMG LLP.
- 24.1 Power of Attorney (included in Part III of this Report under the caption "Signatures").

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- + Confidential treatment has been granted as to certain portions of these exhibits.
- (1) Incorporated by reference to exhibits of Atlantic's Registration Statement on Form SB-2, Registration #33-98478, as filed with the Securities and Exchange Commission (the "SEC") on October 24, 1995 and as amended by Amendment No. 1, Amendment No. 2, Amendment No.3, Amendment No. 4 and Amendment No. 5, as filed with the Commission on November 9, 1995, December 5, 1995, December 12, 1995, December 13, 1995 and December 14, 1995, respectively.
- (2) Incorporated by reference to exhibits of Atlantic's Current Report on Form 8-KSB, as filed with the SEC on August 30, 1996.
- (3) Incorporated by reference to exhibits of Atlantic's Form 10-QSB for the period ended September 30, 1996.
- (4) Incorporated by reference to exhibits of Atlantic's Form 10-QSB for the period ended March 31, 1996.
- (5) Incorporated by reference to exhibits of Atlantic's Current Report on Form 8-KSB, as filed with the SEC on June 9, 1997.
- (6) Incorporated by reference to exhibits of Atlantic's Registration Statement on Form S-3 (Registration No. 333-34379), as filed with the Commission on August 26, 1997, and as amended by Amendment No. 1 as filed with the SEC on August 28, 1997.
- (7) Incorporated by reference to exhibits of Atlantic Form 10-QSB for the period ended September 30, 1999.
- (8) Incorporated by reference to exhibits of Atlantic's Form 10-KSB for the period ended December 31, 1999.
- (9) Incorporated by reference to exhibits of Atlantic's Form 10-QSB for the period ended June 30, 2000.
- (10) Incorporated by reference to exhibits of Atlantic's Form 10-QSB for the period ended September 30, 2000.

- (11) Incorporated by reference to exhibits of Atlantic's Form 8-K filed on January 24, 2001.
- (12) Incorporated by reference to exhibits of Atlantic's Form 8-K filed on December 11, 2000.
- (13) Incorporated by reference to exhibits of Atlantic's Form 8-K filed on March 14, 2001.

REPORTS ON FORM 8-K

On December 11, 2000, we filed with the SEC a report on Form 8-K stating that on December 4, 2000, Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership entered into a stock repurchase agreement, a copy of which was attached thereto.

On December 29, 2000 we filed with the SEC a report on Form 8-K stating that on December 28, 2000, Atlantic, BH Capital Investments, L.P., and Excalibur Limited Partnership amended the stock repurchase agreement entered into on December 4, 2000, by extending from January 2, 2001 to January 9, 2001 the expiration date of our option to repurchase on terms specified in the stock repurchase agreement the remaining 206,898 shares of our Series B convertible preferred stock held by BH Capital Investments, L.P. and Excalibur Limited Partnership.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, Atlantic has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on July 16, 2001.

Atlantic Ventures Technology, Inc.

/s/ Frederic P. Zotos

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Frederic P. Zotos

President, Chief Executive Officer, and Director



Accountants' Consent

The Board of Directors  
Atlantic Technology Ventures, Inc.:

We consent to incorporation by reference in the registration statements (Nos. 333-34379, 333-35079, 333-65393, 333-40916, 333-49036 and 333-57550) on Form S-3 and (Nos. 333-15807 and 333-48531) on Form S-8 of Atlantic Technology Ventures, Inc. (a development stage company) of our report dated March 30, 2001, relating to the consolidated balance sheets of Atlantic Technology Ventures, Inc. and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2000, and for the period from July 13, 1993 (inception) to December 31, 2000, which report appears in the December 31, 2000 Annual Report on Form 10-KSB/A of Atlantic Technology Ventures, Inc.

KPMG LLP

Short Hills, New Jersey  
July 16, 2001

ATLANTIC TECHNOLOGY VENTURES, INC. AND SUBSIDIARIES  
(A Development Stage Company)

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Independent Auditors' Report

The Board of Directors and Stockholders  
Atlantic Technology Ventures, Inc.:

We have audited the accompanying consolidated balance sheets of Atlantic Technology Ventures, Inc. and subsidiaries (a development stage company) as of December 31, 2000 and 1999, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2000 and for the period from July 13, 1993 (inception) to December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Atlantic Technology Ventures, Inc. and subsidiaries (a development stage company) as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, and for the period from July 13, 1993 (inception) to December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Short Hills, New Jersey  
March 30, 2001

ATLANTIC TECHNOLOGY VENTURES, INC. AND SUBSIDIARIES  
(A Development Stage Company)

Consolidated Balance Sheets

Assets	As of December 31,	
	2000	1999
	-----	-----
Current assets:		
Cash and cash equivalents	\$2,663,583	3,473,321
Accounts receivable	192,997	337,323
Prepaid expenses	22,599	17,414
	-----	-----
Total current assets	2,879,179	3,828,058
Property and equipment, net	227,088	131,832
Investment in affiliate	67,344	--
Other assets	2,901	--
	-----	-----
Total assets	\$3,176,512	3,959,890
	=====	=====
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$785,838	542,759
Deferred revenue	1,294,615	--
	-----	-----
Total current liabilities	\$2,080,453	542,759
Redeemable Series B convertible preferred stock.	600,000	--
Authorized 1,647,312 shares; 206,896 shares issued and outstanding at December 31, 2000		
Stockholders' equity:		
Preferred stock, \$.001 par value. Authorized 10,000,000 shares; 1,375,000 shares designated as Series A convertible preferred stock: None issued and outstanding	--	--
Series A convertible preferred stock, \$.001 par value. Authorized 1,375,000 shares; 359,711 and 610,088 shares issued and outstanding at December 31, 2000 and 1999, respectively (liquidation preference aggregating \$4,676,243 and \$7,931,144 at December 31, 2000 and 1999, respectively)	360	610
Convertible preferred stock warrants, 112,896 and 117,195 issued and outstanding at December 31, 2000 and 1999, respectively	520,263	540,074
Common stock, \$.001 par value. Authorized 50,000,000 shares; 6,122,135 and 4,815,990 shares issued and outstanding at December 31, 2000 and 1999, respectively	6,122	4,816
Common stock subscribed. 182 shares at December 31, 2000 and 1999	--	--
Additional paid-in capital	24,796,190	21,662,272
Deficit accumulated during development stage	(24,826,334)	(18,790,099)
	-----	-----
Total stockholders' equity	496,601	3,417,673
Less common stock subscriptions receivable	(218)	(218)
Less treasury stock, at cost	(324)	(324)
	-----	-----
Total stockholders' equity	496,059	3,417,131
	-----	-----
Total liabilities and stockholders' equity	\$3,176,512	3,959,890
	=====	=====

See accompanying notes to consolidated financial statements.

ATLANTIC TECHNOLOGY VENTURES, INC. AND SUBSIDIARIES  
(A Development Stage Company)

Consolidated Statements of Operations

	Year Ended December 31,			Cumulative period from July 13, 1993 Inception to December 31, 2000
	2000	1999	1998	
<b>Revenues:</b>				
Development revenue	\$5,169,288	1,082,510	--	\$6,251,798
License revenue	--	--	2,500,000	2,500,000
Grant revenue	189,658	77,069	--	366,659
<b>Total revenues</b>	<b>5,358,946</b>	<b>1,159,579</b>	<b>2,500,000</b>	<b>9,118,457</b>
<b>Costs and expenses:</b>				
Cost of development revenue	4,135,430	866,008	--	5,001,438
Research and development	1,130,345	1,091,291	3,036,355	9,504,910
Acquired in-process research and development	2,653,382	--	--	2,653,382
General and administrative	2,235,535	1,941,425	2,668,508	15,903,226
Compensation expense relating to stock warrants (general and administrative)	1,020,128	--	--	1,020,865
License fees	--	--	--	173,500
<b>Total operating expenses</b>	<b>11,174,820</b>	<b>3,898,724</b>	<b>5,704,863</b>	<b>34,257,321</b>
<b>Operating loss</b>	<b>(5,815,874)</b>	<b>(2,739,145)</b>	<b>(3,204,863)</b>	<b>(25,138,864)</b>
<b>Other (income) expense:</b>				
Interest and other income	(92,670)	(292,630)	(451,335)	(1,251,136)
Interest expense	--	--	--	625,575
Equity in loss of affiliate	79,274	--	--	79,274
<b>Total other (income) expense</b>	<b>(13,396)</b>	<b>(292,630)</b>	<b>(451,335)</b>	<b>(546,287)</b>
<b>Net loss</b>	<b>\$(5,802,478)</b>	<b>(2,446,515)</b>	<b>(2,753,528)</b>	<b>\$(24,592,577)</b>
Imputed convertible preferred stock dividend	--	--	1,628,251	5,331,555
Dividend paid upon repurchase of Series B	233,757	--	--	233,757
Preferred stock dividend issued in preferred shares	811,514	314,366	--	1,283,063
<b>Net loss applicable to common shares</b>	<b>\$(6,847,749)</b>	<b>(2,760,881)</b>	<b>(4,381,779)</b>	<b>\$(31,440,952)</b>
<b>Per share - basic and diluted</b>				
Net loss applicable to common shares	\$(1.21)	(0.59)	(1.13)	
<b>Weighted average shares of common stock outstanding</b>	<b>5,656,741</b>	<b>4,692,912</b>	<b>3,883,412</b>	

See accompanying notes to consolidated financial statements.

