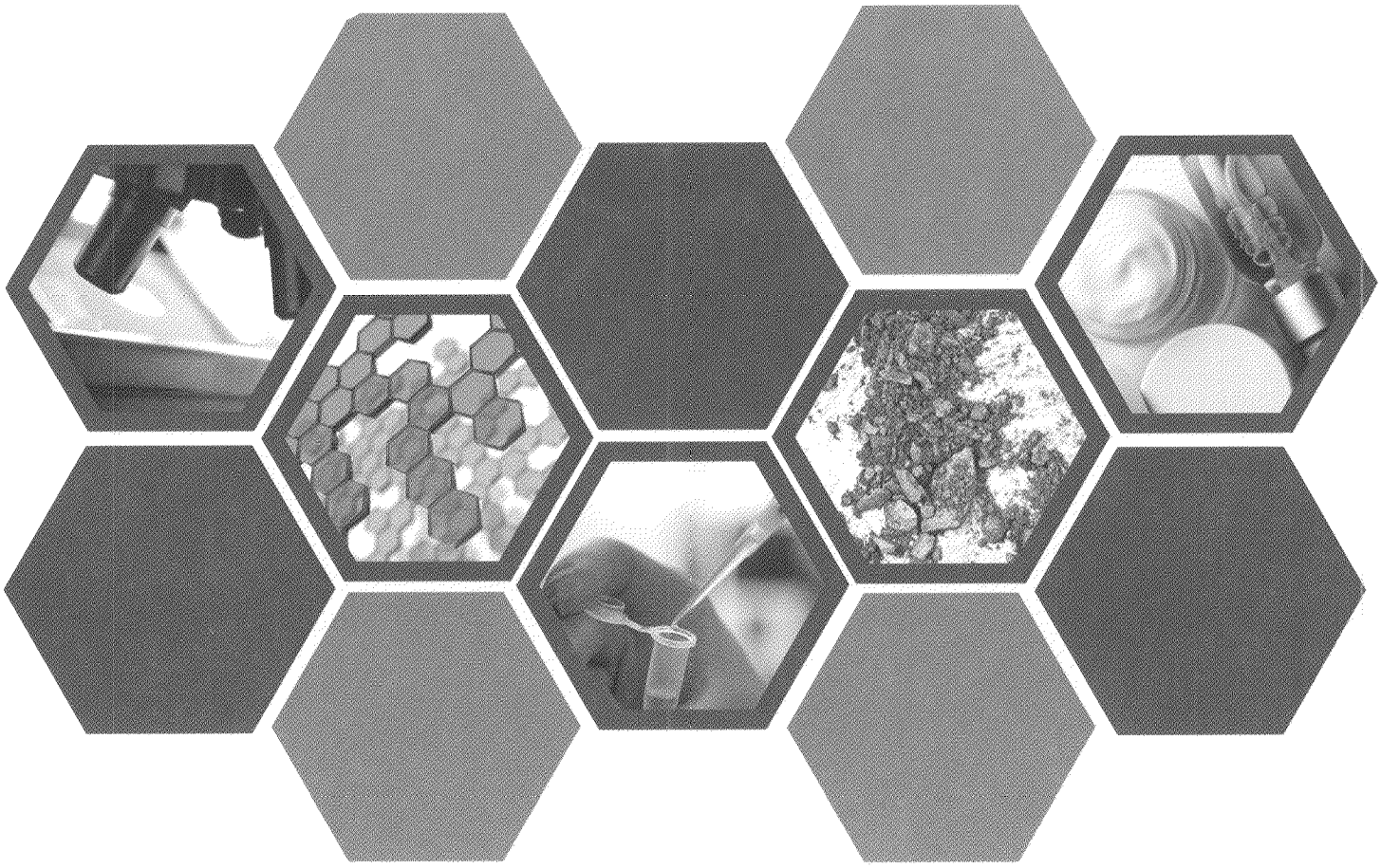


Leading the way in SmartPeptide™ innovation.



Annual Report 2011

HELIX BIOMEDIX™

To Our Shareholders,

2011 was a tremendous year of growth for Helix BioMedix. We strengthened our strategic partnerships, broadened our customer base, dramatically increased product sales and set another revenue record. This has propelled us into 2012 with great momentum, and we look forward to continued progress in the year ahead.

## Accelerating Growth

The successful expansion of our consumer product programs and license partnerships drove a 122% revenue increase in 2011. We achieved record annual revenue of $1.9 million, compared to $852,000 in 2010 and $391,000 in 2009. These results were achieved through a 51% increase in marketing and business development expenditures while maintaining total operating expenses comparable to the prior year in order to reduce our net loss.

License revenue grew by 52% in 2011 as domestic and international partners increased their use of our peptide technologies in a broad array of global consumer products. Peptide and consumer product sales to third parties were up 120% over 2010. These include both Helix BioMedix branded products as well as ingredient and finished good sales to a variety of customers. Finally, sales to our affiliated partner, NuGlow Cosmaceuticals, LLC, grew to $481,000 in 2011 as its marketing efforts produced excellent results.

## Improved Focus

Our 2011 results benefitted from greater penetration of the cosmeceutical skin care market, a more than $27 billion market opportunity in the US alone. Our 30% interest in NuGlow, a direct response company, proved to be a strong driver of our expanded consumer product sales volumes. NuGlow sales rose steadily throughout the year with more opportunities for expansion in the future.

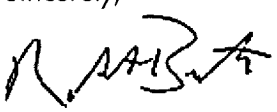
We also formally launched our highly regarded Apothederm™ line in April 2011, which features anti-aging skin care and stretch mark products. Apothederm™ will ultimately replace our Striking® product family with a more comprehensive premium skin care line. These products have received excellent reviews and are available through a growing number of retail outlets as well as directly from Helix BioMedix through our dedicated Apothederm web site.

While these developments were very exciting and visible contributors to our success, we also benefitted from continued strong growth in the licensed use of our proprietary peptide products by well-known skin care and beauty brands and higher volumes of peptide sales, reflecting a diverse and growing global revenue opportunity.

## Building Value

In 2012 we are committed to further increasing revenue while continuing to manage operating expenses, which will allow us to move closer to profitability. Our R&D efforts continue to identify the most promising opportunities to commercialize our peptide technologies and introduce new opportunities with world class partners. I want to thank our employees and strategic partners for an exciting year of record results in 2011, and we look forward to continued success in 2012.

Sincerely,



R. Stephen Beatty
President and Chief Executive Officer
March 27, 2012

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION
## WASHINGTON, D.C. 20549

# FORM 10-K

(Mark One)

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

**For the fiscal year ended December 31, 2011**

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

**For the transition period from _____ to _____**

**Commission File No. 33-20897-D**

# HELIX BIOMEDIX, INC.

*(Exact name of registrant as specified in its charter)*

| **Delaware** | **91-2099117** |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**22118-20th Avenue Southeast, Suite 204, Bothell, Washington 98021**
*(Address of principal executive offices and zip code)*

**(425) 402-8400**
*(Registrant's telephone number, including area code)*

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer ☐ | Accelerated filer ☐ |
| Non-accelerated filer ☐ | Smaller reporting company ☒ |

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the registrant's common stock, $0.001 par value per share, held by non-affiliates on June 30, 2011 was $11,268,305, based on the closing sales price of $0.42 on that date. For purposes of this disclosure, shares of common stock held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates.

As of March 19, 2012, 49,720,255 shares of the registrant's common stock were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement relating to the registrant's 2012 Annual Meeting of Stockholders, to be filed within 120 days of the end of the fiscal year ended December 31, 2011, are incorporated by reference into Part III hereof.

**HELIX BIOMEDIX, INC.**

**FORM 10-K**

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## PART I

### Forward-Looking Statements

Our disclosure and analysis in this Annual Report on Form 10-K and in the documents incorporated by reference contain forward-looking statements, which provide our current expectations, forecasts and assumptions regarding future events. Forward-looking statements include, without limitation:

- statements concerning possible or assumed future results of operations, trends in financial results and business plans, including those relating to earnings growth and revenue growth;
- statements about our product development schedule;
- statements about our future capital requirements and the sufficiency of our cash, cash equivalents, investments, and any other sources to meet these requirements;
- statements about our plans, objectives, expectations, and intentions; and
- other statements that are not historical facts.

Words such as "may," "should," "expect," "plan," "intend," "anticipate," "believe," "estimate," "predict," "potential," "could," "future," "target," and similar expressions may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking. Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including the factors described in Item 1A, "Risk Factors" in this Annual Report. Other factors besides those described in this Annual Report could also affect actual results. You should carefully consider the factors described in Item 1A, "Risk Factors" in evaluating our forward-looking statements.

You should not unduly rely on these forward-looking statements, which speak only as of the date of this Annual Report. We undertake no obligation to publicly revise any forward-looking statement to reflect circumstances or events after the date of this Annual Report or to reflect the occurrence of unanticipated events. You should, however, review the factors and risks we describe in the reports we file from time to time with the Securities and Exchange Commission, or SEC, after the date of this Annual Report.

## ITEM 1. *BUSINESS*

### Overview

As used in this Annual Report, "we," "us" and "our" refer to Helix BioMedix, Inc. We are a biopharmaceutical company with an extensive proprietary library of structurally diverse bioactive peptides and patents covering hundreds of thousands of peptide sequences. Our mission is to enrich clinical practice and the patient/consumer experience by developing and commercializing topically applied products which offer the benefits of our advanced bioactive small molecule peptide technology. Our vision is to be recognized as the world leader in the identification, qualification and commercialization of natural and synthetic peptides.

Our business strategy is to develop our peptide and small molecule portfolio to derive revenue from a broad base of opportunities including licensing rights to third parties to use select proprietary peptides in specific fields of application and commercializing our own branded products. Over the longer term, we intend to pursue applications for products using our technology in medical devices and pharmaceutical preparations. We have developed numerous peptides with unique sequences for use in the following two areas of application:

- Consumer skin care products — we have developed a range of peptides and small molecule technologies capable of improving different aspects of the skin's appearance, texture, tone and barrier function and are marketing these peptides as innovative ingredients for cosmetic use; and
- Prescription (Rx) products — certain of our peptides have demonstrated promising results in the areas of infection control, wound healing and immune modulation and are being developed for Rx applications.

Our Rx focus is on prescription-only topical preparations that would be subject to a shorter regulatory approval process under Section 510(k) of the Food, Drug and Cosmetic Act (510(k) devices). We continue to explore possible sources of funding to support further in-house development work on our pharmaceutical programs, which we believe will enhance potential partnership opportunities with pharmaceutical companies.

Our business was incorporated in 1988, and until early 2007 we operated primarily as a technology development company, generating a portfolio of intellectual property focused on identifying and developing synthetic bioactive peptides and, to a lesser extent, commercializing the extensive library of patented bioactive peptides we had developed. During 2007, we began generating consistent revenue through license agreements with skin care product manufacturers and through collaborative development agreements and moved from the development stage to the commercialization stage.

**Consumer Skin Care Products**

We supply and license to skin care contract manufacturers and materials suppliers certain of our proprietary cosmeceutical peptides for inclusion in their acne treatment, anti-aging skin care, color cosmetics, and specialty body care products. We rely on these industry supplier licensees to create both awareness and demand for our technology among their skin care customers. We believe our peptide technology further holds potential as active ingredients for products marketed and sold by skin care industry leaders and as such, we collaborate directly with leading skin care companies to identify opportunities for strengthening their brand position with differentiated products featuring our peptide technology. We sell our proprietary skin care products through distributors and directly to consumers. Our consumer skin care product development efforts are currently focused on the following:

***Anti-Acne***

Acne is the most common skin disorder in the United States (U.S.), affecting 40 to 50 million Americans. Nearly 85 percent of all people have acne at some point in their lives. By the mid-teens, more than 40 percent of adolescents have acne or acne scarring which requires treatment by a dermatologist. Research from GlobalData, an industry analysis specialist, indicates that the global acne therapeutics market generated approximately $2.9 billion in revenues in 2009 and estimated that revenues from this market could reach $3.1 billion by 2017 at a compound annual growth rate of 0.7%. Global Data attributed the moderate increase in revenue to the overcrowding of generics in the market and the increased acceptance of alternative therapies such as photodynamic therapy and ultraviolet/blue light therapy.

We believe our oligopeptide-10 technology promises significant advantages for skin care companies in the over-the-counter acne treatment market. This proprietary peptide may be formulated into products with certain over-the-counter anti-acne ingredients for improvement in blemish-clearing benefits. The skin care benefits of this peptide derive from its ability to bind to a pro-inflammatory substance on the cell wall of the acne-causing bacteria. This pro-inflammatory substance is known to cause much of the redness associated with acne breakouts but, when bound to our peptide, is rendered inactive. Laboratory and clinical testing confirm the additional treatment benefits and higher level of consumer satisfaction associated with formulations that contain our peptide.

A number of companies have formulated and launched anti-acne products incorporating this peptide under license from us or through sublicense from our licensed distributors. We believe the use of this peptide is advantageous for globally marketed anti-acne products, not only because it supports more favorable outcomes with salicylic acid based treatment products, but also because it offers a favorable alternative to benzoyl peroxide, an ingredient that is limited in application due to regulatory restrictions in certain markets as well as its potential harshness on sensitive skin. We anticipate additional anti-acne product introductions in 2012.

***Anti-Aging***

In January 2012, MarketResearch.com, a provider of global market intelligence products and services, published a report indicating that the cosmeceutical market in the U.S. had reached $27.2 billion in 2010, with anti-aging skin care ranking in the top revenue segment. While the U.S. Food and Drug Administration (FDA) does not recognize cosmeceuticals as a regulatory category, cosmeceuticals are generally described in consumer press as cosmetic products with active ingredient benefits, and peptides are a typical example of such technology.

We have identified and qualified a number of peptides that target changes in the appearance of skin associated with the aging process. As there are anti-aging skin benefits that derive from the skin's natural healing process, much of the anti-aging aspect of our peptide library has evolved from the screening processes associated with our pharmaceutical wound healing programs.

Peptides that target improvement in the appearance of aging skin may affect one or more of the age-related skin characteristics such as lines and wrinkles, loss of elasticity, firmness and definition, the appearance of darkened areas or general unevenness of skin tone, rough texture, and thinning of the skin. Our palmitoyl hexapeptide-14 and hexapeptide-21 peptides are examples of anti-aging peptides that target several aspects of support for the skin's structural matrix. These peptides have been shown in vitro to accelerate the migration of cells from the skin's uppermost layer, a critical process to strengthen tissue. In clinical studies, subjects using products containing these peptides demonstrated improvement in fine lines and wrinkles and a smoother, firmer appearance. Palmitoyl Hexapeptide-14 has also been clinically demonstrated to provide benefits equivalent to those of the leading prescription anti-aging products, but without the risk of irritation associated with aggressive retinoids. These peptides have been formulated into various cosmeceutical skin care products that are currently in the marketplace, and we anticipate further anti-aging product introductions in 2012. Additionally, our tetrapeptide-14 and tetrapeptide-16 peptides have shown benefit in skin soothing products, such as creams and lotions for rosacea prone skin or for sensitive skin care.

Our license agreement with Goldschmidt GmbH, a wholly owned subsidiary of Evonik GmbH (Evonik), a leading supplier of cosmetic ingredients, provides Evonik with exclusive rights to certain of our peptides targeted towards skin care and personal care applications. Evonik launched its first peptides based on our technology in January 2009 and continues to promote the product under the Tego® Pep 4-17 name. Evonik launched a second Helix BioMedix peptide in October 2010 under the name Tego® Pep 4-Even.

We are also working to identify opportunities for peptides to interrupt the pathways that lead to undesirable discoloring and mottled skin tone. We have identified numerous opportunities for the addition of peptides into therapeutic moisturizers and shampoos in support of the healthy appearance and comfort of skin and scalp. Potential benefits of adding certain peptides to cosmetically therapeutic moisturizers and hair care products include resistance to secondary infection associated with compromised skin,

restoration of healthy appearance to cracked, flaky feet that do not respond to ordinary moisturizers, reduced flaking, and improved comfort associated with conditions of the scalp.

***Helix BioMedix Branded Products***

We launched our first proprietary skin care products under the Striking® brand in the fourth quarter of 2008. The product line, which was positioned for the market niche of perimenopausal and menopausal skin, introduced our exclusive Helix BioMedix SmartPeptide™ Heptapeptide-7 technology that helps nourish keratinocytes to support skin renewal.

The Striking® Skin Care line consists of four products: Multi-Vitamin Creme Cleanser, Multi-Peptide Serum, Rejuvenating Eye Creme and Restorative Moisture Creme. Based on market feedback, in 2011, we determined a broader product positioning for anti-aging skin care would provide greater market opportunities, and these products were relaunched under the Apothederm™ brand name in September 2011. We believe the Apothederm™ name better encompasses the brand's core focus in dermatologically-based products and resonates better with consumers. The first Apothederm™ body product, a stretch mark cream using Heptapeptide-7, was officially launched in April 2011. Based on the successful market acceptance of the Apothederm™ brand, we plan to retire the Striking® brand by the end of 2012.

Our products are distributed through our dedicated ecommerce websites at www.apothederm.com and www.strikingskincare.com, as well as through spas, select catalogues and leading skin care internet retailers such as DermStore.com.

In addition, in April 2010, we launched the Cerakine™ Anti-Aging Skin Care product line, which includes a multi-vitamin cleanser, eye cream, moisturizer and serum that form a core daily cleansing and moisturizing ritual. To date, this product line has primarily been dedicated to distribution in the Asian marketplace.

***Helix BioMedix Private Label Products***

We supply private label products to strategic partners with expertise in certain market segments. For example, in July 2010, we entered into a supply agreement with NuGlow Cosmaceuticals, LLC (NuGlow), an affiliated company, for supply of private label products for NuGlow's direct-to-consumer marketing program (see Note 6 of our Notes to Financial Statements). We commenced product shipments to NuGlow in the fourth quarter of 2010. We anticipate providing private label products to additional select customers in 2012.

**Rx Programs**

We are developing a novel, broad-spectrum, topical anti-infective for the treatment of skin and wound infections and the prevention of *Staphylococcus aureus* (*S. aureus*) infections including those caused by Methicillin resistant Staphylococcus aureus (MRSA). These programs are based upon a family of molecules known as lipohexapeptides (or small molecule peptides) that we developed to specifically combine the attributes of small molecule natural products with the advantages of antimicrobial peptides. This class of anti-infective peptides has demonstrated significant improvement in activity, both *in vitro* and *in vivo*, over traditional antimicrobial peptides.

As with traditional antimicrobial peptides, our lead lipohexapeptides are rapidly cidal, fail to engender resistance *in vitro*, are readily synthesized and do not exhibit cross-resistance with other antibiotics. However, these molecules also have the advantage of being more stable, safer and more cost-effective to manufacture than traditional antimicrobial peptides. In addition, primarily due to acylation (addition of a lipid), these molecules are significantly more active in complex biological environments such as human serum or wound fluid. As a result, lipohexapeptides exhibit potent activity in animal infection models.

In pre-clinical testing, our lead molecules exhibited broad-spectrum antimicrobial activity against significant bacterial pathogens such as *S. aureus*, *Streptococcus pyogenes,* and *Pseudomonas aeruginosa,* and also pathogenic fungi such as Candida and Trichophyton species. This activity was maintained against antibiotic-resistant organisms such as MRSA and Vancomycin Resistant Enterococci. Our lead molecules have demonstrated significant activity in both bacterial and fungal animal infection models. In a *S. aureus* abraded skin infection model, our lead lipohexapeptides significantly reduced the number of bacteria following three days of once-daily dosing, and in many cases, our peptide eradicated the pathogen. In a guinea pig dermatophytosis model, our lead peptide candidates significantly reduced pathogen count and delivered clinical benefits comparable to Terbinafine, a drug approved by the FDA for onchomycosis. In both animal models, toxicity was not significantly different from that without peptides.

Our topical Rx product development efforts are currently focused on acne anti-infectives, MRSA, and fungal infections.

**Competition**

The cosmetic, biotechnology, and pharmaceutical industries are characterized by rapidly advancing technologies, intense competition, and a strong emphasis on proprietary products. Many participants in these industries, as well as academic institutions and other research organizations, are actively engaged in the discovery, research and development of products that could compete with our products under development. They may also compete with us in recruiting and retaining skilled scientific and management talent.

We believe that we face two broad classes of competitors:

- other companies developing therapies and skin care products based upon peptide technology; and
- companies using other technologies to address the disease conditions and skin care concerns that we are targeting.

We are currently aware of several companies that are utilizing peptide-based technologies for antimicrobial applications including: Caregen Co., Ltd., DSM N.V., Lytix Biopharma AS, and Inimex Pharmaceuticals, Inc. In addition, in the skin care and personal care markets, several companies, including Lonza Group Ltd., Laboratoires Serobiologiques, Lipotec S.A. and CRODA, Inc., sell patented specialty ingredients for cosmetic use.

**Suppliers**

We believe that there are several readily available sources of amino acids used for our peptides. We do not plan to manufacture peptides ourselves on a commercial scale; instead, we have sought collaborations with several established manufacturers specializing in the production of peptides. With their assistance, we have developed production and cost plans that should support the inclusion of our peptides in a wide range of both consumer and clinical products. We believe several of these contract manufacturers are capable of scaling peptide synthesis to support all of our projected volume and configuration requirements.

**License Agreements**

We entered into a License Agreement with the University of British Columbia (UBC) commencing October 1, 2001, whereby UBC granted us an exclusive, worldwide license to use and sublicense certain defined "Technology" and any improvements within a specified field of use and including the right to manufacture, distribute and sell products utilizing the Technology. The agreement terminates on October 1, 2021 or upon the expiration of the last patent applied for and obtained pursuant to certain provisions of the agreement, unless terminated earlier as provided in the agreement. According to its terms, the agreement terminates automatically if a bankruptcy proceeding is brought by or against us, and terminates at UBC's option upon certain events, including our insolvency or cessation of business, a delinquency of more than 60 days in payments due from us under the agreement, and our breach of certain provisions relating to insurance requirements, use by us of UBC trademarks, and marketing obligations. In addition, either party may terminate the agreement on notice after the opportunity to cure if the other party defaults under the agreement. The Technology licensed under the agreement consists primarily of three U.S. patents for antimicrobial peptides (as set forth in the table under "Intellectual Property Rights" below) and related methods of use. The license may be sublicensed to Helix BioMedix affiliates. Pursuant to the terms of the agreement, we issued to UBC or its assigns 97,500 shares of our common stock and options to purchase up to 152,500 shares of our common stock at $1.50 per share. The options were fully vested upon grant and all expired as of October 1, 2011. Additionally, we agreed to pay UBC a royalty of 3.5% of revenue generated from the Technology and any improvements related thereto. We are also required to pay UBC minimum annual royalties and to reimburse UBC for all further costs incurred with respect to the licensed patents, including maintenance fees.

On August 16, 2007, we entered into a license agreement with Evonik, which has subsequently been amended. Pursuant to the agreement, we granted to Evonik an exclusive license under certain of our patent applications and related rights and technology to, among other things, make and sell formulations for use as ingredients in final products in the cosmetic and non-prescription-drug fields of use. The term of the agreement extends until the expiration of the last-to-expire patent issued under the licensed patent rights, subject to certain termination rights of each party. Either party may terminate the agreement if the other party materially breaches a material provision of the agreement and fails to cure the breach within the specified notice period. In addition, either party may terminate the agreement if, for any consecutive three-year period after 2010, earned running royalties fall short of certain agreed minimum amounts. In consideration for the license, Evonik agreed to make specified upfront payments (subject to certain conditions) and to pay license fees quarterly on its sales of formulations under the agreement.

On September 12, 2007, we entered into a first amended and restated license agreement with Grant Industries, Inc. (Grant), which amended and restated the non-exclusive license agreement between the parties dated December 12, 2006, and which has subsequently been amended. As amended to date, the term of the license agreement will expire on December 31, 2014 subject to certain termination rights of each party. Either party may terminate the agreement if the other party ceases its business or upon certain events relating to bankruptcy, or if the other materially breaches a provision of the agreement and fails to cure the breach within the specified notice period. We may terminate the license or remove a peptide from the scope of the license if Grant fails to meet certain minimum royalty obligations. The license permits Grant to formulate certain of our proprietary peptides into premix products and to market and sell those premix products for use in final products in the cosmetic and over-the-counter personal care market, subject to payment of royalties on its sales of premix and certain minimum royalty obligations. The license grants exclusive rights with respect to five of our peptides.

**Intellectual Property Rights**

We have developed a proprietary library containing a broad and diverse array of synthetic bioactive peptides and small molecule compounds. Our peptide library includes not only multiple proprietary peptides, but also various compositions of and methods of using those peptides. We believe that our patents and patent applications provide broad and early patent coverage that offers important competitive advantages.

We rely on a combination of patent, trademark, copyright, and trade secret laws to protect our proprietary technologies and products. We aggressively seek U.S. and international patent protection applicable to our peptide and small molecule technologies. We also rely on trade secret protection for our confidential and proprietary information and in-license technologies we view as necessary to our business plan.

We currently own or exclusively license ten issued U.S. patents, five pending U.S. patent applications, eight foreign issued patents and forty-five foreign pending patent applications. These patents and patent applications describe not only a vast diversity of sequences, but also structures, including alpha-helical, looped, linear, beta-sheet, lipidated, hinged and unstructured short synthetic sequences. The control of a patent-protected library comprising a broad diversity of structures and sequences distinguishes us from our competitors, many of whom are attempting to develop and protect only single peptide sequences for multiple applications. We believe that the breadth of our library offers us an exceptionally wide range of options in matching optimal peptides with individual product or therapeutic requirements.

Patents expire, on a country by country basis, at various times depending on various factors, including the filing date of the corresponding patent application(s), the availability of patent term extension and supplemental protection certificates and terminal disclaimers. The following table sets forth the patents owned or exclusively licensed by us, and their current years of expiration:

| Patent No. | Description | Country | Expiration Year |
|---|---|---|---|
| 5,962,410 | Inhibition of Eucaryotic Pathogen with Lytec Peptides | United States | 2016 |
| 6,288,212 | Anti-Endotoxic Antimicrobial Peptides and Methods thereof (licensed from University of British Columbia) | United States | 2018 |
| 6,172,185 | Antimicrobial Cationic Peptide Derivatives of Bactenecin (licensed from University of British Columbia) | United States | 2018 |
| 6,337,317 | Antimicrobial Peptides and Methods of Use thereof (licensed from University of British Columbia) | United States | 2020 |
| 7,354,903 | Cosmetic Compositions Containing Short Bioactive Peptides | United States | 2021 |
| 6,875,744 | Short Bioactive Peptides | United States | 2022 |
| 7,381,704 | Methods for Use of Short Bioactive Peptides | United States | 2022 |
| 7,407,940 | Antimicrobial Hexapeptides | United States | 2026 |
| 7,696,174 | Short Bio-Active Peptides for Cellular and Immunological Modulation | United States | 2027 |
| 8,071,555 | Protective Skin Care Peptides | United States | 2030 |
| 1,340,716 | Inhibition of Eucaryotic Pathogens and Neoplasms and Stimulation of Fibroblasts and Lymphocytes with Lytic Peptides | Canada | 2016 |
| 4310107 | Short Bioactive Peptides and Methods for Their Use | Japan | 2022 |
| 4484941 | Short Bioactive Peptides and Methods for Their Use | Japan | 2022 |
| 10-0891157 | Short Bioactive Peptides and Methods for Their Use | South Korea | 2022 |
| 57890/99 | Anti-Endotoxic, Antimicrobial Cationic Peptides and Methods of Use therefor (licensed from University of British Columbia) | Australia | 2019 |
| 2006212922 | Antimicrobial Hexapeptides | Australia | 2026 |
| 2027152 | Peptide Fragments for Inducing Synthesis of Extracellular Matrix Proteins | Europe | 2027 |
| 288451 | Short Bio-Active Peptides for Cellular and Immunological Modulation | Mexico | 2027 |

As described above under the heading "Consumer Skin Care Products," we have entered into license agreements with skin-care contract manufacturers and materials suppliers for inclusion of certain of our patented peptides in anti-acne and anti-aging skin care products. In addition, many of our Striking®, Cerakine™ and Apothederm™ products incorporate various of our proprietary peptides, which together are protected by claims under U.S. patents expiring between 2021 and 2027. Two of these peptides are protected by claims under our three issued foreign patents expiring in 2022.

With respect to proprietary know-how that is not patentable, we have chosen to rely on trade secret protection and confidentiality agreements to protect our interests. We have taken security measures to protect our proprietary know-how, technologies, and confidential data, and continue to explore further methods of protection. We require all employees, consultants, and collaborators to enter into confidentiality agreements, and employees and consultants enter into invention assignment agreements with us. We cannot

assure you, however, that these agreements will provide meaningful protection or adequate remedies for any breach or that our proprietary information will not otherwise become known or be independently discovered by our competitors.

In the case of a strategic partnership or other collaborative arrangement which requires the sharing of data, our policy is to disclose to our partner, under controlled circumstances, only data that is relevant to the partnership or arrangement during the contractual term of the strategic partnership or collaborative arrangement, subject to a duty of confidentiality on the part of our partner or collaborator. Disputes may arise as to the ownership and corresponding rights to know-how and inventions resulting from research by us, and our corporate partners, licensors, scientific collaborators, and consultants. We cannot assure you that we will be able to maintain our proprietary position or that third parties will not circumvent any proprietary protection we have. Our failure to maintain exclusive or other rights to these technologies could harm our competitive position.

To continue developing and commercializing our current and future products, we may license intellectual property from commercial or academic entities to obtain the rights to technology that is required for our discovery, research, development, and commercialization activities.

**Regulation**

Federal, state and local governmental authorities in the U.S. and other countries regulate, among other things, the testing, production, distribution and sale of prescription and over-the-counter drugs and cosmetics. In the U.S., the FDA, acting under the Food Drug and Cosmetic Act (FDCA) and other Federal statutes and FDA regulations, regulates products primarily on the basis of their intended use, as determined by the labeling claims made for the product.

Although under our licensing strategy our collaborators will bear the majority of the regulatory compliance burden, our ability to successfully out-license and collaborate with others on our product candidates requires that we understand the regulations and restrictions on commercialization of cosmetic and drug products.

***FDA Regulation of Cosmetics***

The FDCA defines cosmetics as products and their components intended to be rubbed, poured, sprinkled, sprayed on, introduced into, or otherwise applied to the human body or any part thereof for cleansing, beautifying, promoting attractiveness, or altering the appearance. Cosmetic products are not subject to FDA pre-market approval authority, although the FDA can take enforcement action for marketed cosmetic products that are adulterated or misbranded, including violations of product safety requirements, use and quantity of ingredients, labeling and promotion and methods of manufacture. Additionally, the FDA monitors compliance of cosmetic products through random inspections of cosmetic manufacturers and distributors. The labeling of cosmetic products is subject to the requirements of the FDCA, the Fair Packaging and Labeling Act and other FDA regulations.

Our licensing strategy with cosmetics manufacturers requires that we operate within the confines of cosmetic intended uses when developing and partnering for the commercialization of relevant products.

***FDA Regulation of Drug Products***

The FDCA defines drugs as products intended to cure, mitigate, treat or prevent a disease, or affect the structure or any function of the human body. In comparison to cosmetics, drug products are subject to more comprehensive safety and effectiveness requirements of the FDCA and its implementing regulations. The FDA and its counterparts in other countries extensively regulate the pre-clinical and clinical testing, approval, manufacturing, labeling, storage, record-keeping, reporting, advertising, promotion, import, export, marketing, and distribution, among other things, of drug products. If we or our collaborators do not comply with applicable requirements, we may be fined, our products may be recalled or seized, our clinical trials may be suspended or terminated, our production may be partially or totally suspended, the government may refuse to approve related marketing applications, and we may be subject to an injunction, and/or criminally prosecuted.

The steps required before a new drug may be marketed in the U.S. include (i) pre-clinical laboratory and animal testing, (ii) submission to the FDA of an Investigational New Drug, or IND, application which must become effective before clinical trials may commence, (iii) adequate and well-controlled clinical trials to establish the safety and efficacy of the drug, (iv) submission to the FDA of a New Drug Application, or NDA, and (v) FDA approval of the NDA prior to any commercial sale or shipment of the drug. Pre-clinical testing is generally conducted on laboratory animals to evaluate the potential safety and the efficacy of a drug. The results of these studies are submitted to the FDA as a part of an IND, which must be approved before clinical trials in humans can begin. Typically, clinical evaluation involves a time consuming and costly three-phase process. In Phase I, clinical trials are conducted with a small number of subjects to determine the early safety profile, the pattern of drug distribution and metabolism. In Phase II, clinical trials are conducted with groups of patients afflicted with a specific disease to determine preliminary efficacy, optimal dosages and expanded evidence of safety. In Phase III, large-scale, multi-center, comparative trials are conducted with patients afflicted with a target disease to provide sufficient data to demonstrate the efficacy and safety required by the FDA. The FDA closely monitors the progress of each of the three phases of clinical trials and may, at its discretion, re-evaluate, alter, suspend or terminate the testing based upon the data that have been accumulated to that point and its assessment of the risk/benefit ratio to the patient.

This testing, the preparation of necessary applications, the processing of those applications by the FDA, and potential review of the applications by an FDA advisory panel of outside experts are expensive and typically take many years to complete. The FDA may

not act quickly or favorably in reviewing these applications, or may deny approval altogether, and we or our collaborators may encounter significant difficulties or costs in our efforts to obtain FDA approval.

We believe that certain of our lipohexapeptide product candidates for treatment of topical skin infections may require complete NDA preparation by ourselves and/or our collaborators, as may certain of our Over-the-Counter (OTC) drug product candidates. To date, we have not conducted human clinical trials of our lipohexapeptides.

***The OTC Monograph System***

While FDA approval is generally required before a new drug product may be marketed in the U.S., many OTC drugs are exempt from the FDA's pre-marketing approval requirements. In 1972, the FDA instituted the ongoing OTC Drug Review to evaluate the safety and effectiveness of OTC drug ingredients in the market. Through this process, the FDA issues monographs for therapeutic product categories that set forth the specific active ingredients, dosages, strengths, indications for use, warnings and labeling statements for OTC drug ingredients that the FDA will consider generally recognized as safe and effective for OTC use and therefore not subject to pre-market approval.

For most categories of OTC drugs not yet subject to a final monograph, the FDA usually permits such drugs to continue to be marketed until a final monograph becomes effective, unless the drug will pose a potential health hazard to consumers.

Drugs subject to final monographs, as well as drugs that are subject only to proposed monographs, are subject to various FDA regulations concerning, for example, manufacturing in accordance with current Good Manufacturing Practices (cGMP), general and specific labeling requirements and prohibitions against promotion for conditions other than those stated in the labeling. Drug manufacturing facilities are subject to FDA inspection, and failure to comply with applicable regulatory requirements may lead to administrative or judicially imposed penalties.

Certain products containing our peptides may be regulated under the OTC monograph system by the FDA.

We are also subject to regulation by the Occupational Safety & Health Administration (OSHA), and the Environmental Protection Agency (EPA), and to various laws, and regulations relating to safe working conditions, laboratory, and manufacturing practices, and the use, and disposal of hazardous or potentially hazardous substances, including radioactive compounds used in connection with our research, and development activities, and we may in the future be subject to other federal, state or local laws or regulations. OSHA, EPA or other regulatory agencies may promulgate regulations that affect our research and development programs. We are also subject to regulation by the Department of Transportation, and to various laws and regulations relating to the shipping of cells, and other similar items. We are unable to predict whether any agency will adopt any regulation that could limit or impede our operations.

Depending on the circumstances, failure to meet these other applicable regulatory requirements can result in criminal prosecution, fines or other penalties, injunctions, recall or seizure of products, partial or total suspension of production, denial or withdrawal of pre-marketing product approval or refusal to allow us to enter into supply contracts, including government contracts.

To date, we have not incurred any substantial costs to comply with environmental laws or regulations.

Sales of cosmetics and drug products outside the U.S. are subject to foreign regulatory requirements that vary widely from country to country. Whether or not we or our collaborators have obtained FDA approval, we must obtain approval of a product by comparable regulatory authorities of foreign countries prior to the commencement of marketing the product in those countries. The time required to obtain these approvals may be longer or shorter than that required for FDA approval. The foreign regulatory approval process includes all the risks associated with FDA regulation set forth above, as well as country-specific regulations, including in some countries price controls.

**Research and Development Expenses**

During the years ended December 31, 2011 and 2010, our research and development expenses were approximately $501,000 and $749,000, respectively.

**Employees**

As of December 31, 2011, we employed eight personnel, all on a full-time basis, including two employees in research and development, three employees in marketing and business development, and three employees in finance and administration. None of our employees is covered by a collective bargaining agreement. We have never experienced employment-related work stoppages and consider our employee relations to be positive.

**Available Information**

We make available on our website, free of charge, copies of our Annual Reports on Forms 10-K, Quarterly Reports on Forms 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after filing or furnishing the information to the SEC. The internet address for this information is www.helixbiomedix.com. The information posted on our website is not incorporated into this Annual Report. The SEC maintains an internet site that contains these reports at www.sec.gov.

**Executive Officers**

Our executive officers as of March 1, 2012 are as follows:

| Name | Age | Position |
|---|---|---|
| R. Stephen Beatty | 62 | President and Chief Executive Officer |
| Robin L. Carmichael | 55 | Vice President and Chief Operating Officer |

*R. Stephen Beatty* has served as our President and Chief Executive Officer and as a member of our board of directors since May 1999. Prior to joining us, Mr. Beatty established and operated Beatty Finance, Inc., a private financial services company. Mr. Beatty holds a B.S. in Mathematics from the University of South Alabama and an M.B.A. from the University of New Orleans.

*Robin L. Carmichael* has served as our Vice President and Chief Operating Officer since January 2011, and served as our Vice President, Marketing and Business Development from October 2007 until January 2011. From April 2007 to October 2007, Ms. Carmichael was the Chief Operating Officer of DERMAdoctor, Inc., a company specializing in developing and selling over-the-counter drugs and cosmeceuticals. Prior to joining DERMAdoctor, Inc., from 1998 to September 2006, Ms. Carmichael served as Vice President of Marketing, first with ProCyte Corporation, a biotechnology company specializing in metallic peptides, and then with Photomedex, Inc. following its acquisition of ProCyte in 2005 and as a consultant to the same company from January to June 2007. From 1993 to 1998, she held various marketing and clinical research positions of increasing responsibility with ProCyte. Ms. Carmichael holds a B.S. in Nursing from Seattle University and attended the UCLA Anderson Graduate School of Executive Management.

## ITEM 1A. *RISK FACTORS*

As discussed under Part I, "Business –Forward-Looking Statements," our actual results could differ materially from those expressed in our forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed below. You should carefully consider the risks described below, together with all other information included in this Annual Report, in evaluating our company. Additional risks and uncertainties not presently known to us, or that we currently deem immaterial, may also impair our business operations. If any of the following risks occur, our business, financial condition, operating results, cash flows and the trading price of our common stock could be materially adversely affected.

***We will need to raise additional capital to fund our operations, and our failure to obtain funding when needed may force us to delay, reduce or eliminate our product development programs or collaboration efforts, adversely affect our ability to satisfy our obligations when they become due, or require us to discontinue our operations.***

Developing products and conducting pre-clinical and clinical testing of antimicrobial peptide technologies requires substantial amounts of capital. To date, we have not generated sufficient revenue to meet our capital requirements and we do not expect to do so in the foreseeable future. Accordingly, we have raised capital primarily through equity and convertible debt private placement financings and, more recently, a letter of credit. If we are unable to timely obtain additional funding, we may never achieve the results necessary to satisfy our existing obligations or be profitable. We will need to raise additional capital to, among other things:

- commercialize our peptide compounds and intermediates;
- commercialize skin care products containing our peptides;
- fund our pre-clinical studies;
- fund clinical trials;
- continue our research and development activities;
- finance our operating expenses; and
- prepare, file, prosecute, maintain, enforce, and defend patent and other proprietary rights.

We continue to explore potential sources of funding to support clinical development of certain of our Rx programs. Conducting clinical trials requires significant capital, and significantly more than we have historically raised to support our consumer programs. If we are unable to raise sufficient capital to fund clinical development, we may be required to rely on collaborations with pharmaceutical companies to advance these programs. However, there can be no assurance that any such collaboration would be available on favorable terms to us, if at all, or that if entered into, it would be successful.