ATLANTIC TECHNOLOGY VENTURES, INC. AND SUBSIDIARIES  
(A Development Stage Company)

Consolidated Statements of Stockholders' Equity

	Series A Convertible Preferred Stock		Series B Convertible Preferred Stock	
	Shares	Amount	Shares	Amount
Common stock subscribed at \$.001 per share July-November 1993	--	\$ --	--	\$ --
Issued common stock at \$.001 per share, June 1994	--	--	--	--
Issued and subscribed common stock at \$.05 per share, August 1994	--	--	--	--
Payments of common stock subscriptions	--	--	--	--
Issuance of warrants, September 1995	--	--	--	--
Issued common stock and warrants at \$4 per unit, December 1995 (net of costs of issuance of \$1,454,300)	--	--	--	--
Conversion of demand notes payable and the related accrued interest to common stock, December 1995	--	--	--	--
Repurchase of common stock	--	--	--	--
Compensation related to grant of stock options	--	--	--	--
Amortization of deferred compensation	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 1995	--	--	--	--
Issuance of warrants, April 1996	--	--	--	--
Issued common stock and warrants at \$6.73 per share, August 1996 (net of costs of issuance of \$76,438)	--	--	--	--
Amortization of deferred compensation	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 1996	--	--	--	--
Issued convertible preferred stock at \$10 per unit, May and August 1997 (net of costs of issuance of \$1,758,816)	1,237,200	1,237	--	--
Channel merger	--	--	--	--
Conversion of preferred to common stock	(22,477)	(22)	--	--
Issuance of convertible preferred stock warrants	--	--	--	--
Issuance of warrants	--	--	--	--
Amortization of deferred compensation	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Net loss	--	--	--	--

	Series A Convertible Preferred Stock		Series B Convertible Preferred Stock	
	Shares	Amount	Shares	Amount
Balance at December 31, 1997	1,214,723	1,215	--	--
Conversion of preferred to common stock	(584,265)	(585)	--	--
Cashless exercise of preferred warrants	2,010	2	--	--
Exercise of options	--	--	--	--
Exercise of warrants	--	--	--	--
Expense related to grant of stock options	--	--	--	--
Amortization of deferred compensation	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 1998	632,468	632	--	--
Conversion of preferred to common stock	(95,599)	(95)	--	--
Preferred stock dividend	73,219	73	--	--
Net loss	--	--	--	--
Balance at December 31, 1999	610,088	610	--	--
Conversion of preferred to common stock	(309,959)	(310)	--	--
Preferred stock dividend	59,582	60	--	--
Cashless exercise of preferred warrants	--	--	--	--
Exercise of options	--	--	--	--
Issuance of common stock to TeraComm shareholders	--	--	--	--
Expense related to grant of stock warrants	--	--	--	--
Issuance of Series B convertible preferred stock	--	--	344,828	345
Costs related to issuance of Series B preferred stock	--	--	--	--
Repurchase of Series B convertible preferred stock	--	--	(137,931)	(138)
Dividend upon repurchase of Series B convertible preferred stock	--	--	--	--
Reclassification of Series B convertible preferred stock to redeemable Series B convertible preferred stock	--	--	(206,897)	(207)
Net loss	--	--	--	--
Balance at December 31, 2000	359,711	\$ 360	--	\$ --

	Convertible Preferred Stock Warrants		Common Stock	
	Number	Amount	Shares	Amount
Common stock subscribed at \$.001 per share July-November 1993	--	\$ --	--	\$ --
Issued common stock at \$.001 per share, June 1994	--	--	84	--
Issued and subscribed common stock at \$.05 per share, August 1994	--	--	860	1
Payments of common stock subscriptions	--	--	5,061	5
Issuance of warrants, September 1995	--	--	--	--
Issued common stock and warrants at \$4 per unit, December 1995 (net of costs of issuance of \$1,454,300)	--	--	1,872,750	1,873
Conversion of demand notes payable and the related accrued interest to common stock, December 1995	--	--	785,234	785
Repurchase of common stock	--	--	(269)	--
Compensation related to grant of stock options	--	--	--	--
Amortization of deferred compensation	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 1995	--	--	2,663,720	2,664
Issuance of warrants, April 1996	--	--	--	--
Issued common stock and warrants at \$6.73 per share, August 1996 (net of costs of issuance of \$76,438)	--	--	250,000	250
Amortization of deferred compensation	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 1996	--	--	2,913,720	2,914
Issued convertible preferred stock at \$10 per unit, May and August 1997 (net of costs of issuance of \$1,758,816)	--	--	--	--
Channel merger	--	--	103,200	103
Conversion of preferred to common stock	--	--	47,651	48
Issuance of convertible preferred stock warrants	123,720	570,143	--	--
Issuance of warrants	--	--	--	--
Amortization of deferred compensation	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Net loss	--	--	--	--



	Convertible Preferred Stock Warrants		Common Stock	
	Number	Amount	Shares	Amount
Balance at December 31, 1997	123,720	570,143	3,064,571	3,065
Conversion of preferred to common stock	--	--	1,367,817	1,367
Cashless exercise of preferred warrants	(6,525)	(30,069)	--	--
Exercise of options	--	--	70,000	70
Exercise of warrants	--	--	1,000	1
Expense related to grant of stock options	--	--	--	--
Amortization of deferred compensation	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Imputed convertible preferred stock dividend	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 1998	117,195	540,074	4,503,388	4,503
Conversion of preferred to common stock	--	--	312,602	313
Preferred stock dividend	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 1999	117,195	540,074	4,815,990	4,816
Conversion of preferred to common stock	--	--	1,011,038	1,011
Preferred stock dividend	--	--	--	--
Cashless exercise of preferred warrants	(4,299)	(19,811)	9,453	9
Exercise of options	--	--	85,654	86
Issuance of common stock to TeraComm shareholders	--	--	200,000	200
Expense related to grant of stock warrants	--	--	--	--
Issuance of Series B convertible preferred stock	--	--	--	--
Costs related to issuance of Series B preferred stock	--	--	--	--
Repurchase of Series B convertible preferred stock	--	--	--	--
Dividend upon repurchase of Series B convertible preferred stock	--	--	--	--
Reclassification of Series B convertible preferred stock to redeemable Series B convertible preferred stock	--	--	--	--
Net loss	--	--	--	--
Balance at December 31, 2000	112,896	\$520,263	6,122,135	\$6,122

	Common Stock Subscribed		Additional Paid-in Capital	Deficit Accumulated during Development Stage	Deferred Compen- sation
	Number	Amount			
Common stock subscribed at \$.001 per share July-November 1993	5,231	\$ 5	6,272	--	--
Issued common stock at \$.001 per share, June 1994	--	--	101	--	--
Issued and subscribed common stock at \$.05 per share, August 1994	12	--	52,374	--	--
Payments of common stock subscriptions	(5,061)	(5)	--	--	--
Issuance of warrants, September 1995	--	--	300,000	--	--
Issued common stock and warrants at \$4 per unit, December 1995 (net of costs of issuance of \$1,454,300)	--	--	6,034,827	--	--
Conversion of demand notes payable and the related accrued interest to common stock, December 1995	--	--	2,441,519	--	--
Repurchase of common stock	--	--	--	--	--
Compensation related to grant of stock options	--	--	208,782	--	(144,000)
Amortization of deferred compensation	--	--	--	--	12,000
Net loss	--	--	--	(4,880,968)	--
Balance at December 31, 1995	182	--	9,043,875	(4,880,968)	(132,000)
Issuance of warrants, April 1996	--	--	139,000	--	--
Issued common stock and warrants at \$6.73 per share, August 1996 (net of costs of issuance of \$76,438)	--	--	1,452,063	--	--
Amortization of deferred compensation	--	--	--	--	28,800
Net loss	--	--	--	(3,557,692)	--
Balance at December 31, 1996	182	--	10,634,938	(8,438,660)	(103,200)
Issued convertible preferred stock at \$10 per unit, May and August 1997 (net of costs of issuance of \$1,758,816)	--	--	10,611,947	--	--
Channel merger	--	--	657,797	--	--
Conversion of preferred to common stock	--	--	(26)	--	--
Issuance of convertible preferred stock warrants	--	--	(570,143)	--	--
Issuance of warrants	--	--	159,202	--	--
Amortization of deferred compensation	--	--	--	--	28,800
Imputed convertible preferred stock dividend	--	--	(3,703,304)	--	--
Imputed convertible preferred stock dividend	--	--	3,703,304	--	--
Net loss	--	--	--	(5,151,396)	--