Our net cash used in operations has exceeded our cash generated from operations for each year since our inception. For example, we used approximately $2.3 million and $2.8 million in operating activities for the years ended December 31, 2011 and 2010, respectively. On March 9, 2012, we entered into an LOC Agreement with Frank T. Nickell, our largest stockholder, pursuant to which Mr. Nickell established an irrevocable standby letter of credit by JP Morgan Chase Bank, N.A. (JPMorgan) in our favor in the principal amount of $2.0 million (LOC). The LOC expires on July 1, 2013 but automatically renews until July 1, 2014 unless terminated by JPMorgan at least 14 days prior to the end of the current term, at which time we may draw up to the balance remaining on the LOC. Amounts outstanding under the LOC accrue interest at the rate of 0.75% per annum and are due and payable on or before July 1, 2014. Based upon our current cash and cash equivalents balance, the available LOC with JPMorgan, as well as the current status of our operations and consumer product commercialization, we believe that we will have adequate funds to sustain our operations and expand our revenue base through the next twelve months. However, our future funding requirements will depend on many factors, including, among other things:

- our ability to enter into revenue-producing agreements and the success of our existing agreements;
- the progress, expansion, and cost of our pre-clinical and research and development activities;
- any future decisions we may make about the scope and prioritization of the programs we pursue, including whether we pursue clinical development of our pharmaceutical programs;
- the development of new product candidates or uses for our antimicrobial peptide technologies;
- changes in regulatory policies or laws that affect our operations; and
- competing technological and market developments.

If we are unable to obtain the necessary additional capital, we may not be able to satisfy our existing obligations or we may have to license to other companies our products or technologies that we would prefer to develop and commercialize ourselves, liquidate some or all of our assets, delay, reduce the scope of or eliminate some portion or all of our development programs, or severely reduce the scope of our operations, which would significantly impede our ability to proceed with current operational plans and could lead to the discontinuation of our business.

If we raise additional funds by issuing debt or convertible debt securities, new investors may have rights superior to holders of our currently issued and outstanding common stock. In addition, debt financing, if available, may include covenants, which could restrict

our ability to, among other things, incur additional indebtedness, pay dividends or make other restricted payments on investments, consummate asset sales or similar transactions, create liens, or merge or consolidate with any other person or sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of our assets. Any failure to comply with any such covenants could cause us to be in default under such indebtedness.

***If we default on our letter of credit, our business and financial results would be adversely affected.***

A letter of credit was recently established with a commercial lender on our behalf by our largest stockholder and upon which we may draw to finance our operations. If we default on our obligations related to the LOC, the value of our assets may not be sufficient to fully satisfy our obligations, which could result in the cessation of our business. In addition, any outstanding indebtedness may limit our ability to obtain additional financing in the future.

***We expect to continue to incur substantial losses and we may never achieve profitability.***

We have incurred significant operating losses since we began operations in November 1988, including a net loss of approximately $2.5 million for the year ended December 31, 2011, and we had an accumulated deficit of approximately $46.1 million as of such date. These losses have resulted principally from our operating expenses. If the necessary capital is available to us, we intend to make substantial expenditures to further develop and commercialize our product candidates. We expect that our rate of spending may accelerate due to increased expenses associated with branding and advertising of our existing products, as well as rising costs resulting from expanded in-house research and development of our lead product candidates, out-licensing initiatives, clinical trials and regulatory approvals of our antimicrobial peptide technologies. Because of the numerous risks and uncertainties associated with our product development efforts, we are unable to predict when we may become profitable, and we may never become profitable. If we are unable to achieve and then maintain profitability, the market value of our common stock will likely decline.

***A significant portion of our revenue is derived from consumer product sales to NuGlow Cosmaceuticals, LLC, an affiliated company, and any adverse effects on such company's operations or business could have an adverse effect on our business and financial results.***

Consumer product sales to NuGlow represented 25% of our total revenue for the year ended December 31, 2011, and we expect such sales to continue to be a significant portion of our revenue in the future. In the event economic or other conditions or events have a material adverse effect on such affiliated company, including, without limitation, its personnel, operations or sales, such that the amount of its purchases from us decrease significantly or terminate altogether, our business and financial results could be similarly adversely affected.

***Weak economic conditions could adversely affect our sales, financial condition and growth prospects.***

Weak economic conditions, low consumer spending and decreased consumption may have a negative impact on our operating results. The final consumer products incorporating our peptides may be considered discretionary items for consumers. Factors affecting the level of consumer spending for discretionary items include general economic conditions, the availability of consumer credit and consumer confidence in future economic conditions. Consumer purchases of discretionary items tend to decline during recessionary periods when disposable income is lower. This was particularly evident in 2009 when the economic downturn adversely affected our revenue and results of operations. If the economic recovery is slow or if the economy experiences a prolonged period of decelerating growth, our customers or potential customers may delay or reduce sales of the final products incorporating our peptides, which would harm our business. In addition, adverse economic conditions may lead to price increases by our suppliers, which could adversely affect our operating results.

***Because of the specialized nature of our business, the termination of relationships with key management and scientific personnel or the inability to recruit and retain additional personnel could prevent us from developing our technologies and obtaining financing.***

The competition for qualified personnel in the biotechnology field is intense, and we rely heavily on our ability to attract and retain qualified scientific, technical, and managerial personnel. We are highly dependent upon R. Stephen Beatty, our President and Chief Executive Officer, and Robin L. Carmichael, our Vice President and Chief Operating Officer. Further, in order to commercialize our products successfully, we will be required to expand our workforce, particularly in the areas of research and development, sales and marketing. These activities will require the addition of new personnel, including management, and the development of additional expertise by existing management personnel. If we are unable to successfully manage this growth or if we lose key personnel, our business will be adversely affected.

***We face substantial competition in our product development efforts from personal care, pharmaceutical and biotechnology companies, as well as universities and other not-for-profit institutions.***

We face significant competition in our attempts to develop applications of our peptide technology from entities that have substantially greater research and product development capabilities, financial, scientific, marketing, human resources, and name and brand recognition. These entities include cosmetic, pharmaceutical and biotechnology companies, as well as universities and other not-for-profit institutions. We expect that competition in the development of products analogous to our peptide technology will intensify. Our competitors may succeed in developing products, entering into successful collaborations or obtaining approvals from the FDA or other regulatory agencies for such products before we do, or in developing products that are less expensive, safer or more

effective than those we develop or propose to develop. The success of any one competitor in these or other respects will have a material adverse effect on our business, operating results, and financial condition.

***We rely on collaborators for a substantial portion of the research and development and product commercialization activities relating to our technologies and will need to enter into further collaborations to develop, test and produce commercially viable products. If our collaborators do not perform as expected, or we are unable to enter into further collaborations, our ability to commercialize our products and product candidates would be adversely affected.***

Part of our strategy to date has been to enhance our development programs and fund our capital requirements in part by entering into collaborative agreements with cosmetic, pharmaceutical, and other biotechnology companies, and we will likely pursue further collaborations in the future. The development of commercially viable products from our technology will likely continue to require the technical collaboration and financial assistance of other, significantly larger third parties to bear some or most of the costs of pre-clinical and clinical testing, regulatory approval, manufacturing and marketing prior to commercial sale. This is especially true of our pharmaceutical programs, as to which we expect clinical testing and the regulatory approval process, among other things, to require substantial financial and other resources, and for which we may seek collaborative assistance.

There can be no assurance that we will succeed in attracting and retaining collaborative partners who can assist in the further development and commercialization of our technology, and we may lack the capital and other resources necessary to develop our product candidates in the absence of these collaborations. In addition, any collaboration that we enter into may be unsuccessful in the development and commercialization of our product candidates. When we partner with a third party for development and commercialization of a product candidate, we have in the past and can expect in the future to relinquish some or all of the control over the future success of that product candidate to the collaborator. Existing and potential future collaborators may not devote sufficient resources to the research, development and commercialization of our product candidates, or they may breach or terminate our agreements with them. In addition, the current general economic downturn may adversely impact the ability or willingness of our collaborators to devote such resources to the success of our product candidates. If existing or future collaborations are unsuccessful, our business, operating results and financial condition would be impaired.

***We face risks of product liability and other claims against us and may not be able to obtain adequate insurance to protect against losses.***

The current use of any of our products, including in pre-clinical trials, and the sale of any of our products expose us to liability claims. These claims might be made directly by consumers or our corporate collaborators or others selling such products. We may experience financial losses in the future due to product liability or other claims. Our insurance includes coverage for the sale of commercial products. However, we may be unable to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect against losses. If a successful product liability or other claim or a series of claims is brought against us for uninsured liabilities or in excess of insured liabilities, our assets may be insufficient to cover such claims and our business operations could be impaired.

***If we are unable to protect our proprietary rights, we may not be able to compete effectively.***

Our success depends in part on obtaining, maintaining, and enforcing our patents and other proprietary rights. We believe we own, or have rights under licenses to, issued patents and pending patent applications that are necessary to commercialize our antimicrobial peptides. However, the patents on which we rely may be challenged and invalidated, and our patent applications may not result in issued patents. Moreover, our patents and patent applications may not be sufficiently broad to prevent others from practicing our technologies or developing competing products. We also face the risk that others may independently develop similar or alternative technologies or may design around our proprietary and patented technologies.

The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions for which important legal principles remain unresolved, and applicable patent laws are continually evolving. No consistent policy regarding the breadth of claims allowed in biotechnology patents has emerged to date in the U.S. Furthermore, the application, and enforcement of patent laws and regulations in foreign countries is even more uncertain. Accordingly, we cannot assure you that we will be able to effectively protect or defend our proprietary rights in the U.S. or in foreign jurisdictions on a consistent basis, and the cost of prosecuting, defending and protecting our patents in certain jurisdictions, including Europe, may make it prohibitively expensive.

Third parties may successfully challenge the validity of our patents. We will only be able to protect our technology from unauthorized use by third parties to the extent that valid and enforceable patents or other proprietary rights cover them. Because the issuance of a patent is not conclusive of its validity or enforceability, we cannot assure you how much protection, if any, will be given to our patents if we attempt to enforce them or if others challenge their validity in court. It is possible that a competitor may successfully challenge our patents or that a challenge will result in limiting the coverage of our patents. If the outcome of litigation is adverse to us, third parties may be able to use our technology without payment to us.

In addition, it is possible that competitors may infringe upon our patents or successfully avoid them through design innovation. We may initiate litigation to police unauthorized use of our proprietary rights. However, the cost of litigation to uphold the validity of our patents and to prevent infringement could be substantial, and the litigation will consume time and other resources. Some of our competitors may be better able to sustain the costs of complex patent litigation because they have substantially greater resources.

Moreover, if a court decides that our patents are not valid, we will not have the right to stop others from using our technology. There is also the risk that, even if the validity of our patents were upheld, a court may refuse to stop others on the ground that their activities do not infringe upon our patents. Because protecting our intellectual property is difficult and expensive, we may be unable to prevent misappropriation of our proprietary rights.

We also rely on certain proprietary trade secrets and know-how, especially where we believe patent protection is not appropriate or obtainable. Trade secrets and know-how, however, are difficult to protect. We have taken measures to protect our unpatented trade secrets and know-how, including the use of confidentiality and invention assignment agreements with our employees, consultants and contractors. It is possible, however, that these persons may unintentionally or willingly breach the agreements or that our competitors may independently develop or otherwise discover our trade secrets and know-how.

***If the use of our technology conflicts with the rights of others, we could be subject to costly litigation or other proceedings, and an adverse outcome could have a significant adverse effect on our business.***

Our competitors or others may have or acquire patent rights that they could enforce against us. If they do so, we may be required to alter our peptide technology, pay licensing fees or cease operations. If our peptide technology conflicts with patent rights of others, third parties could bring legal action against us or our licensees, suppliers, customers or potential collaborators, claiming damages and seeking to enjoin manufacturing and marketing of the affected products. If these legal actions are successful, in addition to any potential liability for damages, we might have to alter our affected products or underlying technology such that they do not infringe upon others' patent rights, or obtain a license in order to continue to manufacture or market the affected products. However, modifying our products or technology may not be possible or could require substantial funds or time, and a required license under the related patent may not be available on acceptable terms, if at all.

We may be unaware that the use of our technology conflicts with pending or issued patents. Because patent applications can take many years to issue, there may be currently pending applications, unknown to us, that may later result in issued patents upon which our peptide technology may infringe. There could also be existing patents of which we are unaware upon which our peptide technology may infringe. In addition, if third parties file patent applications or obtain patents claiming technology also claimed by us in pending applications, we may have to participate in interference proceedings in the U.S. Patent and Trademark Office to determine priority of invention. If third parties file oppositions in foreign countries, we may also have to participate in opposition proceedings in foreign tribunals to defend the patentability of the filed foreign patent applications. We may have to participate in interference proceedings involving our issued patents or our pending applications.

***Our rights to use peptides and technologies licensed to us by third parties are not within our control, and we may not be able to implement our peptide technology without these peptides and technologies.***

We have licensed patents and other rights which are necessary to our peptide technology. Our business will significantly suffer if these licenses terminate, if the licensors fail to abide by the terms of the licenses or fail to prevent infringement by third parties or if the licensed patents or other rights are found to be invalid. We have in-licensed several peptide patents and patent applications from the University of British Columbia. These licenses terminate upon the expiration of the last licensed patent and may also be terminated in the event of a material breach.

If we violate the terms of our licenses or otherwise lose our rights to these peptides, patents or patent applications, we may be unable to continue development of our peptide technology. Our licensors or others may dispute the scope of our rights under any of these licenses. Additionally, the licensors under these licenses might breach the terms of their respective agreements or fail to prevent infringement of the licensed patents by third parties. Loss of any of these licenses for any reason could materially harm our financial condition and operating results.

***Our business may be harmed if we do not adequately forecast customer demand.***

We may not be able to maintain proper inventory levels for our skin care products. The timing and amount of customer demand for these products are difficult to predict since we have limited sales history and the manufacturing process of these products begins well in advance of the date the products are expected to be sold. If we overestimate our customer demands, we may be unable to sell the products we have ordered in advance from manufacturers or that we have in our inventory. Inventory levels in excess of customer demand may result in inventory write-downs or the sale of excess inventory at prices below our standard levels. These events could significantly harm our operating results and impair the image of our brands. Conversely, if we underestimate demand for our products or if our manufacturers fail to supply quality products in a timely manner, we may experience inventory shortages, which might result in unfilled orders, negatively impact customer relationships, diminish brand loyalty and lost revenues, any of which could harm our financial condition or operating results.

***If we fail to build and maintain the value of our brands, our business could be harmed.***

Our success depends in part on our ability to effectively define, message and promote our brands. We may be able to develop brand recognition of our products through various means including customer outreach, prospecting, advertising, internet and affiliate marketing, and direct mail. While we believe that our planned marketing programs will help build brand awareness and attract new customers, we cannot provide assurance that our marketing efforts will result in increased sales or that we will have sufficient funds to further develop our brands. If we fail to build and maintain the value of our brands, sales are likely to decline and our business could

be harmed.

***To the extent our cash deposits are maintained in accounts that are not insured, such assets could be at risk.***

As of December 31, 2011, we maintained approximately $982,000 at a major financial institution in a money market account insured by the Securities Investor Protection Corporation (SIPC) up to $500,000 per account. The protection afforded by the SIPC is narrower than that afforded by the Federal Deposit Insurance Corporation with respect to bank deposits and does not cover all losses. If the financial institutions holding our cash deposits experience financial difficulty or failure, the assets in these accounts would be at risk, and their loss would have an adverse effect on our business and results of operations.

***Our business is subject to numerous governmental regulations.***

Our products and our licensees' products and product candidates are subject to extensive regulation by numerous governmental authorities in the U.S., including the FDA, and by regulatory authorities outside the U.S. which govern the manufacturing practices, labeling, packaging, storage, distribution, advertising, promotion, recordkeeping and reporting of safety, and quality assurance. We cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative action, either in the U.S. or abroad. Under our licensing strategy, our collaborators will bear the majority of the regulatory compliance burden. However, if we, our licensees or our collaborators fail to maintain regulatory compliance, such failure could adversely affect our business and results of operations.

***Interruptions to or cyber-attacks on our website operations could damage our reputation and harm our business.***

We derive a portion of our revenue from business generated through our ecommerce websites at www.apothederm.com and www.strikingskincare.com. The satisfactory performance and reliability of our website operations are critical to our reputation and our ability to attract and retain customers in our online business. We could experience temporary interruptions in our website or transaction processing systems for a variety of reasons, including human error, software errors, power loss, telecommunications failures, extreme weather and other events beyond our control. In addition, cyber-attacks on our computer systems could result in the disruption of our operations or the corruption or misappropriation of proprietary information or data. Any failure of or cyber-attacks on our systems could adversely affect our business and results of operations.

***Worldwide economic and political conditions may adversely affect demand for our products.***

As part of our business strategy, we seek to expand the sales of our products and technology in international markets. In 2009, we began to derive revenue from our European licensee. We expect to begin to sell our proprietary consumer products into Asian and European markets in the near future. Our international business expansion will depend on overall worldwide economic conditions and economic, political and business conditions within our customers' industries and countries or other geographic regions. A continued or worsened slowdown in the global economy could adversely impact demand for our products in international markets, which would harm our financial condition and results of operations.

***Our international revenue may be adversely affected by fluctuations in currency exchange rates.***

A significant portion of our license fees is derived from sales denominated in currencies other than the U.S. dollar, which is our reporting currency. As a result, fluctuations in currency exchange rates can factor in the increase or decrease of our license revenue from period to period. We cannot predict the effects of exchange rate fluctuations upon our international revenue and as exchange rates vary, our revenue and operating results may differ from our expectations.

***We incur significant costs and demands upon management as a result of complying with laws affecting public companies, which could affect our operating results.***

We have incurred and will incur significant costs, and have and could experience internal resource constraints, associated with the evaluation of and compliance with evolving corporate governance, reporting and other requirements, including requirements under the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted in July 2010 and rules implemented by the SEC. Compliance with these laws and regulations is costly and personnel-intensive, and any changes in these laws and regulations may materially increase our compliance costs. Our financial condition and operating results may be materially negatively impacted by the financial costs and resource demands of our compliance efforts.

***If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which would adversely affect our business.***

If we are not able to maintain effective internal control over financial reporting and disclosure controls and procedures, we may not be able to produce reliable financial reporting. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. As a result, we cannot assure investors that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Matters affecting our internal controls may cause us to be unable to report our financial information accurately and/or on a timely basis and thereby subject us to adverse regulatory consequences, including sanctions or investigations by the SEC, and may cause investors to lose confidence in us and the reliability of our financial statements. Confidence in the reliability of our financial

statements is also likely to suffer if we report a material weakness in our internal control over financial reporting. These factors could have a material adverse effect on our business, cause a decline in our share price and impair our ability to raise capital.

***Our gross profit deferral depends on the accuracy of reports we receive from an affiliated company.***

The deferred gross profit we report from an affiliated company in our financial statements depends to a large extent on the accuracy of the inventory reports provided by the affiliated company, and any material error in those reports would affect our gross profit deferral. However, we believe that the controls implemented by the affiliated company, including periodic physical inventory verifications and analytical reviews, should reduce the likelihood of any material errors in such reports.

***Our principal stockholders, executive officers and directors may have the ability to control our management and operations and could act in their own best interests and not necessarily in the best interests of other stockholders.***

Our executive officers, directors, principal stockholders and entities affiliated with them beneficially owned in the aggregate approximately 57.9% of our outstanding common stock and common stock equivalents as of March 19, 2012. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. These stockholders have the ability to exert substantial influence over all matters requiring approval by our stockholders, including the election and removal of directors and any proposed merger, consolidation or sale of all or substantially all of our assets, and this concentration of ownership could have the effect of delaying, deferring or preventing a change in control or impeding a merger or consolidation, takeover or other business combination that could be favorable to you.

***Future sales of our common stock could negatively affect our stock price and may cause dilution to existing stockholders.***

Our common stock has generally been thinly traded, meaning that the numbers of persons interested in purchasing our common stock at or near ask prices at any given time may be relatively small or nonexistent. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or nonexistent, as compared to an issuer with a large and steady volume of trading activity that will generally support continuous sales without a considerable adverse effect on share price. If our common stockholders sell substantial amounts of common stock in the public market, or the market perceives that such sales may occur, the market price of our common stock could decline significantly. In addition, we will need to raise substantial additional capital in the future to fund our operations, and if we raise additional funds by issuing equity or convertible debt securities, our stock price may decline and our existing stockholders may experience significant dilution.

***Our common stock may experience extreme price and volume fluctuations, which could lead to costly litigation for us and make an investment in us less appealing.***

The market price of our common stock has and may continue to fluctuate significantly due to a variety of factors, including:

- announcements about our collaborators or licensees;
- announcements about technological innovations or new products or services by us or our competitors;
- announcements concerning our competitors or the biotechnology industry in general;
- new regulatory pronouncements and changes in regulatory guidelines;
- general and industry-specific economic conditions;
- additions or departures of our key personnel;
- changes in financial estimates or recommendations by securities analysts;
- variations in our quarterly results; and
- changes in accounting principles.

The market prices of the securities of many biotechnology companies have been highly volatile and may remain highly volatile in the future. This volatility has often been unrelated to the operating performance of particular companies. In the past, companies that experience volatility in the market price of their securities have often faced class action securities litigation. Moreover, market prices for stocks of biotechnology and other technology companies frequently reach levels that bear no relationship to the operating performance of these companies. These market prices generally are not sustainable and are highly volatile. Whether or not meritorious, litigation brought against us could result in substantial costs, divert our management's attention, and harm our financial condition and results of operations.

***Our certificate of incorporation, bylaws, and stockholder rights agreement may delay or prevent a change in our management.***

Our amended and restated certificate of incorporation, bylaws, and stockholder rights agreement contain provisions that could delay or prevent a change in our board of directors and management teams. Some of these provisions:

- authorize the issuance of preferred stock that can be created and issued by the board of directors without prior stockholder approval, commonly referred to as "blank check" preferred stock, with rights senior to those of our common stock;
- authorize our board of directors to issue dilutive shares of common stock upon certain events; and

- provide for a classified board of directors.

These provisions could make it more difficult for stockholders to replace members of our board of directors. Because our board of directors is responsible for appointing the members of our management team, these provisions could in turn affect any attempt to replace the current management team.

## ITEM 1B. *UNRESOLVED STAFF COMMENTS*

Not applicable.

## ITEM 2. *PROPERTIES*

We occupy approximately 5,300 square feet of leased space in Bothell, Washington for our corporate office and laboratory. This lease will expire on June 30, 2015. We believe that our leased space is adequate to meet our current needs and that suitable additional space will be available in the future to meet our anticipated needs.

## ITEM 3. *LEGAL PROCEEDINGS*

None.

## ITEM 4. *MINE SAFETY DISCLOSURES*

Not applicable.

## PART II

### ITEM 5. *MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES*

Our common stock has been quoted on the OTC Bulletin Board under the symbol "HXBM.OB" since 1999. Prior to 1999, our common stock did not trade publicly. The following table summarizes our common stock's high and low daily closing sales prices for the periods indicated as reported by the OTC Bulletin Board. These quotations reflect inter-dealer prices, without retail markups, markdowns or commissions, and may not represent actual transactions.

| | Year ended December 31, | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | High | Low | High | Low |
| First Quarter | $ 0.45 | $ 0.20 | $ 0.40 | $ 0.19 |
| Second Quarter | $ 0.45 | $ 0.22 | $ 0.43 | $ 0.22 |
| Third Quarter | $ 0.45 | $ 0.15 | $ 0.49 | $ 0.20 |
| Fourth Quarter | $ 0.35 | $ 0.23 | $ 0.59 | $ 0.23 |

As of March 19, 2012, there were approximately 787 record holders of our common stock. Because in some instances our common stock is held by brokers and clearing agencies on behalf of stockholders, we are unable to determine the total number of stockholders represented by these record holders.

**Dividends**

We have never declared or paid cash dividends on our capital stock. We intend to retain any future earnings to fund the development and growth of our business, and do not anticipate paying any cash dividends in the foreseeable future. Any future determination relating to our dividend policy will be made by our board of directors.

### ITEM 6. *SELECTED FINANCIAL DATA*

*The following selected financial data have been derived from our financial statements. These data should be read in conjunction with the financial statements and notes thereto and with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."*

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2008 | 2007 |
| Operations: | | | | | |
| Revenue | $ 1,891,338 | $ 851,683 | $ 391,268 | $ 562,877 | $ 463,941 |
| Loss from operations | (2,404,323) | (2,956,156) | (3,217,908) | (3,544,178) | (3,518,579) |
| Net loss | (2,488,576) | (7,710,802) | (3,775,035) | (4,515,512) | (3,434,004) |
| Net loss per share, basic and diluted | (0.05) | (0.28) | (0.15) | (0.18) | (0.14) |
| Financial position: | | | | | |
| Cash, cash equivalents and marketable securities | 1,688,945 | 4,044,309 | 1,344,719 | 984,844 | 1,161,290 |
| Working capital | 2,147,462 | 4,355,893 | 1,495,026 | 1,014,268 | 1,105,405 |
| Total assets | 2,974,639 | 5,228,482 | 2,012,920 | 2,703,707 | 2,022,071 |
| Stockholders' equity (deficit) | 2,535,336 | 4,874,444 | (5,168,725) | (1,714,522) | 1,670,713 |

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

For a discussion of forward-looking statements and important factors that could cause results to differ materially from the forward-looking statements in this Annual Report, see Part I, "Forward-Looking Statements," and Item 1A, "Risk Factors."

### Business Overview

We are a biopharmaceutical company with an extensive proprietary library of structurally diverse bioactive peptides and patents covering hundreds of thousands of peptide sequences. Our mission is to enrich clinical practice and the patient/consumer experience by developing and commercializing topically applied products which offer the benefits of our advanced bioactive small molecule and peptide technologies. Our vision is to be recognized as the world leader in the identification, qualification and commercialization of natural and synthetic peptides.

Our business strategy is to develop our peptide and small molecule portfolio to derive revenue from a broad base of opportunities including licensing to third parties rights to use select proprietary peptides in specific fields of application and commercializing our own branded products. Over the longer term, we intend to pursue applications for products using our technology in medical devices and pharmaceutical preparations. We have developed numerous peptides with unique sequences for use in the following two areas of application:

- Consumer skin care products — we have developed a range of peptides and small molecule technologies capable of improving different aspects of the skin's appearance, texture, tone and barrier function and are marketing these peptides as innovative ingredients for cosmetic use; and
- Prescription (Rx) products — certain of our peptides have demonstrated promising results in the areas of infection control, wound healing and immune modulation and are being developed for Rx applications.

Our Rx focus is on prescription-only topical preparations that would be subject to a shorter regulatory approval process under Section 510(k) of the Food, Drug and Cosmetic Act (510(k) devices). We continue to explore possible sources of funding to support further in-house development work on our pharmaceutical programs, which we believe will enhance potential partnership opportunities with pharmaceutical companies.

Our business was incorporated in 1988, and until early 2007 we operated primarily as a technology development company, generating a portfolio of intellectual property focused on identifying and developing synthetic bioactive peptides and, to a lesser extent, commercializing the extensive library of patented bioactive peptides we had developed. During 2007, we began generating consistent revenue through license agreements with skin care product manufacturers and through collaborative development agreements and moved from the development stage to the commercialization stage.

#### *Management Review of 2011*

For the year ended December 31, 2011, we continued to make substantial progress in expanding our business. We generated revenue of approximately $1.89 million, representing an increase of 122% from the previous year. The increase in total revenue was primarily attributable to growth in license fees as well as sales of peptides and consumer products.

The following financial information reflects additional metrics of our 2011 results:

- 52% growth in licensing fees from 2010;
- 120% growth in peptide and consumer product sales from 2010;
- Consumer product sales to an affiliated company for the first full year reached $481,000; and
- Loss from operations decreased by 19% to $2.40 million in 2011 compared to $2.96 million in 2010.

#### *2012 Outlook*

Looking forward into 2012, we expect to further capitalize on the momentum gained in 2011 in key areas, including license fees, peptide and consumer product sales, and brand recognition. We anticipate modest growth in license fees and peptide compound sales, and moderate to strong growth in consumer product sales; however, as peptide and consumer product sales (as a percentage of revenue) increase relative to license fees, we expect that our overall gross margin will likely decline. We believe that our expanded revenue opportunities as well as continued management of operating expenses will enable us to further strengthen our operating results.

### Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with U.S. Generally Accepted Accounting Principles (U.S. GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent assets and liabilities as of the dates of the balance sheets and the reported amounts of revenue and expenses during the reporting period. We consider the following accounting policies to be those that require us to make the most subjective or complex judgments in order to fairly present our financial position and results of operations. Actual results may differ from these estimates.

***Revenue Recognition.*** We derive our revenue from technology licenses, sales of peptides and consumer products, and, until September 2009, administrative services provided to a related party. Revenue under technology licenses may include up-front payments and royalties from third-party product manufacturing and sales.

- *Licensing Fees.* We recognize up-front payments when persuasive evidence of an agreement exists, delivery has occurred or services have been performed, the price is fixed and determinable and collection is reasonably assured. We recognize royalty revenue in the period the royalty is earned based on actual reports or estimates received from licensees.
- *Peptide and Consumer Product Sales.* We recognize revenue from sales of our peptides and skin care products when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is reasonably assured.
- *Consumer Product Sales, Affiliated Company.* We sell certain skin care products under private labels to an affiliated company and recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, collection is reasonably assured and the products have been resold to third parties or otherwise used.
- *Administrative Services Revenue, Related Party.* Our administrative services revenue consisted of fees received from DermaVentures, LLC (DermaVentures), a related party, for costs incurred related to the DermaVentures' product line. Administrative services revenue was invoiced to DermaVentures at or near cost and was recorded as earned on a gross basis when services were rendered, no obligations remained outstanding and collection was reasonably assured.

  In September 2009, we terminated the Management Services Agreement with DermaVentures. As a result, we had no further management or administrative responsibilities related to DermaVentures from which our administrative services revenue was derived (see Note 14 of our Notes to Financial Statements).

Revenues are recorded net of related sales taxes. Sales tax amounts collected from customers are included in accrued expenses.

***Inventory.*** Inventory consists of peptides and consumer product finished goods and work in process. Work in process includes inventory at our manufacturer. Inventory is stated at the lower of cost or market. We regularly monitor inventory quantities on hand and record write-downs for potential excess, obsolescence and shrinkage based primarily on our sales forecast and production requirements. If actual demand were to be substantially lower than estimated, additional write-downs or write-offs for excess or obsolete inventories may be required.

***Impairment of Long-Lived Assets, Intangible Assets and Investment in an Affiliated Company.*** We periodically review our long-lived assets including property and equipment, intangible assets and investment in an affiliated company for possible impairment whenever significant events or changes in circumstances indicate that impairment may have occurred. An impairment is indicated when the sum of the expected future undiscounted net cash flows identifiable to that asset or asset group is less than its carrying value. We determine impairment losses from actual or estimated fair values, which are based on market values or projections of discounted cash flows, as appropriate.

***Valuation of Stock Options Granted to Employees, Officers and Non-Employee Directors for Board Service.*** We measure stock-based compensation expense for employee awards based on the estimated fair value of the award at the grant date and recognize such expense on a straight-line basis over the requisite service period, which is generally the vesting period. The determination of the fair value of stock options and warrants using the Black-Scholes option pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, which include management's estimated stock price volatility over the term of the awards, estimated option or warrant exercise behaviors, the risk-free interest rate and expected dividends. Compensation expense is recognized only for the portion of awards expected to vest. For performance-based awards, we record stock-based compensation expense only when the performance-based milestone is deemed probable of achievement. We utilize both quantitative and qualitative criteria to judge whether milestones are probable of achievement.

***Valuation of Option to Purchase Remaining Interest in Affiliated Company.*** In connection with our investment in NuGlow, we have the right to purchase the remaining interest in NuGlow between July 1, 2012 and July 1, 2017 (see Note 6 of our Notes to Financial Statements). We have elected to account for this option at fair value on the balance sheet with changes in value recognized in the statement of operations. We estimate the fair value of this option using the multiple of earnings method based on a number of factors and assumptions regarding the affiliated company's potential future revenue and projected earnings before interest, tax, depreciation and amortization.

***Valuation of Common Stock Used in Calculation of Conversion Inducement Expense.*** To induce our note holders to convert the outstanding notes payable into our common stock in the fourth quarter of 2010, we amended the conversion terms such that the per share conversion price was reduced to $0.60 from $1.00 for the convertible notes payable issued in 2008 and 2009, and from $0.80 for the convertible notes payable issued in 2010. We estimated the fair value of our common stock issued in connection with the note conversions based on implied stock value using the estimated fair value of our convertible notes immediately prior to the amendment of the conversion terms. We estimated the fair value of our convertible notes immediately prior to the amendment of the conversion terms based on prevailing interest rates, our stock price as quoted on the OTC Bulletin Board, as well as assumptions regarding a number of complex and subjective variables.

**Results of Operations**

Our net loss for 2011 was approximately $2.49 million, or $0.05 per share, compared to a net loss of $7.71 million, or $0.28 per share, for 2010 and a net loss of $3.78 million, or $0.15 per share, for 2009. The decrease in net loss in 2011 from 2010 was primarily attributable to increased total revenue and gross profit, coupled with decreases in interest expense, accretion of debt discount and non-cash debt conversion inducement expense incurred in connection with the amendment and conversion into shares of our common stock of certain of our convertible notes payable. In 2010, total interest expense, accretion of debt discount and debt conversion inducement expense totaled approximately $4.75 million (see Note 2 of our Notes of Financial Statements). Additionally, net loss per share for 2011 was based on 49.7 million weighted-average shares outstanding whereas net loss per share for 2010 was based on 27.1 million weighted-average shares outstanding. The increase of $3.94 million in net loss in 2010 from 2009 was due principally to the debt inducement expense recorded in 2010 and, to a lesser extent, increases in operating expenses, interest expense and accretion of debt discount.

As of December 31, 2011, our accumulated deficit was approximately $46.06 million. We may continue to incur substantial operating losses over the next several years based on the estimated costs associated with our current level of operations and commercialization of our technology being greater than our anticipated revenue.

Our ability to achieve a consistent level of revenue depends largely on our ability to successfully commercialize our proprietary technology through royalty-bearing licenses, as well as developing and selling products via collaborations with strategic partners. Even if we are successful in the aforementioned activities, our operations may not be profitable. In addition, any revenue under licensing arrangements are subject to significant fluctuations in timing, amount and currency exchange rates. Therefore, our operating results for any period may fluctuate significantly and may not be comparable to the operating results for any other period.

***Revenue***

Revenue for the years ended December 31, 2011, 2010 and 2009 consisted of license fees, sales of peptides and consumer products, and administrative services revenue from DermaVentures, a related party, as summarized in the table below. Consumer product sales to an affiliated company consisted only of products that had been resold to third parties. Consumer product sales to an affiliated company that were unsold at the end of the reporting period, along with corresponding costs, were included in deferred gross profit.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| License fees | $ 730,635 | 52.4% | $ 479,317 | 221.3% | $ 149,196 |
| Percentage of total revenue | 38.6% | | 56.3% | | 38.1% |
| Peptide and consumer product sales | 679,907 | 119.8% | 309,379 | 39.4% | 221,876 |
| Percentage of total revenue | 36.0% | | 36.3% | | 56.7% |
| Consumer product sales, affiliated company | 480,796 | 663.3% | 62,987 | NM | — |
| Percentage of total revenue | 25.4% | | 7.4% | | — |
| Administrative services revenue, related party | — | — | — | (100.0)% | 20,196 |
| Percentage of total revenue | — | | — | | 5.2% |
| Total revenue | $ 1,891,338 | 122.1% | $ 851,683 | 117.7% | $ 391,268 |

NM - Percentage not meaningful

Total revenue increased by approximately $1.04 million, or 122%, in 2011 from 2010, and by approximately $460,000, or 118%, in 2010 from 2009.

License fees increased by approximately $251,000, or 52%, in 2011 from 2010 and by approximately $330,000, or 221%, in 2010 from 2009. The increases in both 2011 and 2010 were attributable to increased volume of product sales by our licensees.

Peptide and consumer product sales, including sales to an affiliated company, increased by approximately $788,000, or 212%, in 2011 from 2010 and by approximately $150,000, or 68%, in 2010 from 2009. Growth in peptide sales for the years ended December 31, 2011 and 2010 compared to the respective prior year was due to higher demand for our peptides from existing customers, while the increases in consumer product sales for the years ended December 31, 2011 and 2010 compared to the respective previous year were attributable to an expanded revenue base for consumer products sold under our proprietary brands and private labels.

Administrative services revenue from a related party was typically invoiced at or near cost and therefore had no material net effect on our gross profit or net loss. We terminated our Management Services Agreement with DermaVentures in September 2009 and had no further revenue from DermaVentures thereafter.

***Cost of Revenue and Gross Margin***

Cost of revenue consists of cost of peptides and materials associated with consumer products, and cost of administrative services revenue which includes primarily marketing campaign costs associated with DermaVentures' product line and out-of-pocket expenses.

Gross profit is the difference between revenue and cost of revenue, and gross margin is gross profit expressed as a percentage of total revenue. Revenue mix affects our gross margin because our margins from license and development fees are higher than our margins from peptide sales, consumer product sales and administrative services revenue.

Cost of revenue and gross margin for the years ended December 31, 2011, 2010 and 2009 are summarized in the table below.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| Cost of peptide and consumer product sales | $ 482,033 | 119.6% | $ 219,504 | 24.2% | $ 176,720 |
| Percentage of total revenue | 25.5% | | 25.8% | | 45.2% |
| Cost of consumer product sales, affiliated company | $ 251,274 | 513.0% | $ 40,990 | NM | $ — |
| Percentage of total revenue | 13.3% | | 4.8% | | — |
| Cost of administrative services revenue, related party | $ — | — | $ — | (100.0)% | $ 19,800 |
| Percentage of total revenue | — | | — | | 5.0% |
| Total cost of revenue | $ 733,307 | 181.5% | $ 260,494 | 32.6% | $ 196,520 |
| Gross profit | $ 1,158,031 | 95.9% | $ 591,189 | 203.6% | $ 194,748 |
| Gross margin | 61.2% | | 69.4% | | 49.8% |

NM - Percentage not meaningful

Cost of peptide and consumer product sales, including sales to an affiliated company, increased by approximately $473,000, or 182%, in 2011 from 2010, and by approximately $84,000, or 47%, in 2010 from 2009. Increases in cost of revenue for the years ended December 31, 2011 and 2010 compared to the respective prior year were not linear with the growth rates of revenue, due principally to the product mix and customer mix. For 2011, peptides and consumer products sold, including those sold to an affiliated company, resulted in a blended gross margin of 37% compared to 30% in 2010 and 20% in 2009. The progressive increase in gross margin for peptides and consumer products, including those sold to an affiliated company, in 2011 compared to 2010 and 2009 was primarily attributable to higher levels of consumer products sold. As a percentage of revenue, consumer product sales, including those sold to an affiliated company grew to 40% in 2011 from 14% in 2010 and 8% in 2009. Sales of our consumer products generally deliver a higher gross margin compared to sales of peptides; thus, as sales of consumer products grow at a faster rate compared to peptide sales, the blended gross margin for peptide and consumer product sales will improve. However, as peptide and consumer product sales (as a percentage of revenue) increase relative to license fees, we expect that our overall gross margin will likely decline.

Cost of administrative services revenue for the year ended December 31, 2009 consisted primarily of marketing service expenses incurred in the period. As we terminated our Management Service Agreement with DermaVentures in the September 2009, we did not incur further cost of administrative services thereafter.

***Research and Development***

Research and development (R&D) expenses consist primarily of compensation and benefit expenses, stock-based compensation expense, cost of external studies and trials, and contract and other outside service fees related to our R&D efforts. R&D expenses for the years ended December 31, 2011, 2010 and 2009 are summarized in the table below.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| Research and development | $ 501,044 | (33.1)% | $ 748,663 | 3.6% | $ 722,523 |
| Percentage of total revenue | 26.5% | | 87.9% | | 184.7% |

R&D expenses decreased by approximately $248,000, or 33%, in 2011 from 2010, and increased by approximately $26,100, or 4%, in 2010 from 2009. The decrease in R&D expenses in 2011 compared to 2010 was due primarily to savings in salary and other compensation expenses resulting from the departure of our former Chief Scientific Officer in February 2011, as well as decreases in external studies of product candidates and general R&D activities. The increase in R&D expenses in 2010 compared to 2009 was primarily due to increases in expenses related to stock-based compensation, general R&D activities and higher spending on external studies of our product candidates.

We expect to continue to invest in R&D and anticipate that R&D expenses, including testing and studies related to the development of our Rx programs and new consumer products, will increase in absolute dollars in the future.