	Common Stock		Additional	Deficit	Deferred
	Subscribed		Paid-in	Accumulated	Compen-
	Number	Amount	Capital	during	sation
			Development	Stage	
Balance at December 31, 1997	182	--	21,493,715	(13,590,056)	(74,400)
Conversion of preferred to common stock	--	--	(782)	--	--
Cashless exercise of preferred warrants	--	--	30,067	--	--
Exercise of options	--	--	52,430	--	--
Exercise of warrants	--	--	5,499	--	--
Expense related to grant of stock options	--	--	81,952	--	--
Amortization of deferred compensation	--	--	--	--	74,400
Imputed convertible preferred stock dividend	--	--	(1,628,251)	--	--
Imputed convertible preferred stock dividend	--	--	1,628,251	--	--
Net loss	--	--	--	(2,753,528)	--
			21,662,881	(16,343,584)	
Balance at December 31, 1998	182	--			--
Conversion of preferred to common stock	--	--	(218)	--	--
Preferred stock dividend	--	--	(391)	--	--
Net loss	--	--	--	(2,446,515)	--
			21,662,272	(18,790,099)	
Balance at December 31, 1999	182	--			--
Conversion of preferred to common stock	--	--	(701)	--	--
Preferred stock dividend	--	--	(60)	--	--
Cashless exercise of preferred warrants	--	--	19,802	--	--
Exercise of options	--	--	344,512	--	--
Issuance of common stock to TeraComm shareholders	--	--	1,799,800	--	--
Expense related to grant of stock warrants	--	--	1,020,128	--	--
Issuance of Series B convertible preferred stock	--	--	975,943	--	--
Costs related to issuance of Series B preferred stock	--	--	(147,800)	--	--
Repurchase of Series B convertible preferred stock	--	--	(399,862)	--	--
Dividend upon repurchase of Series B convertible Preferred stock	--	--	121,949	(233,757)	--
Reclassification of Series B convertible preferred stock to redeemable Series B convertible preferred stock	--	--	(599,793)	--	--
Net loss	--	--	--	(5,802,478)	--
			\$24,796,190	\$(24,826,334)	--
Balance at December 31, 2000	182	--			--

	Common Stock Subscriptions Receivable	Treasury Stock	Total Stockholders' Equity (Deficit)
Common stock subscribed at \$.001 per share July-November 1993	(6,277)	--	--
Issued common stock at \$.001 per share, June 1994	--	--	101
Issued and subscribed common stock at \$.05 per share, August 1994	(750)	--	51,625
Payments of common stock subscriptions	6,809	--	6,809
Issuance of warrants, September 1995	--	--	300,000
Issued common stock and warrants at \$4 per unit, December 1995 (net of costs of issuance of \$1,454,300)	--	--	6,036,700
Conversion of demand notes payable and the related accrued interest to common stock, December 1995	--	--	2,442,304
Repurchase of common stock	--	(324)	(324)
Compensation related to grant of stock options	--	--	64,782
Amortization of deferred compensation	--	--	12,000
Net loss	--	--	(4,880,968)
Balance at December 31, 1995	(218)	(324)	4,033,029
Issuance of warrants, April 1996	--	--	139,000
Issued common stock and warrants at \$6.73 per share, August 1996 (net of costs of issuance of \$76,438)	--	--	1,452,313
Amortization of deferred compensation	--	--	28,800
Net loss	--	--	(3,557,692)
Balance at December 31, 1996	(218)	(324)	2,095,450
Issued convertible preferred stock at \$10 per unit, May and August 1997 (net of costs of issuance of \$1,758,816)	--	--	10,613,184
Channel merger	--	--	657,900
Conversion of preferred to common stock	--	--	--
Issuance of convertible preferred stock warrants	--	--	--
Issuance of warrants	--	--	159,202
Amortization of deferred compensation	--	--	28,800
Imputed convertible preferred stock dividend	--	--	(3,703,304)
Imputed convertible preferred stock dividend	--	--	3,703,304
Net loss	--	--	(5,151,396)

	Common Stock Subscriptions Receivable	Treasury Stock	Total Stockholders' Equity (Deficit)
Balance at December 31, 1997	(218)	(324)	8,403,140
Conversion of preferred to common stock	--	--	--
Cashless exercise of preferred warrants	--	--	--
Exercise of options	--	--	52,500
Exercise of warrants	--	--	5,500
Expense related to grant of stock options	--	--	81,952
Amortization of deferred compensation	--	--	74,400
Imputed convertible preferred stock dividend	--	--	(1,628,251)
Imputed convertible preferred stock dividend	--	--	1,628,251
Net loss	--	--	(2,753,528)
Balance at December 31, 1998	(218)	(324)	5,863,964
Conversion of preferred to common stock	--	--	--
Preferred stock dividend	--	--	(318)
Net loss	--	--	(2,446,515)
Balance at December 31, 1999	(218)	(324)	3,417,131
Conversion of preferred to common stock	--	--	--
Preferred stock dividend	--	--	--
Exercise of options	--	--	344,598
Issuance of common stock to TeraComm shareholders	--	--	1,800,000
Expense related to grant of stock warrants	--	--	1,020,128
Issuance of Series B convertible preferred stock	--	--	976,288
Costs related to issuance of Series B preferred stock	--	--	(147,800)
Repurchase of Series B convertible preferred stock	--	--	(400,000)
Dividend upon repurchase of Series B convertible preferred stock	--	--	(111,808)
Reclassification of Series B convertible preferred stock to redeemable Series B convertible preferred stock	--	--	(600,000)
Net loss	--	--	(5,802,478)
Balance at December 31, 2000	\$ (218)	\$ (324)	\$ 496,059

See accompanying notes to consolidated financial statements.

ATLANTIC TECHNOLOGY VENTURES, INC. AND SUBSIDIARIES  
(A Development Stage Company)

Consolidated Statements of Cash Flows

	Year ended December 31,			Cumulative period from July 13, 1993 (inception) to December 31, 2000
	2000	1999	1998	
Cash flows from operating activities:				
Net loss	\$(5,802,478)	(2,446,515)	(2,753,528)	(24,592,577)
Adjustments to reconcile net loss to net cash used in operating activities:				
Acquired in-process research and development	1,800,000	--	--	1,800,000
Expense relating to issuance of warrants	--	--	--	298,202
Expense relating to the issuance of options	--	--	81,952	81,952
Expense related to Channel merger	--	--	--	657,900
Change in equity of affiliate	79,274	--	--	79,274
Compensation expense relating to stock options and warrants	1,020,128	--	74,400	1,228,910
Discount on notes payable - bridge financing	--	--	--	300,000
Depreciation	76,095	113,771	166,553	506,505
Loss on disposal of furniture and equipment	--	73,387	--	73,387
Changes in assets and liabilities:				
(Increase) decrease in accounts receivable	144,326	43,692	(381,015)	(192,997)
(Increase) decrease in prepaid expenses	(5,185)	24,694	(40,858)	(22,599)
Increase in deferred revenue	1,294,615	--	--	1,294,615
Increase (decrease) in accrued expenses	243,079	(114,242)	264,435	785,838
Increase (decrease) in accrued interest	--	--	--	172,305
(Increase) decrease in other assets	(2,901)	--	--	(2,901)
Net cash used in operating activities	(1,153,047)	(2,305,213)	(2,588,061)	(17,532,186)
Cash flows from investing activities:				
Purchase of furniture and equipment	(171,351)	(62,917)	(177,765)	(813,081)
Investment in affiliate	(146,618)	--	--	(146,618)
Proceeds from sale of furniture and equipment	--	6,100	--	6,100
Net cash used in investing activities	(317,969)	(56,817)	(177,765)	(953,599)