***Marketing and Business Development***

Marketing and business development (M&BD) expenses consist primarily of compensation and benefit expenses, stock-based compensation expense, consulting fees and various marketing costs. M&BD expenses for the years ended December 31, 2011, 2010 and 2009 are summarized in the table below.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| Marketing and business development | $ 937,508 | 50.5% | $ 622,846 | 22.9% | $ 506,742 |
| Percentage of total revenue | 49.6% | | 73.1% | | 129.5% |

M&BD expenses increased by approximately $314,000, or 51%, in 2011 from 2010, and by approximately $116,100, or 23%, in 2010 from 2009. The increase in M&BD expenses in 2011 compared to 2010 was principally attributable to higher compensation and benefit expenses, increased commissions associated with higher revenue levels, and increased expenses in advertising and other marketing activities. The increase in M&BD expenses in 2010 compared to 2009 was due primarily to increases in spending on marketing activities, compensation and benefit expenses resulting from additional personnel and stock-based compensation.

We anticipate M&BD expenses to increase in absolute dollars as we expect to incur increased expenses on advertising, market testing and promotions for our current products as well as new skin care products we plan to introduce in the foreseeable future.

***General and Administrative***

General and administrative (G&A) expenses consist primarily of salaries and benefit expenses, stock-based compensation expense, consulting fees and general corporate expenditures. G&A expenses for the years ended December 31, 2011, 2010 and 2009 are summarized in the table below.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| General and administrative | $ 1,417,467 | (7.4)% | $ 1,530,333 | 3.9% | $ 1,473,352 |
| Percentage of total revenue | 74.9% | | 179.7% | | 376.6% |

G&A expenses decreased by approximately $113,000, or 7%, in 2011 from 2010, and increased by approximately $57,000, or 4%, in 2010 from 2009. The decrease in G&A expenses in 2011 compared to 2010 was due primarily to decreases in consulting fees, stock-based compensation expense and general corporate expenses. The increase in G&A expenses in 2010 compared to 2009 was due primarily to a higher stock-based compensation expense.

We anticipate G&A expenses to increase in absolute dollars for the foreseeable future as a result of higher consulting fees and patent maintenance fees.

***Accounting, Legal and Professional Fees***

Accounting, legal and professional fees expenses for the years ended December 31, 2011, 2010 and 2009 are summarized in the table below.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| Accounting, legal and professional fees | $ 597,160 | 12.3% | $ 531,726 | (8.2)% | $ 579,443 |
| Percentage of total revenue | 31.6% | | 62.4% | | 148.1% |

Accounting, legal and professional fees expenses increased by approximately $65,000, or 12%, in 2011 from 2010, and decreased by approximately $48,000, or 8%, in 2010 from 2009. The fluctuations in accounting, legal and professional fees in 2011 and 2010 compared to the respective prior year were primarily attributable to the legal fees associated with the protection of our intellectual property, which were driven by the timing of our application for various patents.

We anticipate accounting, legal and professional fees expenses for the foreseeable future to increase in absolute dollars as we expect to incur higher legal expenses related to distribution and licensing agreements and intellectual property protection.

***Depreciation and Amortization***

Depreciation and amortization expenses for the years ended December 31, 2011, 2010 and 2009 are summarized in the table below.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| Depreciation and amortization | $ 109,175 | (4.0)% | $ 113,777 | (12.9)% | $ 130,596 |

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| Percentage of total revenue | 5.8% | | 13.4% | | 33.4% |

Depreciation and amortization expenses decreased by approximately $5,000, or 4%, in 2011 from 2010 and by $16,800, or 13%, in 2010 from 2009. The decreases in depreciation and amortization expenses in 2011 and 2010 compared to the respective prior year were primarily due to incremental depreciation expenses from assets purchased in 2011 and 2010 being offset by reduced depreciation from other assets becoming fully depreciated.

We do not currently anticipate investing significantly in capital assets for the foreseeable future and therefore expect our depreciation and amortization expenses to decrease slightly year over year.

***Other Income (Expense), Net***

Other income (expense), net consists of interest income, interest expense related to the convertible notes payable issued in 2010, 2009 and 2008, accretion of discount on such notes, debt conversion inducement expense, gain from sale of fixed assets, equity in loss of NuGlow and change in fair value of the purchase option of interest in NuGlow.

Other income (expense), net for the years ended December 31, 2011, 2010 and 2009 is summarized in the table below.

| | Year ended December 31, 2011 | % Change from 2010 | Year ended December 31, 2010 | % Change from 2009 | Year ended December 31, 2009 |
|---|---|---|---|---|---|
| Interest income | $ 3,728 | 21.3% | $ 3,074 | (68.1)% | $ 9,649 |
| Interest expense on convertible notes payable | — | (100.0)% | (138,979) | 43.4 % | (96,897) |
| Interest expense on convertible notes payable, related party | — | (100.0)% | (534,465) | 37.5 % | (388,625) |
| Accretion of discount on convertible notes payable | — | (100.0)% | (73,468) | 128.9 % | (32,094) |
| Accretion of discount on convertible notes payable, related party | — | (100.0)% | (141,440) | 187.7 % | (49,160) |
| Debt conversion inducement expense | — | (100.0)% | (3,806,966) | NM | — |
| Gain from sale of asset | 6,000 | NM | — | — | — |
| Equity in loss of affiliated company | (85,686) | 30.6% | (65,601) | — | — |
| Change in value of purchase option, affiliated company | (8,295) | (359.3)% | 3,199 | NM | — |
| Other income (expense), net | $ (84,253) | (98.2)% | $ (4,754,646) | 753.4 % | $ (557,127) |

NM - Percentage not meaningful

*Interest Income.* Interest income earned in 2011 approximated the interest income earned in 2010, due to a fairly consistent average monthly balance of cash and cash equivalents and prevailing interest rates for both years. Interest income decreased by approximately $6,600, or 68%, in 2010 from 2009, principally due to lower interest rates available for our cash and cash equivalents. In light of the prolonged uncertainty in the financial market, we continued to maintain the majority of our cash and cash equivalent assets in very short-term and liquid investments during the year ended December 31, 2011 and expect to do so for the foreseeable future. As a result, we anticipate that the yield on our cash and cash equivalent balances will remain at a low level for the near future.

*Interest Expense on Convertible Notes Payable, Including Related Party.* For the year ended December 31, 2011, we incurred no interest expense as we had no outstanding debt during the period. For the years ended December 31, 2010 and 2009, interest expense was derived from the convertible notes payable issued in 2010, 2009 and 2008. As these convertible notes payable and accrued interest were converted to shares of common stock or repaid during the fourth quarter of 2010 (see Note 2 of our Notes to Financial Statements), we did not incur further interest expense thereafter.

*Accretion of Discount on Convertible Notes Payable, Including Related Party.* For the year ended December 31, 2011, we did not incur any accretion of debt discount as we had no outstanding debt during the period. For the year ended December 31, 2010 and 2009, the accretion of discount on the convertible notes payable represented the increase in carrying value of the convertible notes issued in 2010 and 2009 through the dates of conversion in the fourth quarter of 2010.

*Debt Conversion Inducement Expense.* For the year ended December 31, 2010, we recorded a non-cash debt conversion inducement expense of approximately $3.81 million, which represented the fair value of the stock issued in the fourth quarter of 2010 in connection with the note conversion in excess of the stock issuable under the original conversion terms.

*Gain from Sale of Asset.* For the year ended December 31, 2011, we recorded a gain from sale of asset of $6,000 to reflect the sale proceed of a fully depreciated capital asset that we no longer used.

*Equity in Loss of Affiliated Company.* For the year ended December 31, 2011, we recorded equity in loss of affiliated company of approximately $86,000, which represented our share in NuGlow's net loss for the period. For the year ended December 31, 2010, we recorded equity in loss of affiliated company of approximately $66,000, which represented our share in NuGlow's net loss from July 1, 2010 through December 31, 2010.

*Change in Value of Option to Purchase Interest in Affiliated Company.* For the years ended December 31, 2011 and 2010, we recorded a loss of approximately $8,000 and a gain of approximately $3,200, respectively, to reflect the change in value of our option to purchase the remaining interest in NuGlow (see Note 6 of our Notes to Financial Statements). We did not have any assets or liabilities which we elected to measure by fair value in 2009.

**Liquidity and Capital Resources**

Since inception, we have financed our operations primarily through the private sale of debt and equity securities. Our current principal sources of liquidity are our existing cash and cash equivalents and our letter of credit. As of December 31, 2011, our cash and cash equivalents totaled approximately $1.69 million, a decrease of approximately $2.35 million from the balance of approximately $4.04 million at December 31, 2010. The decrease in cash and cash equivalents from December 31, 2010 was primarily attributable to cash used in operating activities of approximately $2.30 million and cash used in investing activities of $59,000, which included investment in an affiliated company of $42,000 and payment for website development costs and purchases of capital assets of approximately $23,000, partially offset by proceeds from a sale of assets of $6,000.

The following table summarizes our cash flows from operating, investing and financing activities for the years ended December 31, 2011, 2010 and 2009:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Net cash used in operating activities | $ (2,296,040) | $ (2,796,869) | $ (3,071,568) |
| Net cash provided by (used in) investing activities | (59,324) | (355,305) | 927,443 |
| Net cash provided by financing activities | — | 5,851,764 | 2,504,000 |

***Cash Flows from Operating Activities***

Net cash used in operating activities for the years ended December 31, 2011, 2010 and 2009 was approximately $2.30 million, $2.80 million and $3.07 million, respectively, derived primarily from the net loss for the periods plus the effect of non-cash expenses. We continue to experience negative cash flows from operating activities due to the cash requirements to support our current level of operations and efforts to expand our revenue base. The primary working capital uses of cash in 2011 were increases in accounts receivable, inventory and prepaid expenses and decreases in accounts payable and accrued expenses, partially offset by increases in deferred gross profit and accrued compensation and benefits. The primary working capital uses of cash in 2010 were increases in accounts receivable and inventory, partially offset by increases in accounts payable, accrued expenses and deferred gross profit.

Accounts receivable, including affiliated company, increased by approximately $153,000 in 2011 and $232,000 in 2010, primarily due to a larger amount of royalty receivable recorded at the end of 2011 and 2010 compared to the respective prior year. Inventory increased by approximately $85,000 in 2011 and $76,000 in 2010, primarily driven by our broader product offering and our need to maintain inventory at certain levels to meet customer required lead times. Deferred gross profit increased by approximately $84,000 in 2011 and $50,000 in 2010, reflecting increases in our sales of consumer products to NuGlow that had not yet been resold to third-party customers, net of costs of such products.

***Cash Flows from Investing Activities***

Cash used in investing activities for the year ended December 31, 2011 was approximately $59,000, which included the additional investment in NuGlow of $42,000 and payment for website development costs and purchases of capital assets of approximately $23,000. Cash used in investing activities for the year ended December 31, 2010 was approximately $355,000, which included the equity investment in NuGlow of $350,000 and capital asset purchases of approximately $5,000. Net cash provided by investing activities for the year ended December 31, 2009 was $927,000, comprising $970,000 of debt financing subscription deposits reclassified from restricted cash, offset by purchases of capital assets and payments for website development costs totaling approximately $43,000.

***Cash Flows from Financing Activities***

We have financed our operations primarily with proceeds from the private placement of debt and equity securities.

We did not have a financing event for the year ended December 31, 2011. For the year ended December 31, 2010, net cash provided by financing activities was approximately $5.85 million, which included proceeds of $3.20 million from the issuance of convertible notes payable and detachable warrants in the first half of 2010 and net proceeds of approximately $2.16 million from warrant exercises and approximately $595,000 from the sale and issuance of common stock, less debt repayment of $100,000.

For the year ended December 31, 2009, cash provided by financing activities was $2.50 million, which reflected the aggregate proceeds of $3.47 million from the issuance of convertible promissory notes and detachable warrants (see Note 2 of our Notes to Financial Statements) less $970,000 of cash deposits already received as of December 31, 2008.

On March 9, 2012, we entered into an LOC Agreement with Frank T. Nickell, our largest stockholder, pursuant to which Mr. Nickell established an irrevocable standby letter of credit by JP Morgan Chase Bank, N.A. (JPMorgan) in our favor in the principal amount of of $2.0 million (LOC). The LOC expires on July 1, 2013 but automatically renews until July 1, 2014 unless terminated by JPMorgan at least 14 days prior to the end of the current term, at which time we may draw up to the balance remaining on the LOC. Amounts outstanding under the LOC accrue interest at the rate of 0.75% per annum and are due and payable on or before July 1, 2014. Based on the current status of our operating and product commercialization plans, we estimate that our existing cash and cash equivalents together with the letter of credit will be sufficient to fund our operations, continue with our Rx product development and support the expansion of our consumer program through the next twelve months. We will need substantial additional capital in order to maintain the current level of operations beyond the next twelve months, broaden the commercialization of our technology and advance our pharmaceutical programs. Accordingly, we will need to raise additional funding, which may include debt and/or equity financing. However, there is no assurance that additional funding will be available on favorable terms, if at all. If we are unable to obtain the necessary additional funding, we would be required to severely reduce the scope of our operations, which would significantly impede our ability to proceed with current operational plans and could lead to the discontinuation of our business.

The amount of capital we will need in the future will depend on many factors, including capital expenditures and hiring plans to accommodate future growth, research and development plans, future demand for our products and technology, and general economic conditions.

**Contractual Obligations and Commercial Commitments**

We occupy approximately 5,300 square feet of leased space in Bothell, Washington for our corporate office and laboratory.

Rental expense including operating costs for the years ended December 31, 2011, 2010 and 2009 was approximately $102,000, $101,000 and $109,000, respectively. The following table summarizes our minimum rental expenses and estimated commercial commitments as of December 31, 2011 and the effect such obligations are expected to have on liquidity in future periods:

| | Payments due by periods | | | |
|---|---|---|---|---|
| **Contractual Obligations** | **2012** | **2013 through 2014** | **2015** | **Total** |
| Operating lease | $ 79,256 | $ 165,717 | $ 43,195 | $ 288,168 |
| Purchase order commitments [1] | 276,860 | — | — | 276,860 |
| | $ 356,116 | $ 165,717 | $ 43,195 | $ 565,028 |

(1) Purchase order commitments represent open orders for inventory.

**Recent Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04 (ASU 2011-4), *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* to provide a uniform framework for fair value measurements and related disclosures between U.S. GAAP and International Financial Reporting Standards (IFRS). Additional disclosure requirements in the update include: (1) for Level 3 fair value measurements, quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements to changes in the unobservable inputs; (2) for an entity's use of a nonfinancial asset that is different from the asset's highest and best use, the reason for the difference; (3) for financial instruments not measured at fair value but for which disclosure of fair value is required, the fair value hierarchy level in which the fair value measurements were determined; and (4) the disclosure of all transfers between Level 1 and Level 2 of the fair value hierarchy. ASU 2011-04 requires prospective application for interim and annual periods beginning on or after December 15, 2011. We do not expect the adoption of this update to have a material impact on our financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05 (ASU 2011-05), *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* ASU No. 2011-05 amends existing guidance by allowing an entity the option to present the components of net income and other comprehensive income in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. ASU No. 2011-05 requires retrospective application and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. We believe the adoption of this guidance concerns disclosure only and will not have a material impact on its financial position, results of operations or cash flows.

**Subsequent Events**

***NuGlow Operating Agreement***

On March 6, 2012, we entered into a Second Amendment to the Amended and Restated Operating Agreement of NuGlow Cosmaceuticals, LLC (NuGlow) pursuant to which we consented to certain monthly payments by NuGlow in consideration for which our option to purchase the remaining interest of NuGlow was extended from July 1, 2015 to July 1, 2017.

***Letter of Credit***

On March 9, 2012, we entered into an LOC Agreement with Frank T. Nickell, who beneficially owns approximately 40% of our outstanding common stock, pursuant to which Mr. Nickell established an irrevocable standby letter of credit by JPMorgan Chase Bank, N.A. (JPMorgan) in our favor in the principal amount of $2.0 million (LOC). The LOC expires on July 1, 2013 but automatically renews until July 1, 2014 unless terminated by JPMorgan at least 14 days prior to the end of the current term, at which time we may draw up to the balance remaining on the LOC. Amounts outstanding under the LOC accrue interest at the rate of 0.75% per annum and are due and payable on or before July 1, 2014.

Pursuant to the LOC Agreement, we agreed to use commercially reasonable efforts to consummate an equity financing prior to the termination date of the LOC in which we would sell and issue shares of our common stock at a price per share of at least $0.60 for aggregate proceeds of at least $3.0 million, upon consummation of which all amounts outstanding under the LOC shall be immediately repaid. In addition, we issued to Mr. Nickell a five-year fully vested warrant to purchase 2,000,000 shares of our common stock at an exercise price of $0.25 per share and agreed to reimburse Mr. Nickell for his reasonable expenses in connection with the LOC, including, without limitation, any interest accrued and payable by Mr. Nickell in connection with the LOC.

## ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Not applicable.

## ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Helix BioMedix, Inc.

We have audited the accompanying balance sheets of Helix BioMedix, Inc. as of December 31, 2011 and 2010, and the related statements of operations and comprehensive loss, stockholders' equity (deficit), and cash flows for each of the years in the three-year period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Helix BioMedix, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Seattle, Washington
March 27, 2012

**HELIX BIOMEDIX, INC.**

**BALANCE SHEETS**

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,688,945 | $ 4,044,309 |
| Accounts receivable, net | 239,773 | 235,149 |
| Accounts receivable, affiliated company, net | 200,935 | 52,795 |
| Inventory | 363,869 | 278,392 |
| Prepaid expenses and other current assets | 64,583 | 63,471 |
| Total current assets | 2,558,105 | 4,674,116 |
| Property and equipment, net | 26,098 | 44,178 |
| Intangible assets, net | 146,297 | 214,068 |
| Other long term assets | 20,884 | 29,179 |
| Investment in affiliated company | 223,255 | 266,941 |
| Total assets | $ 2,974,639 | $ 5,228,482 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 125,324 | $ 130,489 |
| Accrued compensation and benefits | 87,859 | 30,285 |
| Accrued expenses | 55,463 | 102,123 |
| Deferred gross profit, related party | 134,842 | 50,479 |
| Deferred rent, current | 7,155 | 4,847 |
| Total current liabilities | 410,643 | 318,223 |
| Deferred rent, non-current | 28,660 | 35,815 |
| Total liabilities | 439,303 | 354,038 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, $0.001 par value, 25,000,000 shares authorized; no shares issued or outstanding | — | — |
| Common stock, $0.001 par value, 100,000,000 shares authorized; 49,720,255 shares issued and outstanding at December 31, 2011 and 2010 | 49,721 | 49,721 |
| Additional paid-in capital | 48,542,453 | 48,392,985 |
| Accumulated deficit | (46,056,838) | (43,568,262) |
| Total stockholders' equity | 2,535,336 | 4,874,444 |
| Total liabilities and stockholders' equity | $ 2,974,639 | $ 5,228,482 |

See accompanying notes to financial statements.

## HELIX BIOMEDIX, INC.

## STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Revenue: | | | |
| Licensing fees | $ 730,635 | $ 479,317 | $ 149,196 |
| Peptide and consumer product sales | 679,907 | 309,379 | 221,876 |
| Consumer product sales to affiliated company | 480,796 | 62,987 | — |
| Administrative services revenue, related party | — | — | 20,196 |
| Total revenue | 1,891,338 | 851,683 | 391,268 |
| Cost of revenue: | | | |
| Cost of peptide and consumer product sales | 482,033 | 219,504 | 176,720 |
| Cost of consumer product sales to affiliated company | 251,274 | 40,990 | — |
| Cost of administrative services revenue, related party | — | — | 19,800 |
| Total cost of revenue | 733,307 | 260,494 | 196,520 |
| Gross profit | 1,158,031 | 591,189 | 194,748 |
| Operating expenses: | | | |
| Research and development | 501,044 | 748,663 | 722,523 |
| Marketing and business development | 937,508 | 622,846 | 506,742 |
| General and administrative | 1,417,467 | 1,530,333 | 1,473,352 |
| Accounting, legal and professional fees | 597,160 | 531,726 | 579,443 |
| Depreciation and amortization | 109,175 | 113,777 | 130,596 |
| Total operating expenses | 3,562,354 | 3,547,345 | 3,412,656 |
| Loss from operations | (2,404,323) | (2,956,156) | (3,217,908) |
| Other income (expense): | | | |
| Interest income | 3,728 | 3,074 | 9,649 |
| Interest expense on convertible notes payable | — | (138,979) | (96,897) |
| Interest expense on convertible note payable, related party | — | (534,465) | (388,625) |
| Accretion of discount on convertible notes payable | — | (73,468) | (32,094) |
| Accretion of discount on convertible notes payable, related party | — | (141,440) | (49,160) |
| Debt conversion inducement expense | — | (3,806,966) | — |
| Gain from sale of assets | 6,000 | — | — |
| Equity in loss of affiliated company | (85,686) | (65,601) | — |
| Change in value of option to purchase interest in affiliated company | (8,295) | 3,199 | — |
| Other income (expense), net | (84,253) | (4,754,646) | (557,127) |
| Net loss and comprehensive loss | $ (2,488,576) | $ (7,710,802) | $ (3,775,035) |
| Basic and diluted net loss per share | $ (0.05) | $ (0.28) | $ (0.15) |
| Weighted average shares outstanding | 49,720,255 | 27,124,159 | 25,653,512 |

See accompanying notes to financial statements.

## HELIX BIOMEDIX, INC.

## STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

| | Common Stock | | Additional paid-in capital | Accumulated deficit | Accumulated other comprehensive income | Stockholders' equity (deficit) |
|---|---|---|---|---|---|---|
| | Number of shares | Amount | | | | |
| Balance at December 31, 2008 | 25,653,512 | $ 25,654 | $ 30,342,249 | $ (32,082,425) | $ — | $ (1,714,522) |
| Stock-based compensation | — | — | 101,970 | — | — | 101,970 |
| Relative fair value of detachable warrants issued with convertible notes payable | — | — | 218,862 | — | — | 218,862 |
| Net loss for the year | — | — | — | (3,775,035) | — | (3,775,035) |
| Balance at December 31, 2009 | 25,653,512 | 25,654 | 30,663,081 | (35,857,460) | — | (5,168,725) |
| Stock-based compensation | — | — | 188,920 | — | — | 188,920 |
| Relative fair value of detachable warrants issued with convertible notes payable | — | — | 77,300 | — | — | 77,300 |
| Proceeds from warrant exercises, net | 4,852,000 | 4,852 | 2,151,415 | — | — | 2,156,267 |
| Issuance of stock from conversion of notes payable | 7,048,102 | 7,048 | 4,221,825 | — | — | 4,228,873 |
| Issuance of stock from conversion of notes payable, related party | 11,166,910 | 11,167 | 6,688,981 | — | — | 6,700,148 |
| Proceeds from private placement, net | 999,731 | 1,000 | 594,497 | — | — | 595,497 |
| Debt conversion inducement expense | — | — | 3,806,966 | — | — | 3,806,966 |
| Net loss for the year | — | — | — | (7,710,802) | — | (7,710,802) |
| Balance at December 31, 2010 | 49,720,255 | $ 49,721 | $ 48,392,985 | $ (43,568,262) | $ — | $ 4,874,444 |
| Stock-based compensation | — | — | 149,468 | — | — | 149,468 |
| Net loss for the year | — | — | — | (2,488,576) | — | (2,488,576) |
| Balance at December 31, 2011 | 49,720,255 | $ 49,721 | $ 48,542,453 | $ (46,056,838) | $ — | $ 2,535,336 |

See accompanying notes to financial statements.

## HELIX BIOMEDIX, INC.

## STATEMENTS OF CASH FLOWS

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| **Cash Flows from Operating Activities** | | | |
| Net loss | $ (2,488,576) | $ (7,710,802) | $ (3,775,035) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation | 41,404 | 46,007 | 58,831 |
| Amortization | 67,771 | 67,770 | 71,765 |
| Stock-based compensation expense | 149,468 | 188,920 | 101,970 |
| Interest expense on convertible notes payable | — | 123,965 | 96,897 |
| Interest expense on convertible notes payable, related party | — | 534,465 | 388,625 |
| Accretion of discount on convertible notes payable | — | 73,468 | 32,094 |
| Accretion of discount on convertible notes payable, related party | — | 141,440 | 49,160 |
| Debt conversion inducement expense | — | 3,806,966 | — |
| (Gain) from sale of assets | (6,000) | — | — |
| Equity in loss of affiliated company | 85,686 | 65,601 | — |
| Change in valuation of option to purchase interest in affiliated company | 8,295 | (3,199) | — |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable, net | (4,624) | (232,259) | (5,218) |
| Accounts receivable from affiliated company, net | (148,140) | — | — |
| Inventory | (85,477) | (75,577) | (91,404) |
| Prepaid expenses and other current assets | (1,112) | (29,010) | 70,245 |
| Accounts payable | (5,165) | 64,034 | (5,369) |
| Accrued compensation and benefits | 57,574 | 588 | (72,037) |
| Other accrued liabilities | (51,507) | 90,275 | 7,908 |
| Deferred gross profit, affiliated company | 84,363 | 50,479 | — |
| Net cash used in operating activities | (2,296,040) | (2,796,869) | (3,071,568) |
| **Cash Flows from Investing Activities** | | | |
| Restricted cash from convertible debt subscriptions | — | — | 970,000 |
| Purchase of property and equipment | (2,669) | (5,305) | (17,037) |
| Proceeds from sale of assets | 6,000 | — | — |
| Website development | (20,655) | — | (25,520) |
| Investment in affiliated company | (42,000) | (350,000) | — |
| Net cash provided by (used in) investing activities | (59,324) | (355,305) | 927,443 |
| **Cash Flows from Financing Activities** | | | |
| Proceeds from issuance of convertible notes payable | — | 550,000 | 404,000 |
| Proceeds from issuance of convertible notes payable, related party | — | 2,650,000 | 2,100,000 |
| Proceeds from warrant exercises, including related party, net | — | 2,156,267 | — |
| Proceeds from issuance of common stock, net | — | 595,497 | — |
| Repayment of convertible note payable | — | (100,000) | — |
| Net cash provided by financing activities | — | 5,851,764 | 2,504,000 |
| **Net increase in cash and cash equivalents** | (2,355,364) | 2,699,590 | 359,875 |
| **Cash and cash equivalents at beginning of period** | 4,044,309 | 1,344,719 | 984,844 |
| **Cash and cash equivalents at end of period** | $ 1,688,945 | $ 4,044,309 | $ 1,344,719 |
| Supplemental cash flow information: | | | |
| Cash paid for income taxes | $ — | $ — | $ — |
| Cash paid for interest | $ — | $ 15,014 | $ — |
| Non-cash investing and financing activities | | | |
| Relative fair value of detachable warrants issued with convertible notes payable | $ — | $ — | $ 218,862 |
| Issuance of stock from notes payable conversion | $ — | $ 4,228,873 | $ — |
| Issuance of stock from notes payable conversion, related party | $ — | $ 6,700,148 | $ — |

See accompanying notes to financial statements.

## Note 1. Description of the Business and Summary of Significant Accounting Policies

### The Business

Helix BioMedix, Inc. (the Company), a Delaware corporation, is a biopharmaceutical company with an extensive proprietary library of structurally diverse bioactive peptides and patents covering hundreds of thousands of peptide sequences. The Company's mission is to enrich clinical practice and the patient/consumer experience by developing and commercializing topically applied products which offer the benefits of its advanced bioactive small molecule and peptide technologies. The Company's vision is to be recognized as the world leader in the identification, qualification and commercialization of natural and synthetic peptides.

The Company's business strategy is to develop its peptide and small molecule portfolio to derive revenue from a broad base of opportunities including licensing to third parties rights to use select proprietary peptides in specific fields of application and commercializing our own branded products. Over the longer term, the Company intends to pursue applications for products using its technology in medical devices and pharmaceutical preparations. The Company has developed numerous peptides with unique sequences for use in the following two areas of application:

- Consumer skin care products — the Company has developed a range of peptides and small molecule technologies capable of improving different aspects of the skin's appearance, texture, tone and barrier function and are marketing these peptides as innovative ingredients for cosmetic use; and
- Prescription (Rx) products — certain of the Company's peptides have demonstrated promising results in the areas of infection control, wound healing and immune modulation and are being developed for Rx applications.

The Company's Rx focus is on prescription-only topical preparations that would be subject to a shorter regulatory approval process under Section 510(k) of the Food, Drug and Cosmetic Act (510(k) devices). The Company continues to explore possible sources of funding to support further in-house development work on its pharmaceutical programs, which management believes will enhance potential partnership opportunities with pharmaceutical companies.

Although the Company has made progress in licensing its peptide technology and implementing its intellectual property into revenue-generating products for a wide range of dermal applications, the Company's cost to conduct its business development efforts and other operating activities has exceeded its revenues each year since inception. Additionally, the Company's net cash used in operations has exceeded its cash generated from operations for each year since its inception. The Company has financed its operations largely through the private sale of equity and debt securities.

On March 9, 2012, the Company entered into an LOC Agreement (LOC Agreement) with Frank T. Nickell, who beneficially owns approximately 40% of the Company's outstanding Common Stock, pursuant to which Mr. Nickell established an irrevocable standby letter of credit by JPMorgan Chase Bank, N.A. (JPMorgan) in favor of the Company in the principal amount of $2.0 million (LOC). The LOC expires on July 1, 2013 but automatically renews until July 1, 2014 unless terminated by JPMorgan at least 14 days prior to the end of the current term, at which time the Company may draw up to the balance remaining on the LOC. Amounts outstanding under the LOC accrue interest at the rate of 0.75% per annum and are due and payable on or before July 1, 2014.

Based on the current status of the Company's operating and product commercialization plans, management estimates that the Company's existing cash and cash equivalents together with the letter of credit will be sufficient to fund its operations, continue with work towards its Rx product development and support the expansion of its consumer program through the next twelve months. The Company will need substantial additional capital in order to maintain the current level of operations beyond the next twelve months, broaden the commercialization of its technology and advance its pharmaceutical programs. Accordingly, the Company will need to raise additional funding, which may include debt and/or equity financing. However, there is no assurance that additional funding will be available on favorable terms, if at all. If the Company is unable to obtain the necessary additional funding, we would be required to severely reduce the scope of its operations, which would significantly impede its ability to proceed with current operational plans and could lead to the discontinuation of its business.

The amount of capital the Company will need in the future will depend on many factors, including capital expenditures and hiring plans to accommodate future growth, research and development plans, future demand for the Company's products and technology, and general economic conditions.

**Basis of Presentation and Preparation**

The preparation of the Company's financial statements in conformity with generally accepted accounting principles in the United States (U.S. GAAP) requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the balance sheets and the reported amounts of revenue and expenses during the reporting periods. In the opinion of management, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the Company's financial position and its results of operations and cash flows for the periods indicated. Significant items subject to such estimates and assumptions include, but are not limited to, the carrying amount of investments, property, plant and equipment, intangibles; valuation allowances for receivables, inventories, deferred income tax assets; and valuation of share-based compensation and option to purchase the remaining interest in an affiliated company. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

The Company considers all highly liquid debt instruments with an original maturity of 90 days or less at the time of purchase to be cash equivalents. Cash and cash equivalents consisted of demand deposits and money market funds and are stated at cost, which approximates fair value. The Company deposits its cash and cash equivalents with a high credit quality financial institution. The Company regularly maintains cash balances in excess of federally insured limits. To date, the Company has not experienced any losses on its cash and cash equivalents.

**Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable are shown at their net realizable value which approximates their fair value. The Company does not currently maintain an allowance for doubtful accounts based on the Company's management's consideration of historical collection experience and the characteristics of existing accounts. The Company has not had any accounts receivable allowances or write-offs for any period presented.

**Inventory**

Inventory consists of peptides and consumer product finished goods and work in process. Work in process includes inventory at the Company's manufacturer. Inventory is stated at the lower of cost or market. The Company regularly monitors inventory quantities on hand and records write-downs or write-offs for any excess, obsolescence and shrinkage based primarily on its sales forecast and production requirements.

**Property and Equipment**

Property and equipment, which includes laboratory equipment, furniture and leasehold improvements, are stated at cost. Depreciation of equipment is provided using the straight-line basis over three to five years. Leasehold improvements are amortized over the lesser of the economic useful lives of the improvements or the term of the related lease. Repair and maintenance costs are expensed as incurred.

**Website Development**

The Company maintains a corporate website along with product websites focusing on sales of the Company's proprietary branded skin care products. The Company capitalizes eligible costs associated with website development and amortizes these costs on a straight-line basis over the estimated useful lives of the websites, ranging from two to three years. Costs associated with minor enhancements and maintenance for the Company's websites are expensed as incurred.

**Intangible Assets**

Acquired patents and certain costs for issued patents, consisting primarily of legal fees, are capitalized. Patents are amortized on the straight line basis over the useful life of the patents, generally thirteen years.

Licensing agreements and antimicrobial technology, which was purchased in conjunction with certain patents, has been capitalized at the basis of the debt issued for it. Licensing agreements and antimicrobial technology are amortized ratably over seventeen years. The Company's antimicrobial technology has been fully amortized.

**Impairment of Long-Lived Assets**

The Company reviews long-lived assets including property and equipment and intangible assets for possible impairment whenever significant events or changes in circumstances, including changes in the Company's business strategy and plans, indicate that impairment may have occurred. An impairment is indicated when the sum of the expected future undiscounted net cash flows identifiable to that asset or asset group is less than its carrying value. Impairment losses are determined from actual or estimated fair values, which are based on market values or projections of discounted net cash flows, as appropriate. No impairment of long-lived assets has been recognized in the accompanying financial statements.

**Investment in Affiliated Company**

The Company uses the equity method to account for its investment in an affiliated company in which it owns a 30% interest and has significant influence. The excess of the investment's carrying value over the Company's share of the fair value of the investee's net assets was attributable to goodwill. This equity-method goodwill is not amortized, but rather, the investment is analyzed for impairment. The Company adjusts the carrying value of this investment at each reporting period to recognize its share of the affiliated company's net earnings or losses and distributions, if any.

**Deferred Gross Profit, Affiliated Company**

Deferred gross profit, affiliated company, relates to sales of products to an affiliated company which have not yet been resold to third parties, net of costs of such products.

**Revenue Recognition**

The Company derives its revenue from technology licenses, sales of peptides and consumer products, and, until September 2009, administrative services provided to a related party. Revenue from technology licenses may include up-front payments and royalties from third-party product manufacturing and sales.

- **Licensing Fees**. The Company recognizes up-front payments when persuasive evidence of an agreement exists, delivery has occurred or services have been performed, the price is fixed and determinable and collection is reasonably assured. The Company recognizes royalty revenue in the period the royalty is earned based on actual reports or estimates received from licensees.
- **Peptide and Consumer Product Sales**. The Company recognizes revenue from sales of its peptides and skin care products when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is reasonably assured.
- **Consumer Product Sales to Affiliated Company.** The Company sells certain skin care products under private labels to an affiliated company and recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, collection is reasonably assured and the products have been resold to third parties or otherwise used.
- **Administrative Services Revenue, Related Party**. The Company's administrative services revenue consisted of fees received from DermaVentures, LLC (DermaVentures), a related party, for costs incurred related to the DermaVentures' product line. Administrative services revenue was invoiced to DermaVentures at or near cost and was recorded as earned on a gross basis when services had been rendered, no obligations remained outstanding and collection was reasonably assured.

  In September 2009, the Company terminated the Management Services Agreement with DermaVentures. As a result, the Company had no further management or administrative responsibilities related to DermaVentures from which the Company's administrative services revenue was derived (see Note 14).

Revenues are recorded net of related sales taxes. Sales tax amounts collected from customers are included in accrued expenses.

**Shipping and Handling Costs**

The Company records shipping and handling costs billed to customers as revenue. Freight costs associated with shipping goods to customers are recorded as a cost of revenue. Shipping and handling costs for all periods presented were immaterial.

**Advertising Expense**

The Company expenses advertising costs as incurred. Advertising expenses for the year ended December 31, 2011, 2010 and 2009 were approximately $154,000, $44,000 and $33,000, respectively.

**Research and Development**

Research and development costs are expensed as incurred. Research and development expenses include, but are not limited to, payroll and personnel expenses, lab supplies and expenses, and external trials and studies. In instances where the Company enters into agreements with third parties for research and development activities, which may include personnel costs, supplies and other costs associated with such collaborative agreements, the Company expenses these items as incurred.

**Income Taxes**

The Company recognizes deferred tax assets and liabilities for the expected future income tax consequences of transactions that have been included in the financial statements or tax returns. The Company measures deferred tax assets and liabilities based on the differences between the financial reporting and the tax bases of the assets and liabilities using enacted tax rates in effect in the years in which those differences are expected to be recovered or settled. The Company records an allowance against deferred tax assets when it

is more likely than not that such tax benefits will not be realized. Due to the uncertainty regarding the Company's profitability, the future tax benefits of its losses have been fully reserved for and no net benefit has been recorded in the financial statements.

The Company applies a "more-likely-than-not" threshold for the recognition and derecognition of tax positions taken or expected to be taken in a tax return. The evaluation of uncertain tax positions is based on factors including, but not limited to, changes in tax laws, effectively sustained issues under audit and changes in facts or circumstances surrounding a tax position.

**Loss per Share**

Loss per share has been computed using the weighted average number of shares outstanding during the period. Diluted per share amounts reflect potential dilution from the exercise or conversion of securities into common stock or from other contracts to issue common stock. The Company's capital structure includes common stock options and common stock warrants, all of which have been excluded from net loss per share calculations as they are antidilutive, as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| Year | 2011 | 2010 | 2009 |
| 2012 | 3,604,521 | 3,647,638 | 3,325,726 |
| 2013 | 1,971,034 | 4,667,445 | 4,197,816 |

**Fair Value of Financial Instruments**

The reported amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and other current liabilities, approximate fair values due to the short-term nature of these instruments.

**Valuation of Option to Purchase Remaining Interest in Affiliated Company**

In connection with the Company's investment in an affiliated company, the Company has the right to purchase the remaining interest in the investee between July 1, 2012 and July 1, 2017 (see Note 6). The Company elected to account for this option at fair value on the balance sheet with changes in value recognized in the statement of operations.

**Stock-Based Compensation**

The Company measures stock-based compensation expense for employee awards at the grant date based on the fair value of the award and recognizes such expense on a straight-line basis over the requisite service period, which is generally the vesting period. Compensation expense is recognized only for those options expected to vest. The Company recognizes the fair value of stock options and warrants issued to non-employees over the applicable performance period.

The Company uses the Black-Scholes option pricing model to determine the fair value of stock options. The determination of the fair value of stock-based awards on the date of grant using an option pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include management's estimated stock price volatility over the expected term of the awards, estimated employee stock option exercise behaviors, the risk-free interest rate, and expected dividends.

**Recent Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04 (ASU 2011-4), *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* to provide a uniform framework for fair value measurements and related disclosures between U.S. GAAP and International Financial Reporting Standards (IFRS). Additional disclosure requirements in the update include: (1) for Level 3 fair value measurements, quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements to changes in the unobservable inputs; (2) for an entity's use of a nonfinancial asset that is different from the asset's highest and best use, the reason for the difference; (3) for financial instruments not measured at fair value but for which disclosure of fair value is required, the fair value hierarchy level in which the fair value measurements were determined; and (4) the disclosure of all transfers between Level 1 and Level 2 of the fair value hierarchy. ASU 2011-04 requires prospective application for interim and annual periods beginning on or after December 15, 2011. The Company does not expect the adoption of this update to have a material impact on its financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05 (ASU 2011-05), *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* ASU No. 2011-05 amends existing guidance by allowing an entity the option to present the components of net income and other comprehensive income in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. ASU No. 2011-05 requires retrospective application and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. The Company believes the

adoption of this guidance concerns disclosure only and will not have a material impact on its financial position, results of operations or cash flows.

**Note 2. Financing Events**

***2008 Debt Financing – Convertible Note Payable, Related Party, Issued on February 14, 2008 and Amended on June 27, 2008***

On February 14, 2008, the Company issued to RBFSC Inc. (RBFSC), a related party, a convertible promissory note (the 2008 Note) in the principal amount of $3.0 million with an interest rate of 8% per annum, which was subsequently amended on June 27, 2008 (the 2008 Amended Note). In connection with the issuance of the 2008 Amended Note, the Company issued a five-year warrant to purchase 750,000 shares of the Company's common stock at an exercise price of $1.00 per share (2008 Warrant). The 2008 Amended Note, which was due and payable on July 1, 2011, included a call option which gave the holder the right to demand repayment in the case of default and a put option which allowed the Company to prepay the unpaid balance of the 2008 Amended Note and related accrued interest at any time and without penalty.