	Year ended December 31,			Cumulative period from July 13, 1993 (inception) to December 31, 2000
	2000	1999	1998	
Cash flows from financing activities:				
Proceeds from exercise of warrants	--	--	5,500	5,500
Proceeds from exercise of stock options	344,598	--	52,500	397,098
Proceeds from issuance of demand notes payable	--	--	--	2,395,000
Repayment of demand notes payable	--	--	--	(125,000)
Proceeds from the issuance of notes payable - bridge financing	--	--	--	1,200,000
Proceeds from issuance of warrants	--	--	--	300,000
Repayment of notes payable - bridge financing	--	--	--	(1,500,000)
Repurchase of common stock	--	--	--	(324)
Preferred stock dividend paid	--	(318)	--	(318)
Proceeds from the issuance of common stock	--	--	--	7,547,548
Proceeds from issuance of convertible preferred stock	828,488	--	--	11,441,672
Repurchase of convertible preferred stock	(511,808)	--	--	(511,808)
Net cash provided by financing activities	661,278	(318)	58,000	21,149,368
Net decrease in cash and cash equivalents	(809,738)	(2,362,348)	(2,707,826)	2,663,583
Cash and cash equivalents at beginning of period	3,473,321	5,835,669	8,543,495	--
Cash and cash equivalents at end of period	\$ 2,663,583	3,473,321	5,835,669	2,663,583
Supplemental disclosure of noncash financing activities:				
Issuance of common stock in exchange for common stock subscriptions	\$--	--	--	7,027
Conversion of demand notes payable and the related accrued interest to common stock	--	--	--	2,442,304
Cashless exercise of preferred warrants	19,811	--	30,069	49,880
Conversion of preferred to common stock	1,011	313	1,367	2,426
Preferred stock dividend issued in shares	811,514	314,366	--	1,125,880

See accompanying notes to consolidated financial statements.

ATLANTIC TECHNOLOGY VENTURES, INC. AND SUBSIDIARIES  
(A Delaware Stage Company)

Notes to Consolidated Financial Statements

December 31, 2000, 1999 and 1998

(1) Organization, Liquidity and Basis of Presentation

Organization

Atlantic Technology Ventures, Inc. (the Company) was incorporated on May 18, 1993, began operations on July 13, 1993, and is the majority owner of two operating companies - Gemini Technologies, Inc. (Gemini), and Optex Ophthalmologics, Inc. (Optex), and has one wholly-owned subsidiary - Channel Therapeutics, Inc. (Channel) (collectively, the Operating Companies).

Gemini (an 84.7%-owned subsidiary) was incorporated on May 18, 1993 to exploit a new proprietary technology which combines 2'-5' oligoadenylate (2-5A), with standard antisense compounds to alter the production of disease-causing proteins. Optex (an 81.2%-owned subsidiary) was incorporated on October 19, 1993 to develop its principal product, a novel cataract removal device. On March 2, 2001, the Company concluded the sale of substantially all of its Optex assets to Bausch & Lomb, Inc. (see note 12.) Channel was incorporated on May 18, 1993 to develop pharmaceutical products in the fields of cardiovascular disease, pain and inflammatory disorders. Prior to 1997, Channel was an 88%-owned subsidiary. The Company purchased the remaining 12% of Channel in 1997 for \$657,900 through the issuance of common stock (see note 7). Channel ceased operations during 1999. The Company also holds a 14.4% ownership in a fiber optic switching company, TeraComm Research, Inc. (see note 4).

The Company and each of its operating companies are in the development stage, devoting substantially all efforts to obtaining financing and performing research and development activities.

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

Liquidity

The accompanying consolidated financial statements have been prepared assuming that the Company will operate as a going concern. The Company anticipates that their current liquid resources, together with the \$2.4 million in net proceeds received in March 2001 from an agreement between the Company and Bausch & Lomb (see note 12) less \$617,067 paid to certain investors in conjunction with the repurchase of Series B convertible preferred stock (see note 7) will be sufficient to finance their currently anticipated needs for operating and capital expenditures for at least the next 12 months. In addition, the Company will attempt to generate additional capital through a combination of collaborative agreements, strategic alliances and equity and debt financing. However, the Company can give no assurance that they will be able to obtain additional capital through these sources or upon terms acceptable to them.

Basis of Presentation

The consolidated financial statements have been prepared in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 7, "Accounting and Reporting by Development Stage Enterprises," which requires development stage enterprises to employ the same accounting principles as operating companies.



(2) Summary of Significant Accounting Policies

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is calculated principally using straight-line methods over their useful lives, generally five years, except for leasehold improvements which are depreciated over the lesser of five years or the term of the lease.

Minority Interest

The Company has recorded 100% of the losses of the Operating Companies in its consolidated statements of operations as the minority shareholders are not required to and have not funded their pro rata share of losses. Minority interest losses recorded by the Company since inception total \$454,075 as of December 31, 2000 and will only be recovered if and when the Operating Companies generate income to the extent of those losses recorded by the Company.

Research and Development

All research and development costs are expensed as incurred and include costs of consultants who conduct research and development on behalf of the Company and the Operating Companies. Costs related to the acquisition of technology rights and patents for which development work is still in process, are expensed as incurred and considered a component of research and development costs.

Revenue Recognition

Revenue under research contracts is recorded as earned under the contracts, generally as services are provided. Revenues from the achievement of research and development milestones will be recognized when and if the milestones are achieved and are presented as license revenue. Continuation of certain contracts and grants are dependent upon the Company achieving specific contractual milestones; however, none of the payments received to date are refundable regardless of the outcome of the project. Grant revenue is recognized in accordance with the terms of the grant and as services are performed, and generally equals the related research and development expense.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities, and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

## Comprehensive Income

In accordance with SFAS No. 130, "Reporting Comprehensive Income," the Company applies the rules for the reporting and display of comprehensive income and its components. The net loss is equal to the comprehensive loss for all periods presented.

## Computation of Net Loss per Common Share

Basic net loss per common share is calculated by dividing net loss applicable to common shares by the weighted-average number of common shares outstanding for the period. Diluted net loss per common share is the same as basic net loss per common share, as common equivalent shares from stock options, stock warrants, stock subscriptions, and convertible preferred stock would have an antidilutive effect because the Company incurred a net loss during each period presented.

## Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

## Stock-Based Compensation

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation an interpretation of APB Opinion No. 25," issued in March 2000, to account for its fixed plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123.

Options of stock awards issued to non-employees and consultants are recorded at their fair value as determined in accordance with SFAS No. 123 and EITF No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and recognized as expense over the related vesting period.

## Financial Instruments and Derivatives

At December 31, 2000 and 1999, the fair values of cash and cash equivalents, accounts receivable, prepaid expenses, accounts payable and accrued expenses, and deferred revenue approximate carrying values due to the short-term nature of these instruments.

In June 1998, SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" was issued and, as amended, is effective for all fiscal years beginning after June 15, 2000. SFAS No. 133 standardizes the accounting for derivative instruments including certain derivative instruments embedded in other

contracts and requires derivative instruments to be recognized as assets and liabilities and recorded at fair value. The Company currently is not party to any derivative instruments. Any future transactions involving derivative instruments will be evaluated based on SFAS No. 133.

(3) Property and Equipment

Property and equipment consists of the following at December 31, :

	2000	1999
Furniture and equipment	\$ 440,493	269,142
Leasehold improvements	83,861	83,861
	524,354	353,003
Less accumulated depreciation	(297,266)	(221,171)
Net property and equipment	\$ 227,088	131,832

(4) Investment in Affiliate

On May 12, 2000, the Company acquired shares of preferred stock representing a 35% ownership interest in TeraComm Research, Inc. (TeraComm), a privately-held company that is developing next-generation high-speed fiberoptic communications technologies. The purchase price for this ownership interest was \$5,000,000 in cash, 200,000 shares of the Company's common stock, and a warrant to purchase a further 200,000 shares of the Company's common stock. The warrants have a term of 3 years and are exercisable at \$8.975 per share of common stock, but only if the market price of the Company's common stock is \$30 or more. Of the \$5,000,000 cash portion of the purchase price, the Company paid \$1,000,000 in 2000. The Company is accounting for its investments in TeraComm in accordance with the equity method of accounting for investments since the Company has the ability to exert significant influence over TeraComm, primarily through its representation on the TeraComm Board of Directors.

On July 18, 2000, the Company and TeraComm amended the purchase agreement. In the amendment, the parties agreed that the \$4,000,000 balance of the \$5,000,000 cash component of the purchase price would not be due until TeraComm achieved a specified milestone. Within ten days after TeraComm achieved that milestone or December 30, 2000, whichever occurred earlier, the Company was required to pay TeraComm \$1,000,000 and thereafter make to TeraComm three payments of \$1,000,000 at the three-month intervals. If the Company failed to make any of these payments, TeraComm's only recourse would be reducing proportionately the Company's ownership interest. When the Company failed to make the first \$1,000,000 payment by midnight at the end of December 30, 2000, the Company was deemed to have surrendered to TeraComm a proportion of the Company's TeraComm shares equal to the proportion of the dollar value of the purchase price for the Company's TeraComm shares (\$6,795,000) that was represented by the unpaid \$4,000,000 of the cash portion of the purchase price. This had the effect of reducing to 14.4% the Company's actual ownership interest in TeraComm. However, the Company continues to hold a seat on the Board of Directors of TeraComm and continues to have the ability to exert significant influence through its involvement with TeraComm management.