***2009 Debt Financing – Convertible Notes Payable Issued on February 10 and March 5, 2009***

In 2009, the Company issued to accredited investors convertible promissory notes in an aggregate principal amount of $3.47 million (the 2009 Notes) and five-year warrants to purchase an aggregate of 868,500 shares of the Company's common stock at an exercise price of $1.00 per share (the 2009 Warrants). The 2009 Notes bore interest at the rate of 8% per annum and were due and payable on July 1, 2011. The 2009 Notes also included a call option giving the holders the right to demand repayment in the case of default and a put option allowing the Company to prepay the unpaid balance of the 2009 Notes and accrued interest at any time and without penalty.

The Company determined the relative fair value of the 2009 Warrants to be $218,862 and recorded this amount as a discount to the 2009 Notes, to be amortized over the life of the 2009 Notes.

Holders of the 2009 Notes included three related parties: 1) two members of the Company's Board of Directors who each purchased a convertible note in the principal amount of $100,000 and received a warrant to purchase 25,000 shares of the Company's common stock and 2) Cardinal Court LLC which purchased a convertible note in the principal amount of $2.0 million and received a warrant to purchase 500,000 shares of the Company's common stock. The Vice President and Treasurer of Cardinal Court LLC is Frank T. Nickell, who is also the President and a director of RBFSC and owns an interest that allows him to exercise significant influence.

***2010 Debt Financing – Convertible Notes Payable Issued on March 5 and May 10, 2010***

Over the first half of 2010, the Company issued to accredited investors convertible promissory notes in an aggregate principal amount of $3.2 million (2010 Notes) and five-year warrants to purchase an aggregate of 800,000 shares of the Company's common stock at an exercise price of $0.80 per share (2010 Warrants). The 2010 Notes bore interest at the rate of 8% per annum and were due and payable on July 1, 2013. The 2010 Notes also included a call option giving the holders the right to demand repayment in the case of default (which included a default under the 2008 Amended Note or the 2009 Notes), and a put option allowing the Company to prepay the unpaid balance of the 2010 Notes and accrued interest at any time and without penalty.

The Company determined the relative fair value of the 2010 Warrants to be an aggregate of approximately $77,000 and recorded this amount as a discount to the 2010 Notes, to be amortized over the life of these notes.

The holders of the 2010 Notes included three related parties: 1) two members of the Company's Board of Directors who purchased convertible notes in an aggregate principal amount of $450,000 and received warrants to purchase an aggregate of 112,500 shares of the Company's common stock and 2) RBFSC which purchased a convertible note in the principal amount of $2,200,000 and received a warrant to purchase 550,000 shares of the Company's common stock.

***2010 Debt Conversion, Warrant Exercises and Equity Financing***

*Debt Conversion and Warrant Exercise Transactions with RBFSC*

On November 22, 2010, the Company entered into a Convertible Promissory Note Conversion and Warrant Exercise Agreement with RBFSC pursuant to which RBFSC:

(i) amended and converted $3,665,425 of aggregate principal amount and accrued interest due on the 2008 Amended Note into 6,109,041 shares of the Company's common stock at a conversion price of $0.60 per share;

(ii) amended and converted $2,326,334 of aggregate principal amount and accrued interest due on its 2010 Note into 3,877,223 shares of the Company's common stock at a conversion price of $0.60 per share;

(iii) amended and exercised the 2008 Warrant to purchase 1,500,000 shares of the Company's common stock at an exercise price of $0.50 per share for a total of $750,000; and

(iv) amended and exercised its 2010 Warrant to purchase 1,100,000 shares of the Company's common stock at an exercise price of $0.40 per share for a total of $440,000.

In addition, on December 27, 2010, the Company entered into a Warrant Amendment and Exercise Agreement with RBFSC, pursuant to which:

(i) RBFSC amended and exercised its warrant issued on March 3, 2006 for 300,000 shares of the Company's common stock at an exercise price of $0.50 per share for a total of $150,000; and

(ii) the Company agreed to comply with the requirements for "qualified small business stock" under Section 1202 of the Internal Revenue Code of 1986, as amended.

*Debt Conversion and Warrant Exercise Transactions with Other Note Holders*

On November 24, 2010, the Company filed with the SEC a Tender Offer Statement on Schedule TO pursuant to which, on December 27, 2010:

(i) $3,877,164 of aggregate principal amount and accrued interest of the 2009 Notes was converted into 6,461,921 shares of the Company's common stock at a conversion price of $0.60 per share;

(ii) $115,014 of aggregate principal amount and accrued interest of the 2009 Notes was repaid;

(iii) $1,060,099 of aggregate principal amount and accrued interest of the 2010 Notes was converted into 1,766,827 shares of the Company's common stock at a conversion price of $0.60 per share;

(iv) certain of the 2009 Warrants were exercised for an aggregate of 1,452,000 shares of the Company's common stock at an exercise price of $0.50 per share for a total of $726,000; and

(v) the 2010 Warrants were exercised for an aggregate of 500,000 shares of the Company's common stock at an exercise price of $0.40 per share for a total of $200,000.

The per share fair value of the Company's common stock immediately prior to the RBFSC's note conversion on November 22, 2010 and the note conversions on December 27, 2010 pursuant to the Tender Offer was estimated at $0.61 and $0.57, respectively. In aggregate, the value of the common stock issued in connection with the conversion of the convertible notes payable in the fourth quarter of 2010 in excess of the carrying amount of the principal and accrued interest on the convertible notes payable was $3,806,966. This amount was charged to debt conversion inducement expense in the accompanying statements of operations for the year ended December 31, 2010.

*Equity Financing*

On December 31, 2010, the Company issued to seven accredited investors an aggregate of 999,731 shares of the Company's common stock at a purchase price of $0.60 per share for an aggregate purchase price of $599,839. Participants in the December 2010 equity financing included RBFSC which acquired 500,000 shares of the Company's common stock for a total of $300,000.

**Note 3. Inventory**

Inventory consisted of the following:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Work in process | $ 156,425 | $ 66,365 |
| Finished goods | 207,444 | 212,027 |
| | $ 363,869 | $ 278,392 |

## Note 4. Property and Equipment

Property and equipment consisted of the following:

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Machinery and equipment | $ 520,950 | $ 569,809 |
| Website development costs | 63,175 | 42,520 |
| Furniture and fixtures | 50,441 | 55,614 |
| Leasehold improvements | 43,993 | 43,993 |
| | 678,559 | 711,936 |
| Less accumulated depreciation | (652,461) | (667,758) |
| Property and equipment, net | $ 26,098 | $ 44,178 |

Aggregate depreciation expense for property and equipment was $41,404, $46,007 and $58,831 for the years ended December 31, 2011, 2010 and 2009, respectively.

## Note 5. Identifiable Intangible Assets

Identifiable intangible assets, subject to amortization, were as follows:

| | Weighted average amortization period (in years) | December 31, 2011 Gross carrying amount | December 31, 2011 Accumulated amortization | December 31, 2011 Intangible assets, net | December 31, 2010 Gross carrying amount | December 31, 2010 Accumulated amortization | December 31, 2010 Intangible assets, net |
|---|---|---|---|---|---|---|---|
| Antimicrobial technology | 17 | $ 222,187 | $ (222,187) | $ — | $ 222,187 | $ (222,187) | $ — |
| Licensing agreements | 17 | 61,391 | (35,950) | 25,441 | 61,391 | (32,355) | 29,036 |
| Patents pending and approved | 13 | 834,301 | (713,445) | 120,856 | 834,301 | (649,269) | 185,032 |
| Total | | $ 1,117,879 | $ (971,582) | $ 146,297 | $ 1,117,879 | $ (903,811) | $ 214,068 |

Amortization expense related to identifiable intangible assets was $67,771, $67,770 and $71,765 for the years ended December 31, 2011, 2010 and 2009, respectively. Scheduled amortization charges from identifiable intangible assets as of December 31, 2011 were as follows:

| Year | Licensing agreements | Patents pending and approved | Total |
|---|---|---|---|
| 2012 | $ 3,595 | $ 64,175 | $ 67,770 |
| 2013 | 3,595 | 37,814 | 41,409 |
| 2014 | 3,595 | 5,054 | 8,649 |
| 2015 | 3,595 | 5,054 | 8,649 |
| 2016 | 3,595 | 5,054 | 8,649 |
| Thereafter | 7,466 | 3,705 | 11,171 |

## Note 6. Investment in Affiliated Company

### *Membership Interest Agreement*

On July 1, 2010, the Company entered into a Membership Interest Agreement (NuGlow Membership Agreement) in NuGlow Cosmaceuticals, LLC (NuGlow), a direct-response company selling specialty skin care products, in exchange for a capital contribution of $350,000 (Initial Contribution). In connection with NuGlow's capital raise of $140,000 in September 2011 (2011 Contribution), the Company contributed an additional $42,000 to maintain its 30% interest in NuGlow.

### *Amended and Restated Operating Agreement*

On July 1, 2010, the Company also entered into an Amended and Restated Operating Agreement of NuGlow (NuGlow Operating Agreement), which was amended on September 1, 2011 to stipulate the following terms:

(i) Camden shall manage NuGlow;

(ii) any profit distribution by NuGlow is to be paid in the following order: (a) 30% to the Company and 70% to NuGlow's other member until the 2011 Contribution is fully repaid; (b) 70% to the Company and 30% to NuGlow's other member until the Company's Initial Contribution is fully repaid; and (c) ratably among members in accordance with each member's percentage interest;

(iii) upon a dissolution or liquidation, all of NuGlow's liquidation proceeds is to be paid in the following order: (a) 30% to the Company and 70% to NuGlow's other member until the 2011 Contribution is fully repaid; (b) 100% to the Company until the Company's Initial Contribution is fully repaid; and (c) ratably among members in accordance with each member's percentage interest;

(iv) NuGlow may not take certain actions or engage in certain transactions without the Company's prior written consent, including, without limitation, the incurrence of indebtedness, the admission of additional members, the merger or sale of NuGlow or its assets, or the dissolution of NuGlow;

(v) NuGlow shall establish a product oversight committee consisting of two designees of the Company and one designee of Camden to oversee certain matters related to NuGlow product management;

(vi) transfers of NuGlow membership interests shall be subject to certain restrictions, including, without limitation, a right of first refusal by NuGlow and its members;

(vii) upon certain circumstances, the Company has the right to purchase all of Camden's membership interest in NuGlow (Purchase Option); and

(viii) if the Company does not exercise the Purchase Option, or at any time before the Company exercises its Purchase Option upon a change of control of the Company or a sale of substantially all of its assets or upon the Company's insolvency or bankruptcy, Camden has the right to purchase all of the Company's membership interest in NuGlow.

The Company's cumulative investment in NuGlow is accounted for as an equity investment and is adjusted at each reporting period to reflect the Company's share of NuGlow's net earnings, losses, contributions and any profit distributions. The Company has also elected to account for the Purchase Option at fair value on the balance sheet with changes in value recognized in the statement of operations over the life of the option. Additionally, at each reporting period, the Company assesses its investment in NuGlow to determine whether events or changes in circumstances indicate that the carrying amount may not be recoverable. The primary factors the Company considers in its determination are NuGlow's financial condition and operating performance. If the decline in value is deemed to be other than temporary, the Company would recognize an impairment loss.

For the years ended December 31, 2011 and 2010, the Company recorded a loss of $85,686 and $65,601, respectively, to "Equity in loss of affiliated company" which reflected its share of NuGlow's net loss during those periods. The carrying value of the Company's investment in NuGlow was $223,255 and $266,941 at December 31, 2011 and 2010, respectively.

NuGlow's condensed balance sheet at December 31, 2011 and 2010 and statements of operations for the years ended December 31, 2011 and 2010 are summarized below:

| NuGlow's Condensed Balance Sheets | December 31, 2011 (Unaudited) | December 31, 2010 (Unaudited) |
|---|---|---|
| **Assets** | | |
| Cash | $ 200 | $ 75,147 |
| Accounts receivable, net | 18,276 | 2,574 |
| Inventory | 275,838 | 140,443 |
| Prepaid expenses and other current assets | 9,513 | 11,455 |
| Total assets | $ 303,827 | $ 229,619 |
| **Liabilities and members' equity** | | |
| Accounts payable and current liabilities | $ 280,867 | $ 61,041 |
| Members' equity | 514,661 | 374,661 |
| Accumulated deficit | (491,701) | (206,083) |
| Total liabilities and members' equity | $ 303,827 | $ 229,619 |

| NuGlow's Condensed Statements of Operations | Year ended December 31, 2011 (Unaudited) | 2010 (Unaudited) |
|---|---|---|
| Revenue | $ 1,065,639 | $ 103,797 |
| Cost of goods sold | (444,663) | (88,336) |
| Operating expenses | (906,594) | (221,544) |
| Net loss | $ (285,618) | $ (206,083) |

***Supply Agreement***

The Company and NuGlow entered into a Supply Agreement dated as of July 1, 2010 and amended as of September 1, 2011, pursuant to which NuGlow agreed to purchase from the Company for resale certain of the Company's proprietary skincare products for beauty and cosmetic and over-the-counter uses. The term of the Supply Agreement continues until June 30, 2013 and automatically renews for successive one-year terms thereafter unless earlier terminated as provided therein.

**Note 7. Other Assets**

Other assets consisted of the following as of December 31, 2011 and 2010:

| | Year ended December 31, 2011 | 2010 |
|---|---|---|
| Deposits | $ 8,522 | $ 8,522 |
| Option to purchase interest in affiliated company (see Note 6) | 12,362 | 20,657 |
| Other assets | $ 20,884 | $ 29,179 |

**Note 8. Deferred Gross Profit, Affiliated Company**

Deferred gross profit from affiliated company consisted of the following as of December 31, 2011 and 2010:

| | Year ended December 31, 2011 | 2010 |
|---|---|---|
| Deferred revenue, affiliated company | $ 254,826 | $ 115,527 |
| Deferred cost of revenue, affiliated company | 119,984 | 65,048 |
| Deferred gross profit, affiliated company | $ 134,842 | $ 50,479 |

**Note 9. Fair Value of Financial Instruments**

The inputs used to measure fair value are summarized in the three broad levels listed below:

- Level 1 — Quoted prices in active markets for identical securities;
- Level 2 — Other significant observable inputs (including quoted prices in active markets for similar securities); and
- Level 3 — Significant unobservable inputs (including the Company's own assumptions in determining fair value of investments).

The following tables set forth by level, within the fair value hierarchy, financial assets and liabilities accounted for at fair value as of December 31, 2011 and 2010. As required by Accounting Standard Codification (ASC) 820-10, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

| | December 31, 2011 | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Money market funds | $ 1,484,101 | $ 1,484,101 | $ — | $ — |
| Option to purchase interest in affiliated company | 12,362 | — | — | 12,362 |

| | December 31, 2010 | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Money market funds | $ 3,680,348 | $ 3,680,348 | $ — | $ — |
| Option to purchase interest in affiliated company | 20,657 | — | — | 20,657 |

*Option to purchase interest in affiliated company.* The Company estimated the fair value of this asset to be $12,362 and $20,657 at December 31, 2011 and 2010, respectively, using the multiple of earnings method based on a number of factors and assumptions regarding the affiliated company's potential future revenue and projected earnings before interest, tax, depreciation and amortization (EBITDA). A decrease of $8,295 and an increase $3,199 in fair value was recorded in the statement of operations for the years ended December 31, 2011 and 2010, respectively.

*Financial Instruments.* The carrying amount of the Company's cash, accounts receivable, accounts payable, accrued compensation and benefits, and accrued expenses approximated their estimated fair values at December 31, 2011 and December 31, 2010 because of the short-term nature of these instruments.

***Preferred Stock***

The Company's board of directors (the Board) may authorize the issuance of preferred stock from time to time in one or more series and each series shall have such voting, redemption, liquidation and dividend rights as the Board may deem advisable. As of December 31, 2011, no preferred series shares had been designated by the Board.

***Stockholder Rights Agreement***

On August 15, 2003, the Board approved the adoption of a Stockholder Rights Agreement pursuant to which all of the Company's stockholders as of September 15, 2003 (the Record Date) received rights to purchase shares of a new series of preferred stock. The rights will be distributed as a non-taxable dividend and will expire ten years from the Record Date. The rights will be exercisable only if a person or group acquires 15 percent or more of the Company's common stock or announces a tender offer for 15 percent or more of the common stock. If a person acquires 15 percent or more of common stock, all rights holders, except the buyer, will be entitled to acquire the Company's common stock at a discount. The effect will be to discourage acquisitions of more than 15 percent of the Company's common stock without negotiations with the Board.

***Common Stock Purchase Warrants***

Information concerning outstanding common stock purchase warrants is set forth below:

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | | 2010 | | |
| | Number | Price range | Weighted Average | Number | Price range | Weighted Average |
| Warrants issued to employees and non-employees for services | 701,169 | $ 0.25 – $1.50 | $ 1.00 | 1,707,419 | $ 0.25 – $6.00 | $ 1.56 |
| Warrants issued in connection with 2001 convertible debt financing | 124,000 | $ 1.00 | $ 1.00 | 308,000 | $ 1.00 | $ 1.00 |
| Warrants issued in connection with 2002 and 2003 equity financings | 258,600 | $ 1.00 | $ 1.00 | 258,600 | $ 1.00 | $ 1.00 |
| Warrants issued in connection with 2006 equity financing | — | $ — | $ — | 109,800 | $ 1.00 | $ 1.00 |
| Warrants issued in connection with 2009 convertible debt financing | 142,500 | $ 1.00 | $ 1.00 | 142,500 | $ 1.00 | $ 1.00 |
| Total outstanding warrants | 1,226,269 | $ 0.25 – $1.50 | $ 1.00 | 2,526,319 | $ 0.25 – $6.00 | $ 1.38 |

During the year ended December 31, 2011, warrants to purchase an aggregate of 1,300,050 shares of the Company's common stock expired and were therefore cancelled.

On March 9, 2012, in connection with the establishment of a letter of credit (see Note 18), the Company issued to its largest stockholder and guarantor of the letter of credit a five-year fully vested warrant to purchase 2,000,000 shares of the Company's common stock at an exercise price of $0.25 per share.

**Note 10. Stock-Based Compensation**

***2011 Stock Option Plan***

On February 10, 2011, the Company's board of directors adopted, and on May 25, 2011, the Company's stockholders approved, the Helix BioMedix, Inc. 2011 Stock Option Plan (the 2011 Plan). The 2011 Plan provides for the grant of incentive stock options to employees and non-statutory stock options to employees, non-employee directors and consultants. The 2011 Plan is administered by the board of directors, which has the authority to select the individuals to whom awards are to be granted, the number of awards granted, and the vesting schedule. A total of 12,000,000 shares of common stock are reserved for issuance under the 2011 Plan. Options granted under the 2011 Plan to employees generally vest over a three-year period with 1/3 of the shares vesting after one year from the date of grant and 1/36 of the shares vesting monthly thereafter. Option awards to non-employee directors may vest fully upon grant or quarterly over one year. All option awards have a maximum term of ten years and exercise prices equal to the closing market price of the Company's common stock on the grant date.

***2000 Stock Option Plan***

In 2000, the Company's stockholders approved the Helix BioMedix 2000 Stock Option Plan (the 2000 Plan). The 2000 Plan provided for the granting of incentive stock options to employees and nonqualified stock options to employees, directors and consultants. Options granted under the 2000 Plan generally became exercisable over periods ranging from one to three years, had a maximum term of ten years and exercise prices equal to the closing market price of the Company's common stock on the grant date. Effective November 6, 2010, additional option awards under the 2000 Plan were discontinued. Remaining authorized shares under the 2000 Plan that were not subject to outstanding awards as of November 6, 2010 were then cancelled. The 2000 Plan will remain in effect as to any outstanding options granted prior to November 6, 2010.