Upon acquiring an interest in TeraComm, the Company allocated a portion of the purchase price based on the fair value of the identifiable tangible assets acquired and liabilities assumed. At the time of acquisition, such assets and liabilities were minimal. TeraComm had no other intangible assets beyond the technology then under development -- a high-speed fiber-optic switch. This technology at the date of acquisition, was not commercially viable, did not then have any identifiable revenue stream and did not

have any alternate future use. This high-speed fiber-optic switch is TeraComm's only subscribable technology. TeraComm is a very early-stage development company with no identifiable revenue sources, therefore the excess of the purchase price over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed is not considered to represent "goodwill". The Company's acquisition of the interest in TeraComm was based solely on the value of the future commercialized products and therefore the excess of the purchase price as described above was attributed to the research and development activities of TeraComm.

As such, of the \$1,000,000 cash and common stock and common stock warrants valued at \$1,800,000 currently invested in TeraComm, the Company has expensed approximately \$2,650,000 as acquired in-process research and development, as TeraComm's product development activity is in the very early stages. The Company's share of losses of TeraComm amounted to \$79,274 in 2000.

(5) Demand Notes Payable to Related Parties

Demand notes payable at December 31, 1994 consisted of advances from one of the founders of the Company, who served as a director and was, at that time, the controlling shareholder of the Company (Controlling Shareholder), totaling \$485,000, advances from a partnership including certain family members of the Controlling Shareholder (the Partnership) totaling \$400,000, and advances under a line of credit agreement with the Controlling Shareholder totaling \$500,000. All unpaid principal and accrued interest through June 30, 1995, including a note payable of \$1,010,000 issued in 1995, was converted into 785,234 shares of common stock of the Company upon the consummation of the initial public offering (IPO).

Demand notes payable at December 31, 1995 totaling \$125,000 consisted of a loan provided to the Company by the Partnership in July 1995. This loan had an interest rate of 10% annually. Terms of the loan required the Company to repay the principal amount of such loan, together with the interest accrued thereon, with a portion of the proceeds received by the Company in the IPO. This loan and the related accrued interest was fully repaid in January 1996.

(6) Notes Payable - Bridge Financing

On September 12, 1995, the Company closed the sale of thirty units with each unit consisting of an unsecured 10% promissory note of the Company in the principal amount of \$50,000 and 50,000 warrants, each exercisable to purchase one share of common stock of the Company at an initial exercise price of \$1.50 per share. The total proceeds received of \$1,500,000 were allocated to the notes payable and warrants based on the estimated fair value as determined by the Board of Directors of the Company of \$1,200,000 and \$300,000, respectively. The warrants were reflected as additional paid-in capital.

Proceeds from the IPO were used to pay these notes payable, with \$75,000 remaining unpaid at December 31, 1995. This remaining obligation was paid in January 1996.

(7) Stockholders' Equity

Common Stock

In 1993, the Company received common stock subscriptions for 5,231 shares of common stock from various individuals, including the Controlling Shareholder and the Partnership, in exchange for common

stock subscriptions receivable of \$6,277. In December 1994, the Company issued 2,606 shares of common stock upon receipt of payment of \$3,127 representing a portion of these common stock subscriptions receivable.

In June 1994, the Company received common stock subscriptions for 84 shares of common stock from various individuals including directors and employees. Payment of the related common stock subscriptions receivable in the amount of \$101 was received in December 1994 which resulted in the issuance of 84 shares of common stock.

In August 1994, the Company received common stock subscriptions for 872 shares of common stock from certain investors. Payment of the related common stock subscriptions receivable in the amount of \$33,000 and \$18,625 was received in August 1994 and December 1994, respectively, which resulted in the issuance of 860 shares of common stock.

In March 1995, June 1995, and August 1995, the Company repurchased 62, 20, and 187 shares of common stock, respectively, for an aggregate total of \$324.

In March 1995, May 1995, and June 1995, the Company issued 2,170, 125, and 160 shares of common stock, respectively, upon receipt of payment of \$3,682 representing subscriptions receivable.

In December 1995, the Company issued 1,872,750 shares of common stock through a public offering, resulting in net proceeds, after deducting applicable expenses, of \$6,036,700. Concurrent with this offering, 785,234 shares of common stock were issued upon the conversion of certain demand notes payable and accrued interest totaling \$2,442,304 (see note 5).

In August 1996, the Company sold in a private placement 250,000 shares of common stock to certain investors resulting in net proceeds of \$1,452,313. In connection with this private placement, the Company paid Paramount Capital, Inc. (Paramount) a finders fee of \$76,438 and issued an employee of Paramount a warrant to purchase 12,500 shares of the Company's common stock at \$6.73 per share, which expires August 16, 2001. Paramount is owned by the Controlling Shareholder.

Pursuant to an Agreement and Plan of Reorganization by and among the Company, Channel, and New Channel, Inc., a Delaware corporation, dated February 20, 1997, all of the stockholders of Channel (except for the Company) agreed to receive an aggregate of 103,200 shares of common stock of the Company in exchange for their shares of common stock, par values \$0.001 per share, of Channel. On February 20, 1997, Channel became a wholly-owned subsidiary of the Company. Subsequent to this transaction, Channel issued a dividend to the Company consisting of all of Channel's rights to the CT-3 technology, which is in the field of pain and inflammation. On May 16, 1997, the Company issued 103,200 shares of common stock of the Company to stockholders of Channel. In connection with the issuance of these shares, the Company recognized an expense in the amount of \$657,900. This expense was recorded as research and development expense in the consolidated statement of operations for the year ended December 31, 1997.

In May 2000, the Company issued 200,000 shares of common stock to shareholders of TeraComm (see note 4).

Convertible Preferred Stock

Series A Preferred

In May and August, 1997, the Company sold in a private placement 1,237,200 shares of Series A convertible preferred stock (Series A Preferred) to certain investors resulting in net proceeds of \$10,613,184.

Prior to August 7, 1998 (the Reset Date), each share of Series A Preferred was convertible into 2.12 shares of common stock initially at a conversion price of \$4.72 per share of common stock. Pursuant to the Certificate of Designations for the Series A Preferred, the conversion price was adjusted on the Reset Date such that now each share is convertible into 3.27 shares of common stock at a conversion price of \$3.06. This conversion price is subject to adjustment upon the occurrence of certain events, including the issuance of common stock at a per share price less than the conversion price, or the occurrence of a merger, reorganization, consolidation, reclassification, stock dividend or stock split which will result in an increase or decrease in the number of common stock shares outstanding.

Holder of Series A Preferred will be entitled to receive dividends, as, when, and if declared by the Board of Directors. Commencing on the Reset Date, the holders of the Series A Preferred are entitled to payment-in-kind dividends, payable semi-annually in arrears, on their respective shares of Series A Preferred at the annual rate of 0.13 shares of Series A Preferred for each outstanding share of Series A Preferred. The Company did not make the February 7, 1999 dividend payment. On August 9, 1999, the Company issued a payment-in-kind dividend of 0.13325 of a share of Series A Preferred for each share of Series A Preferred held as of the record date of August 2, 1999, amounting to an aggregate of 73,219 shares. This dividend included the dividend payment of 0.065 of a share of Series A Preferred for each share of Series A Preferred held which had not been made on February 7, 1999, and the portion of the dividend payment due August 9, 1999, was increased from 0.065 of a share to 0.06825 of a share to reflect non-payment of the February 7, 1999 dividend. On February 15, 2000, and August 7, 2000, the Company issued the respective payment-in-kind dividends, amounting to an aggregate of 59,582 shares of Series A Preferred, based on the holders as of the record dates of February 2, 2000, and August 7, 2000, respectively. The estimated fair value of the respective dividends are included in the Company's calculation of the 2000 and 1999 net loss per common share.

The holders of shares of Series A Preferred have the right at all meetings of stockholders of the Company to that number of votes equal to the number of shares of common stock issuable upon conversion of the Series A Preferred at the record or vote date for determination of the stockholders entitled to vote on such matters.

In connection with the issuance of the Series A Preferred, the Company recognized \$1,628,251 and \$3,703,304 in 1998 and 1997, respectively, as an imputed preferred stock dividend in the calculation of net loss per common share to record the difference between the conversion price of the preferred stock and the market price of the common stock on the effective date of the private placement.

Upon liquidation, the holders of shares of Series A Preferred then outstanding will first be entitled to receive, pro rata, and in preference to the holders of common stock, Series B Preferred and any capital stock of the Company, an amount per share equal to \$13.00 plus any accrued but unpaid dividends, if any.

The Certificate of Designations of Series A Preferred provides that the Company may not issue securities that have superior rights to Series A Preferred without the consent of the holders of Series A Preferred. Accordingly, so long as these convertible securities remain unexercised and shares of Series A Preferred remain uncovered, the terms under which the Company could obtain additional funding, if at all, may be adversely affected.

## Redeemable Series B Preferred

On September 28, 2000, pursuant to a Convertible Preferred Stock and Warrants Purchase Agreement (the Purchase Agreement) the Company issued to BH Capital Investments, L.P. and Excalibur Limited Partnership (together, the Investors) for a purchase price of \$2,000,000, 689,656 shares of the Company's Series B convertible preferred stock (Series B Preferred) and warrants to purchase 134,000 shares of the Company's common stock. Half of the shares of the Series B Preferred (344,828 shares) and warrants to purchase half of the shares of common stock (67,000 shares) were held in escrow, along with half of the purchase price.

On December 4, 2000, the Company and the Investors entered into a stock repurchase agreement (the Stock Repurchase Agreement) pursuant to which the Company repurchased from the Investors for \$500,000, 137,930 shares of Series B Preferred, which represents 125% of the purchase price paid by the Investors for those shares and for warrants to purchase 26,800 shares of the Company's common stock with an estimated value of \$28,719, and agreed to the release from escrow to the Investors of the \$1,000,000 purchase price of the 344,828 shares of Series B Preferred held in escrow. The Company also allowed the Investors to keep all of the warrants issued under the Purchase Agreement and released from escrow to the Investors warrants to purchase 67,000 shares of the Company's common stock with an estimated value of \$71,799, and issued to the Investors warrants to purchase a further 20,000 shares of the Company's common stock at the same exercise price with an estimated value of \$21,432. In addition, the Company was required to pay the legal expenses of the Investors, totaling \$11,807. The carrying amount of the 137,930 shares repurchased is equal to \$400,000; therefore, the amount paid in excess of the carrying amount plus the value of the warrants given to the Investors, totaling \$233,757, was recorded as a dividend upon repurchase of Series B Preferred shares and deducted from net loss to arrive at net loss applicable to common shares.

The warrants are exercisable at the fixed exercise price or 110% of the market price 180 days after the date of issuance, whichever is lower. Pursuant to a second amendment to the Purchase Agreement, executed on January 9, 2001, the fixed exercise price of the warrants was lowered from \$3.19, the fixed exercise price upon their issuance, to \$1.00, the market price of the Company's common stock at the time of the renegotiations. Each warrant may be exercised any time during the 5 years from the date of granting. The warrants may not be exercised if doing so would result in the Company's issuing a number of shares of common stock in excess of the limit imposed by the rules of the Nasdaq SmallCap Market.

Pursuant to the Company's renegotiations with the Investors, the Company is required, among other things, to redeem on March 28, 2002, all outstanding shares of Series B Preferred for (A) 125% of the original issue price per share or (B) the market price of the shares of common stock into which they are convertible, whichever is greater (the Redemption Price). The Company may at any time redeem all outstanding shares of Series B Preferred at the Redemption Price. As a result of the renegotiations discussed in this paragraph, the Series B Preferred is considered redeemable and the remaining outstanding shares at December 31, 2000 are classified outside of permanent equity in the accompanying consolidated balance sheet. At December 31, 2000, the Company had 206,898 shares outstanding at a carrying amount of \$2.90 per share.

Holders of shares of the Company's outstanding Series B Preferred could convert each share into shares of common stock without paying the Company any cash. The conversion price per share of the Series B Preferred was also amended by the second amendment to the Purchase Agreement. The conversion price per share of Series B Preferred on any given day is the lower of (1) \$1.00 or (2) 90% of the average of the two lowest closing bid prices on the principal market of the common stock out of the fifteen trading days immediately prior to conversion, but the conversion price will be reduced by an additional 5% if the common stock is not listed on either the Nasdaq SmallCap Market or Nasdaq National Market as of that



date, and in no event will the conversion price be lower than the floor price (\$0.50 for the conversion of a share of Series B Preferred effected on or before March 28, 2002). The conversion price may be adjusted in favor of holders of shares of Series B Preferred upon certain triggering events. The conversion rate is determined by dividing the original price of the Series B Preferred by the conversion price in effect at the time of conversion; but before any adjustment is required upon the occurrence of any such triggering events, the conversion price will be equal to the original price of the Series B Preferred. The change in conversion price upon the renegotiations on January 9, 2001 resulted in a difference between the conversion price of the Series B Preferred and the market price of the common stock on the effective date of the renegotiation. This amount, estimated at approximately \$620,000, will be recorded as an imputed preferred stock dividend within equity and will be included in the calculation of net earnings/(loss) per common share in the first quarter of 2001.

On January 19, 2001, 41,380 shares of Series B Preferred were converted by the Investors into 236,422 shares of the Company's common stock. On March 9, 2001, the Company and the Investors entered into Stock Repurchase Agreement No. 2, pursuant to which the Company repurchased from the Investors, for an aggregate purchase price of \$617,067, all 165,518 shares of the Company's Series B Preferred held by the Investors on March 9, 2001. The carrying amount of the 165,518 shares is equal to \$480,000; therefore the amount in excess of the carrying amount, which equals \$137,067, will be recorded as a dividend upon repurchase of Series B Preferred shares and deducted from net loss to arrive at net loss applicable to common shares.

#### (8) Stock Options

In August 1995, in connection with a severance agreement entered into between the Company and a former CEO, the Company granted options (not pursuant to the 1995 Stock Option Plan) to purchase 23,557 shares of common stock at an exercise price of \$1.00 per share with immediate vesting. Total compensation expense recorded at the date of grant with regards to those options was \$64,782 with the offset recorded as additional paid-in capital.

#### Stock Option Plan

In July 1995, the Company established the 1995 Stock Option Plan (the Plan), which provided for the granting of up to 650,000 options to officers, directors, employees and consultants for the purchase of stock. In July 1996, the Plan was amended to increase the total number of shares authorized for issuance by 300,000 shares to a total of 950,000 shares and beginning with the 1997 calendar year, by an amount equal to one percent (1%) of the shares of common stock outstanding on December 31 of the immediately preceding calendar year. At December 31, 2000 and 1999, 1,102,977 and 1,054,817 shares were authorized for issuance. The options have a maximum term of 10 years and vest over a period determined by the Company's Board of Directors (generally 4 years).

The Company applies APB Opinion No. 25 in accounting for its Plan. Accordingly, compensation cost has been recognized for stock options granted to employees and directors only to the extent that the quoted market price of the Company's stock at the date of grant exceeded the exercise price of the option.

During 1995, the Company granted options to purchase 246,598 shares of the Company's common stock at exercise prices below the quoted market prices of its common stock. Deferred compensation expense in the amount of \$144,000 was recorded at the date of grant with the offset recorded as an increase to additional paid-in capital. Compensation expense in the amount of \$74,400, \$28,800, \$28,800 and 12,000 was recognized in 1998, 1997, 1996, and 1995, respectively.

In November 1997, the Company granted options to purchase 24,000 shares of the Company's common stock at \$9.50 per share to Investor Relations Group (Investor). These options expire November 10, 2002. The Company recognized expense of \$81,952, which is included in general and administrative expense in the consolidated statement of operations for the year ended December 31, 1998. The expense represents the estimated fair market value of the options, in accordance with SFAS No. 123.

During 2000, the Company granted employees and directors an aggregate of 407,000 plan options and 175,000 options outside of the Plan. All stock options granted during 2000, 1999 and 1998 were granted at the quoted market price on the date of grant. On February 20, 2001, the Company agreed to issue an aggregate of 550,000 stock options to certain executive officers and employees at the quoted market price on the date of grant.

Had compensation costs been determined in accordance with the fair value method prescribed by SFAS No. 123, the Company's net loss applicable to common shares and net loss per common share (basic and diluted) for Plan options would have been increased to the pro forma amounts indicated below:

	2000 -----	1999 -----	1998 -----
Net loss applicable to common shares:			
As reported	\$ 6,847,749	2,760,881	4,381,779
Pro forma	8,190,926	3,623,177	5,038,676
Net loss per common share - basic and diluted:			
As reported	1.21	0.59	1.13
Pro forma	1.45	0.77	1.30

The fair value of each option granted is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions used for the grants in 2000, 1999, and 1998: dividend yield of 0%; expected volatility of 170% for 2000, 94% for 1999 and 95% for 1998; risk-free interest rate of 6.5% for 2000 and 1999 and 5.0% for 1998; and expected lives of eight years for each year presented.

A summary of the status of the Company's stock options as of December 31, 2000, 1999 and 1998 and changes during the years then ended is presented below:

	2000 shares	Weighted average exercise price	1999 shares	Weighted average exercise price	1998 shares	Weighted average exercise price
	-----	-----	-----	-----	-----	-----
At the beginning of the year	396,200	\$3.25	837,798	\$5.06	715,598	\$5.16
Granted	582,000	4.10	221,000	1.39	192,200	3.19
Exercised	(14,000)	2.56	--	--	(70,000)	0.75
Cancelled	(160,000)	3.97	(662,598)	4.93	--	--
	-----	-----	-----	-----	-----	-----
At the end of the year	804,200	\$3.73 =====	396,200	\$3.25 =====	837,798	\$5.06 =====
Options exercisable at year end	354,478		211,869		574,660	
Weighted-average fair value of options granted during the year	\$4.05 =====		\$1.20 =====		\$2.84 =====	

The following table summarizes the information about Plan stock options outstanding at December 31, 2000:

Exercise price	Number of options outstanding	Remaining contractual life	Number of options exercisable
-----	-----	-----	-----
\$1.313	50,000	8.61 years	25,000
\$1.375	20,000	8.41 years	6,666
\$1.500	75,000	8.81 years	75,000
\$1.750	6,000	8.73 years	6,000
\$2.313	2,000	7.66 years	2,000
\$3.188	54,000	9.75 years	50,000
\$3.250	40,000	7.61 years	31,112
\$3.438	50,000	9.38 years	12,500
\$4.188	445,000	9.28 years	111,250
\$5.125	23,000	9.27 years	5,750
\$6.125	10,000	9.22 years	--
\$6.813	1,200	2.19 years	1,200
\$7.000	2,000	6.46 years	2,000
\$7.500	2,000	5.56 years	2,000
\$9.500	24,000	1.86 years	24,000
	----- 804,200 =====		----- 354,478 =====

(9) Stock Warrants

In connection with notes payable - bridge financing, the Company issued warrants to purchase 1,500,000 shares of common stock at an initial exercise price of \$1.50 per share; subject to an upward adjustment upon consummation of the IPO. Simultaneously with the consummation of the IPO, these warrants were converted into redeemable warrants at an exercise price of \$5.50 per share on a one-for-one basis (see note 6). These redeemable warrants expired unexercised on December 13, 2000.

As of December 14, 1996, the redeemable warrants are subject to redemption by the Company at a redemption price of \$0.05 per redeemable warrant on 30 days prior written notice, provided that the average closing bid price of the common stock as reported on Nasdaq equals or exceeds \$8.25 per share, subject to adjustment, for any 20 trading days within a period of 30 consecutive trading days ending on the fifth trading day prior to the date of notice of the redemption.

In December 1995, in connection with the IPO, the Company issued redeemable warrants to purchase 1,872,750 shares of common stock at an exercise price of \$5.50 per share. The remainder of these redeemable warrants expired unexercised on December 13, 2000. Commencing December 14, 1996, these redeemable warrants are subject to redemption by the Company at its option, at a redemption price of \$.05 per warrant provided that the average closing bid price of the common stock equals or exceeds \$8.25 per share for a specified period of time, and the Company has obtained the required approvals from the Underwriters of the Company's IPO. In January 1998, 1,000 warrants were exercised.

In connection with the IPO, the Company granted to Joseph Stevens & Co., L.P. (the Underwriter) warrants to purchase from the Company 165,000 units, each unit consisting of one share of common stock and one redeemable warrant at an initial exercise price of \$6.60 per unit. Such warrants are exercisable during the four-year period commencing December 13, 1996. The redeemable warrants issuable upon exercise of these warrants have an exercise price of \$6.05 per share. As long as the warrants remain unexercised, the terms under which the Company could obtain additional capital may be adversely affected. These redeemable warrants expired unexercised on December 13, 2000.

The Company entered into an agreement with Paramount effective April 15, 1996 pursuant to which Paramount will, on a non-exclusive basis, render financial advisory services to the Company. Two warrants exercisable for shares of the Company's common stock were issued to Paramount in connection with this agreement. These included a warrant to purchase 25,000 shares of the Company's common stock at \$10 per

share, which warrant expires on April 16, 2001 and a warrant to purchase 25,000 shares of the Company's common stock at \$8.05 per share, which warrant expires on June 16, 2001. In connection with the issuance of these warrants, the Company recognized an expense in the amount of \$139,000 for the fair value of the warrants. This expense was recorded as general and administrative in the consolidated statement of operations for the year ended December 31, 1996.

In connection with the Channel merger discussed in note 7, the Company issued a warrant to a director of the Company to purchase 37,500 shares of the Company's common stock at \$5.33 per share, which warrant expires on July 14, 2006. The Company recognized expense of \$48,562 for the fair value of the warrants which was recorded as a research and development expense in the consolidated statement of operations for the year ended December 31, 1997.

The Company entered into an agreement with an investor pursuant to which the investor will render investor relations and corporate communication services to the Company. A warrant to purchase 24,000 shares of the Company's common stock at \$7.00 per share, which warrant expires on November 22, 2001, was issued in 1996. The Company recognized expense of \$110,640 for the fair value of the warrants, which was recorded as a general and administrative expense in the consolidated statements of operations for the year ended December 31, 1997.

Concurrent with the private placement offering of Series A Preferred in 1997, the Company issued 123,720 warrants to designees of Paramount, the placement agent. These warrants are initially exercisable at a price equal to \$11.00 per share and may be exercised at any time during the 10-year period commencing February 17, 1998. The rights, preferences and privileges of the shares of Series A Preferred issuable upon exercise of these warrants are identical to those offered to the participants in the private placement. The warrants contain anti-dilution provisions providing for adjustment of the number of securities underlying the Series A Preferred issuable upon exercise of the warrants and the exercise price of the warrants under certain circumstances. The warrants are not redeemable and will remain outstanding, to the extent not exercised, notwithstanding any mandatory redemption or conversion of the Series A Preferred underlying the warrants. In accordance with SFAS No. 123, the Company determined the fair value of the warrants using the Black-Scholes Model and allocated this value of \$570,143, to convertible preferred stock warrants with a corresponding reduction in additional paid-in capital. In April 2000 and June 1998, 4,299 and 6,525 warrants, respectively, were exercised via a cashless method for 6,955 and 2,010 shares of Series A Preferred, respectively.

On January 4, 2000, the Company entered into a Financial Advisory and Consulting Agreement with the Underwriters. In this agreement, the Company engaged the Underwriters to provide investment-banking services for one year commencing January 4, 2000. As partial compensation for the services to be rendered by the Underwriters, the Company issued the Underwriters three warrants to purchase an aggregate of 450,000 shares of its common stock. The exercise price ranges between \$2.50 and \$4.50 and the exercise period of each warrant is at various times through 2007. In addition, each warrant may only be exercised when the market price per share of common stock is at least \$1.00 greater than the exercise price of that warrant. In connection with the issuance of the warrants, the Company and the Underwriters entered into a letter agreement granting registration rights in respect of the shares of common stock issuable upon exercise of the warrants. In accordance with EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and other relative accounting literature, the Company recorded the estimated fair value of the warrants of \$1,020,128, which represents a general and administrative expense, as compensation expense relating to stock warrants over the vesting period through January 4, 2001.

(10) Related-Party Transactions

During 1999, the Company entered into consulting agreements with certain members of its Board of Directors. Prior to 1999, the Company had several consulting agreements with directors of the Company. These agreements, all of which have been terminated, required either monthly consulting fees or project-based fees. No additional agreements were entered into during 2000. Consulting expense under these agreements was \$8,000, \$99,000 and \$96,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

(11) Income Taxes

There was no current or deferred tax expense for the years ended December 31, 2000, 1999 and 1998 because of the Company's operating losses.

The components of deferred tax assets and deferred tax liabilities as of December 31, 2000 and 1999 are as follows:

	2000	1999
Deferred tax assets:		
Tax loss carryforwards	\$9,139,517	7,003,948
Research and development credit	743,286	495,555
Fixed assets	2,563	9,651
Gross deferred tax assets	9,985,366	7,509,154
Less valuation allowance	(9,985,366)	(7,509,154)
Net deferred tax assets	--	--
Deferred tax liabilities	--	--
Net deferred tax asset (liability)	\$ --	--

The reasons for the difference between actual income tax expense (benefit) for the years ended December 31, 2000, 1999 and 1998 and the amount computed by applying the statutory federal income tax rate to losses before income tax (benefit) are as follows:

	2000		1999		1998	
	Amount	% of pretax earnings	Amount	% of pretax earnings	Amount	% of pretax earnings
Income tax expense at statutory rate	\$(1,973,000)	(34.0%)	\$(832,000)	(34.0%)	\$(936,000)	(34.0%)
State income taxes, net of Federal tax benefit	(640,000)	(10.9%)	(147,000)	(6.0%)	(165,000)	(6.0%)
Change in valuation reserve	2,476,000	42.1%	527,000	21.5%	1,255,000	45.6%
Credits generated in current year	(248,000)	(4.2%)	(74,000)	(3.0%)	(183,000)	(6.6%)
Adjustment to prior estimated income tax expense	--	--	529,000	21.6%	--	--%
Other, net	385,000	7.0%	(3,000)	(0.1%)	29,000	1.0%
Income tax benefit	\$ --	--%	\$ --	--%	\$ --	--%

A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The net change in the total valuation allowance for the years ended December 31, 2000, 1999 and 1998 was an increase of \$2,476,000, \$527,000 and \$1,255,000, respectively. The tax benefit assumed using the federal statutory tax rate of 34% has been reduced to an actual benefit of zero due principally to the aforementioned valuation allowance.

At December 31, 2000, the Company had federal and state net operating loss tax carryforwards of approximately \$23,500,000. The net operating loss carryforwards expire in various amounts starting in 2008 and 2001 for federal and state tax purposes, respectively. The Tax Reform Act of 1986 contains provisions which limit the ability to utilize net operating loss carryforwards in the case of certain events including significant changes in ownership interests. If the Company's net operating loss carryforwards are limited, and the Company has taxable income which exceeds the permissible yearly net operating loss carryforward, the Company would incur a federal income tax liability even though net operating loss carryforwards would be available in future years.

(12) License Agreement

On May 14, 1998, Optex entered into a Development and License Agreement (the Agreement) with Bausch & Lomb to complete the development of Catarex, a cataract-removal technology owned by Optex. Under the terms of the Agreement, Optex and Bausch & Lomb intend jointly to complete the final design and development of the Catarex System. Bausch & Lomb was granted an exclusive worldwide license to the Catarex technology for human ophthalmic surgery and will assume responsibility for commercializing Catarex globally. The Agreement is cancellable by Bausch & Lomb at any time upon six months written notice.

The Agreement provides that Bausch & Lomb will pay Optex milestone payments of (a) \$2,500,000 upon the signing of the Agreement, (b) \$4,000,000 upon the successful completion of certain clinical trials, (c) \$2,000,000 upon receipt of regulatory approval to market the Catarex device in the United States (this payment is creditable in full against royalties), and (d) \$1,000,000 upon receipt of regulatory approval to market the Catarex device in Japan. Pursuant to the Agreement, Bausch & Lomb shall reimburse Optex for its research and development expenses not to exceed \$2,500,000. Bausch & Lomb shall pay Optex a royalty of 7% of net sales and an additional 3% royalty when certain conditions involving liquid polymer lenses are met.

During 1998, the Company received the first nonrefundable milestone payment of \$2,500,000 and recorded this amount as license revenue. In addition, the Company recorded \$1,047,511 in 1998 as a reduction of expenses related to the reimbursement of research and development costs associated with the Catarex device.

On September 16, 1999, the Company and Bausch & Lomb amended the Agreement to provide for an expanded role for Optex in development of the Catarex surgical device. Under the amended Agreement, Optex, in addition to the basic design work provided for in the original agreement, is required to deliver to Bausch & Lomb within a stated period Catarex devices for use in clinical trials, and is required to assist

Bausch & Lomb in connection with development of manufacturing processes for scale-up of manufacture of the Catarex device. Additionally, Bausch & Lomb will reimburse Optex for all costs, including labor, professional services and materials, incurred by Optex in delivering those Catarex devices and performing manufacturing services, and will pay Optex a fixed profit component of 25% based upon certain of those costs.

During 2000 and 1999, Optex recorded revenue pursuant to the amended Agreement of \$5,169,288 and \$1,082,510, respectively. The revenue recorded in 2000 and 1999 pursuant to the amended Agreement is inclusive of the fixed profit component of 25% presented on a gross basis with the related costs incurred presented separately as cost of development revenue on the consolidated statement of operations. Of this amount, \$192,992 and \$304,752 are recorded as an account receivable at December 31, 2000 and 1999, respectively. Prior to the amended Agreement, the research and development expenses of the Catarex device incurred and the related reimbursement were presented by the Company on a net basis as the reimbursement reflects a dollar for dollar reimbursement arrangement, effectively being a pass-through of expenses. The 1999 reimbursement received by the Company prior to the amendment to the Agreement was \$1,229,068. As of December 31, 2000, the Company recorded \$1,294,615 of deferred revenue related to the amended Agreement, which represents expenses paid in advance by Bausch & Lomb at a rate of 125% during 2000. Revenue and related expense will be recorded as operations are incurred during 2001. No such amounts existed at December 31, 1999.

As of December 31, 2000, Optex received reimbursement for costs, including labor, professional services and materials, incurred by Optex in delivering Catarex devices and performance manufacturing services totalling \$5 million. The amended agreement provides that Bausch & Lomb will reimburse Optex for such costs up to \$8 million.

In connection with the revised agreement, the Company agreed to pay a bonus to its President totaling \$141,000, payable monthly through March 2001. At December 31, 2000 and 1999, \$23,502 and \$117,500, respectively, were due and were included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

On January 31, 2001, the Company entered into an agreement to sell substantially all of the assets of Optex (mostly intangible assets with no book value) to Bausch & Lomb for \$3,000,000 and certain future royalties. The sale closed on March 2, 2001, on which date Optex received \$3,000,000, approximately \$600,000 of which was distributed to the minority shareholders of Optex.

#### (13) Commitments and Contingencies

##### Consulting and Research Agreements

The Company has entered into consulting agreements, under which stock options may be issued in the foreseeable future. The agreements are cancellable with no firm financial commitments.

##### Employment Agreements

The Company entered into employment agreements with four executives during April and May, 2000. These agreements provide for the payment of signing and year-end bonuses in 2000 totaling \$225,000, and annual base salaries aggregating \$550,000. Each agreement has an initial term of three years and can be terminated by the Company, subject to certain provisions, with the payment of severance amounts that range from three to six months.



## Proprietary Rights

The Company has an exclusive worldwide license to four U.S. patents and corresponding foreign applications covering a group of compounds, including CT-3. The licensor is Dr. Sumner Burstein, a professor at the University of Massachusetts. This license extends until the expiration of the underlying patent rights. The primary U.S. patent expires in 2012 and the new analog patent 6,162,829 expires in 2017. The Company has the right under this license to sublicense its rights under the license. The license requires that the Company pay royalties of 3% to Dr. Burstein based on sales of products and processes incorporating technology licensed under the license, as well as 8% of any income derived from any sublicense of the licensed technology. Furthermore, pursuant to the terms of the license, the Company must satisfy certain other terms and conditions in order to retain the license rights. If the Company fails to comply with certain terms of the license, its license rights under the license could be terminated.

## Operating Leases

The Company rents certain office space under operating leases which expire in various years through 2003.

Aggregate annual lease payments for noncancellable operating leases are as follows:

Year ending December 31, -----	
2001	\$ 138,000
2002	81,000
2003	26,000
	-----
	\$ 245,000
	=====

Rent expense related to operating leases for the years ended December 31, 2000, 1999 and 1998 was \$161,810, \$118,264 and \$97,756, respectively.

## Resignation of CEO

In July 1998, the CEO of the Company resigned. The Company recorded \$211,250 of expense for salary continuation through April 1999. Of this amount, \$140,833 was recorded in accrued expenses at December 31, 1998. Pursuant to the resignation, all unvested stock options held by the CEO vested immediately and the unexercised options expired in July 1999.

## Termination of Agreement with the Trustees of the University of Pennsylvania

On October 12, 1999, the Company and Channel announced the termination of the license agreement dated as of June 16, 1994, between the Trustees of the University of Pennsylvania (Penn) and Channel pursuant to which Channel received the rights to use cyclodextrin technology. The Company and Channel, on the one hand, and Penn, on the other hand, released each other from any further obligations under the license agreement. The Company paid Penn a portion of the patent costs for which Penn was seeking reimbursement under the agreement.