***Stock Option Activities***

During the years ended December 31, 2011, 2010 and 2009, the Company granted options to purchase an aggregate of 407,000, 785,000 and 240,500 shares of common stock, respectively, with a weighted-average grant date fair value of $0.24, $0.28 and $0.32, respectively. Fair value for options granted was calculated using the Black-Scholes option pricing model with the following assumptions:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Risk-free interest rate | 0.90 – 2.17% | 1.41 – 2.77% | 1.89 – 2.78% |
| Expected dividend yield | 0 | 0 | 0 |
| Expected term in years | 5.0 – 6.0 | 5.0 – 6.0 | 5.5 – 6.0 |
| Expected volatility | 112 – 118% | 98 – 106% | 101 – 105% |

The risk free rate is based on the implied yield available on U.S. Treasury zero–coupon issues with a remaining term equal to the expected term of options issued. The Company does not anticipate declaring dividends in the foreseeable future. For the years ended December 31, 2011, 2010 and 2009, the Company calculated expected volatility based on the annualized daily historical volatility of the Company's stock price commensurate with the expected term of the option and other factors, including peer company data. The Company estimates the expected term as the average of the vesting period and the contractual term. The Company will continue to use this method of estimation until it has sufficient historical data to provide reasonable estimates of expected lives of stock options. The Company's stock price volatility and option term involves management's best estimates at that time, both of which impact the fair value of the option calculated under the Black-Scholes pricing model and, ultimately, the expense that will be recognized over the life of the option. The Company recognizes compensation expense for only the portion of options that is expected to vest. Therefore, the Company applies an estimated forfeiture rate that is derived from historical employee termination behavior. Forfeiture rates are revised in subsequent periods if actual forfeitures differ from those estimates.

The amount of stock-based compensation expense recognized for the years ended December 31, 2011, 2010 and 2009 related to stock options was approximately $149,500, $188,900 and $102,000, respectively. Stock-based compensation for 2011 included a total of approximately $89,000 of expenses related to the modifications of options held by the Company's Vice President and Chief Scientific Officer who left in February 2011 and three members of the board of directors who were not re-elected in May 2011.

As of December 31, 2011, the total unrecognized stock-based compensation related to non-vested stock options was approximately $87,000, which is expected to be recognized over a weighted-average period of approximately 2.0 years. A summary of the Company's stock-based compensation expense for 2011, 2010 and 2009 is summarized as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Research and development | $ 41,778 | $ 9,887 | $ 1,533 |
| Marketing and business development | 17,068 | 33,264 | 22,011 |
| General and administrative | 90,622 | 145,769 | 78,426 |
| Total stock-based compensation | $ 149,468 | $ 188,920 | $ 101,970 |

A summary of the Company's stock option activity for the years ended December 31, 2011, 2010 and 2009 is presented in the following table:

| | Shares Subject to Options | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding, December 31, 2008 | 3,305,194 | $ 1.17 | | |
| Granted | 240,500 | $ 0.40 | | |
| Exercised | — | — | | |
| Forfeited | — | — | | |
| Expired | (434,444) | $ 1.61 | | |
| Outstanding, December 31, 2009 | 3,111,250 | $ 1.04 | | |
| Granted | 785,000 | $ 0.35 | | |
| Exercised | — | $ — | | |
| Forfeited | — | $ — | | |
| Expired | (27,300) | $ 0.70 | | |
| Outstanding, December 31, 2010 | 3,868,950 | $ 0.91 | | |
| Granted | 407,000 | $ 0.28 | | |
| Exercised | — | $ — | | |
| Forfeited | (38,543) | $ 0.37 | | |
| Expired | (973,200) | $ 1.53 | | |
| Outstanding, December 31, 2011 | 3,264,207 | $ 0.65 | 4.28 | $ 10,200 |
| Exercisable, December 31, 2011 | 2,872,372 | $ 0.70 | 3.64 | $ 2,000 |

The aggregate intrinsic value in the table above is based on the Company's closing stock price of $0.25 per share on December 30, 2011 which would have been the closing price of shares received by the optionees had all of the options with exercise prices less than $0.25 per share been exercised on that date.

As of December 31, 2011, there were 12,000,000 shares of common stock reserved for issuance pursuant to the 2011 Plan, of which 11,593,000 shares remained available for grants. Additional information regarding options outstanding as of December 31, 2011 under the 2000 Plan and the 2011 Plan is as follows:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Shares | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| $0.15 - $0.40 | 1,273,957 | 6.42 | $ 0.33 | 882,122 | $ 0.34 |
| $0.49 - $0.76 | 815,000 | 4.43 | $ 0.58 | 815,000 | $ 0.58 |
| $0.77 - $0.85 | 245,000 | 4.36 | $ 0.82 | 245,000 | $ 0.82 |
| $1.00 - $1.80 | 930,250 | 1.20 | $ 1.11 | 930,250 | $ 1.11 |
| $0.15 - $1.80 | 3,264,207 | 4.28 | $ 0.65 | 2,872,372 | $ 0.70 |

## Note 11. Employee Savings Plan

The Company offers a 401(k) plan to all of its employees. Company matching contributions are determined in accordance with the provisions of the Company's contribution plan. During the years ended December 31, 2011, 2010 and 2009, employer-matching cash contributions totaled $30,562, $34,236 and $32,194, respectively.

## Note 12. Concentration of Risks

The Company maintains its cash balances in one financial institution, which at times may exceed federally insured limits. As of December 31, 2011, the Company maintained approximately $982,000 at a major financial institution in a money market account insured by the Securities Investor Protection Corporation up to $500,000 per account. The Company has not experienced any losses in such account.

A significant portion of the Company's revenue is concentrated with a limited number of customers. The following individual customers accounted for 10% or more of revenue for the years ended December 31, 2011, 2010 and 2009:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Customer A | 36% | 49% | 71% |
| Customer B | — | — | 10 |
| Customer C | 21 | 34 | — |
| Customer D | 25 | — | — |
| Customer E | 10 | — | — |

## Note 13. Income Taxes

Deferred income taxes reflect the net tax effects of (1) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, and (2) operating losses and tax credit carryforwards.

The tax effects of significant components comprising the Company's deferred taxes as of December 31, 2011 and 2010 were as follows:

| | As of December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Gross deferred tax assets (liabilities): | | |
| Net operating loss carryforwards | $ 11,560,200 | $ 10,879,800 |
| Stock compensation | 588,000 | 561,400 |
| Accrued expenses | 15,100 | 17,900 |
| Fixed and intangible assets | 49,300 | 45,900 |
| Deferred gross profit, related party | 45,800 | — |
| Other | 1,800 | 17,200 |
| Gross deferred tax assets | 12,260,200 | 11,522,200 |
| Less valuation allowance | (12,260,200) | (11,522,200) |
| Net deferred tax assets | — | — |
| Deferred tax liabilities | — | — |
| Net deferred tax assets/liabilities | $ — | $ — |

ASC 740 requires that the tax benefit of net operating losses, temporary differences and credit carryforwards be recorded as an asset to the extent that management assesses that realization is "more likely than not." Realization of the future tax benefits is dependent on the Company's ability to generate sufficient taxable income within the carryforward period. Because of the Company's history of operating losses, management believes that recognition of the deferred tax assets arising from the above-mentioned future tax benefits is currently not likely to be realized and, accordingly, has provided a full valuation allowance at December 31, 2011 and 2010 for financial reporting purposes. The Company's valuation allowance for deferred tax assets increased by $738,000, $1,360,600 and $1,029,400 during the years ended December 31, 2011, 2010 and 2009, respectively. The increases in the deferred tax assets in 2011, 2010 and 2009 were primarily the result of increasing net operating loss carryforwards during those years.

The Company has unrecognized research and development tax credits totaling approximately $70,300 and $77,600 as of December 31, 2011 and 2010, respectively, as these deferred tax assets did not meet the "more likely than not" recognition threshold. The change in unrecognized tax benefits during 2011 and 2010 was due to unrecognized research and development tax credits expiring unutilized. During 2011, 2010 and 2009, there was no interest or penalty recognized.

At December 31, 2011, the Company had gross unrecognized tax benefits of $1,364,600. The increase in unrecognized tax benefits during 2011 was due to the Company unrecognizing net operating losses related to the debt conversion inducement expense as this deferred tax asset did not meet the "more likely than not" recognition threshold. The decrease in unrecognized tax benefits during 2011, 2010, and 2009 was due to unrecognized research and development tax credits expiring unutilized. The accrued interest and penalties on unrecognized tax benefits were $0 at December 31, 2011, 2010, and 2009.

The total amount of unrecognized tax benefits that would, if recognized, affect the effective tax rate is $1,364,600, of which $5,300 will decrease within 12 months due to research and development tax credits expiring unused.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | |
|---|---|
| Balance at January 1, 2011 | $ 77,600 |
| Addition based on tax positions taken during a prior period | 1,294,300 |
| Reductions based on tax positions taken during a prior period | (7,300) |
| Balance at December 31, 2011 | $ 1,364,600 |

The Company's operating losses and tax credit carryforwards as of December 31, 2011 are as follows:

| | Amount | Expiration Years |
|---|---|---|
| Net operating losses, federal | $ 37,782,400 | 2012-2031 |
| Net operating losses, state | 147,200 | 2030-2031 |
| Tax credits, federal | 70,300 | 2012-2021 |

The Company's ability to utilize the carryforwards may be limited in the event of an ownership change as defined in current income tax regulations.

The effective tax rate of the Company's provision (benefit) for income taxes differs from the federal statutory rate as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Statutory rate | 34.00% | 34.00% | 34.00% |
| State tax | 0.35% | — | — |
| Net operating loss carryforward adjustments | — | — | (1.46)% |
| Change in valuation allowance | (29.66)% | (17.65)% | (27.27)% |
| Permanent items | (0.56)% | (0.30)% | (0.30)% |
| True up of debt conversion expense | — | (16.79)% | — |
| True up of original issued discount related to convertible notes payable | — | — | (3.23)% |
| Other | (4.13)% | 0.74% | (1.74)% |
| Total | 0.00% | 0.00% | 0.00% |

The Company files income tax returns in the U.S. All of the Company's tax returns for years with unexpired net operating loss carryforwards may be subject to examination in the event that the Company utilizes the net operating losses from those years in its future tax returns.

**Note 14. Other Related Party Transactions**

In April 2007, the Company entered into a License Agreement (the License Agreement) with DermaVentures, LLC in which the Company owned a 25% membership interest pursuant to the Operating Agreement of DermaVentures, LLC dated as of January 31, 2007 (the Operating Agreement). Pursuant to the License Agreement, the Company granted to DermaVentures a non-exclusive license to formulate certain of the Company's proprietary peptides into cosmetics and over-the-counter products to be sold in North and Central America and DermaVentures agreed to pay the Company royalties on its sales of peptide-containing products.

At the same time, the Company entered into a Management Services Agreement (the Services Agreement) with DermaVentures and RMS, a member and the sole manager of DermaVentures. Pursuant to the Services Agreement, the Company agreed to provide certain management services to DermaVentures in exchange for a fee of $400,000 payable as a cash distribution to the Company after $1.2 million in cash had been distributed to RMS.

The Company's membership interest in DermaVentures was accounted for using the equity method because the Company was not the primary beneficiary. The Company contributed no capital to DermaVentures. There were no earnings recognized by the Company related to its membership interest in DermaVentures because DermaVentures incurred a net loss and the Company was not required to fund DermaVentures' losses. The carrying value of the Company's membership interest in DermaVentures was zero at inception and at September 18, 2009 and December 31, 2008. The Company's exposure to loss as a result of its involvement with DermaVentures was limited to the cost of the services the Company was required to provide under the Services Agreement.

In September 2009, the Company entered into an amendment to the Operating Agreement, License Agreement and Services Agreement pursuant to which the Company agreed to, among other things, mutually terminate the Services Agreement effective as of September 21, 2009, after which the Company had no further management responsibilities or obligations related to DermaVentures or its business.

For the year ended December 31, 2009, the Company received approximately $20,000 of administrative services revenue from DermaVentures for marketing services associated with DermaVentures' product line and other out-of-pocket expenses the Company incurred on DermaVentures' behalf. Administrative services revenue was invoiced to DermaVentures at or near cost and therefore has no material effect on the Company's net loss.

**Note 15. Commitments and Contingencies**

***Leases***

In July 2009, the Company renewed the operating lease for its office and laboratory space in Bothell, Washington. The renewed lease, which has a term of five years and seven months beginning on December 1, 2009, provides for seven months of free rent at a monthly base rent equal to $6,210 and includes scheduled rent increases over the lease term. The Company accounts for free rent periods and scheduled rent increases on a straight-line basis over the term of the lease. Rent expense including operating costs for the years ended December 31, 2011, 2010 and 2009 was $102,237, $101,395 and $108,729, respectively. The future minimum payment under the existing lease from January 2012 through June 2015 is approximately $288,000.

## Note 16. License Agreements

The Company entered into a License Agreement with the University of British Columbia (UBC) commencing October 1, 2001, whereby UBC granted the Company an exclusive, worldwide license to use and sublicense certain defined "Technology" and any improvements within a specified field of use and including the right to manufacture, distribute and sell products utilizing the Technology. The agreement terminates on October 1, 2021 or upon the expiration of the last patent applied for and obtained pursuant to certain provisions of the agreement, unless terminated earlier as provided in the agreement. According to its terms, the agreement terminates automatically if a bankruptcy proceeding is brought by or against the Company, and terminates at UBC's option upon certain events, including the Company's insolvency or cessation of business, a delinquency of more than 60 days in payments due from the Company under the agreement, and the Company's breach of certain provisions relating to insurance requirements, use by the Company of UBC trademarks, and marketing obligations. In addition, either party may terminate the agreement on notice after the opportunity to cure if the other party defaults under the agreement. The Technology licensed under the agreement consists primarily of three U.S. patents for antimicrobial peptides (as set forth in the table under "Intellectual Property Rights" below) and related methods of use. The license may be sublicensed to the Company's affiliates. Pursuant to the terms of the agreement, the Company issued to UBC or its assigns 97,500 shares of the Company's common stock and options to purchase up to 152,500 shares of the Company's common stock at $1.50 per share. The options were fully vested upon grant and have all expired as of October 1, 2011. Additionally, the Company agreed to pay UBC a royalty of 3.5% of revenue generated from the Technology and any improvements related thereto. The Company is also required to pay UBC minimum annual royalties and to reimburse UBC for all further costs incurred with respect to the licensed patents, including maintenance fees. The Company paid UBC $67,450, $47,870 and $44,574 in 2011, 2010 and 2009, respectively, for minimum royalties and reimbursements for patent-related expenses.

On August 16, 2007, the Company entered into a License Agreement with Goldschmidt GmbH, a wholly owned subsidiary of Evonik GmbH, which has subsequently been amended. Pursuant to the agreement, the Company granted to Evonik an exclusive license under certain of the Company's patent applications and related rights and technology to, among other things, make and sell formulations for use as ingredients in final products in the cosmetic and non-prescription-drug fields of use. The term of the agreement extends until the expiration of the last-to-expire patent issued under the licensed patent rights, subject to certain termination rights of each party. Either party may terminate the agreement if the other party materially breaches a material provision of the agreement and fails to cure the breach within the specified notice period. In addition, either party may terminate the agreement if, for any consecutive three-year period after 2010, earned running royalties fall short of certain agreed minimum amounts. In consideration for the license, Evonik agreed to make specified upfront payments (subject to certain conditions) and to pay license fees quarterly on its sales of formulations under the agreement.

On September 12, 2007, the Company entered into a First Amended and Restated License Agreement with Grant Industries, Inc., which amended and restated the Non-Exclusive License Agreement between the parties dated December 12, 2006, and which has subsequently been amended. As amended to date, the term of the license agreement will expire on December 31, 2014 subject to certain termination rights of each party. Either party may terminate the agreement if the other party ceases its business or upon certain events relating to bankruptcy, or if the other materially breaches a provision of the agreement and fails to cure the breach within the specified notice period. The Company may terminate the license or remove a peptide from the scope of the license if Grant Industries fails to meet certain minimum royalty obligations. The license permits Grant Industries to formulate certain of the Company proprietary peptides into premix products and to market and sell those premix products for use in final products in the cosmetic and over-the-counter personal care market, subject to payment of royalties on its sales of premix and certain minimum royalty obligations. The license grants exclusive rights with respect to six of the Company's peptides.

## Note 17. Condensed Quarterly Financial Data (unaudited)

| | Three Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | March 31, 2011 | June 30, 2011 | September 30, 2011 | December 31, 2011 | March 31, 2010 | June 30, 2010 | September 30, 2010 | December 31, 2010 |
| Net revenue | $ 357,628 | $ 693,103 | $ 394,707 | $ 445,900 | $ 69,718 | $ 330,398 | $ 93,680 | $ 357,887 |
| Gross profit | 236,801 | 340,410 | 266,912 | 313,908 | 45,229 | 205,653 | 64,643 | 275,664 |
| Operating expenses | 963,446 | 881,997 | 858,003 | 858,908 | 804,344 | 930,518 | 956,674 | 855,809 |
| Loss from operations | (726,645) | (541,587) | (591,091) | (545,000) | (759,115) | (724,865) | (892,031) | (580,145) |
| Other expense, net | 16,911 | (83,288) | (14,526) | (3,350) | (167,934) | (217,622) | (227,158) | (4,141,932) |
| Net loss | $ (709,734) | $ (624,875) | $ (605,617) | $ (548,350) | $ (927,049) | $ (942,487) | $ (1,119,189) | $ (4,722,077) |
| Basic and diluted net loss per share | $ (0.01) | $ (0.01) | $ (0.01) | $ (0.01) | $ (0.04) | $ (0.04) | $ (0.04) | $ (0.15) |
| Weighted average shares outstanding | 49,720,255 | 49,720,255 | 49,720,255 | 49,720,255 | 25,653,512 | 25,653,512 | 25,653,512 | 31,488,144 |

**Note 18. Subsequent Events**

***NuGlow Operating Agreement***

On March 6, 2012, the Company entered into a Second Amendment to the Amended and Restated Operating Agreement of NuGlow Cosmaceuticals, LLC (NuGlow), pursuant to which the Company consented to certain monthly payments by NuGlow in consideration for which the Company's option to purchase the remaining interest of NuGlow was extended from July 1, 2015 to July 1, 2017.

***Letter of Credit***

On March 9, 2012, the Company entered into an LOC Agreement with Frank T. Nickell, who beneficially owns approximately 40% of the Company's outstanding common stock, pursuant to which Mr. Nickell established an irrevocable standby letter of credit by JPMorgan Chase Bank, N.A. (JPMorgan) in favor of the Company in the principal amount of $2.0 million (LOC). The LOC expires on July 1, 2013 but automatically renews until July 1, 2014 unless terminated by JPMorgan at least 14 days prior to the end of the current term, at which time the Company may draw up to the balance remaining on the LOC. Amounts outstanding under the LOC accrue interest at the rate of 0.75% per annum and are due and payable on or before July 1, 2014.

Pursuant to the LOC Agreement, the Company agreed to use commercially reasonable efforts to consummate an equity financing prior to the termination date of the LOC in which it would sell and issue shares of its common stock at a price per share of at least $0.60 for aggregate proceeds of at least $3.0 million, upon consummation of which all amounts outstanding under the LOC shall be immediately repaid. In addition, the Company issued to Mr. Nickell a five-year fully vested warrant to purchase 2,000,000 shares of the Company's common stock at an exercise price of $0.25 per share and agreed to reimburse Mr. Nickell for his reasonable expenses in connection with the LOC, including, without limitation, any interest accrued and payable by Mr. Nickell in connection with the LOC.

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

None.

## ITEM 9A. *CONTROLS AND PROCEDURES*

### Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that the information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Acting Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our senior management, including our Chief Executive Officer and Acting Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Acting Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings.

### Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining effective internal control over financial reporting. Internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, is a process designed by, or under the supervision of, our Chief Executive Officer and Acting Chief Financial Officer, or persons performing similar functions, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our management, with the participation of our Chief Executive Officer and Acting Chief Financial Officer, has established and maintained policies and procedures designed to maintain the effectiveness of our internal control over financial reporting, and include those policies and procedures that:

1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;

2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Management has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2011 based on the control criteria established in a report entitled *Internal Control — Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on its assessment and those criteria, our management has concluded that our internal control over financial reporting is effective as of December 31, 2011.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all errors or misstatements and all fraud. Therefore, even those systems determined to be effective can provide only reasonable, not absolute, assurance that the objectives of the policies and procedures are met. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the fourth quarter of 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## ITEM 9B. *OTHER INFORMATION*

None.

## PART III

### ITEM 10. *DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE*

Certain information required by this item is incorporated by reference to the section captioned "Proposal No. 1 — Election of Directors" of the Proxy Statement for our 2012 Annual Meeting of Stockholders.

The remaining information required by this item is set forth in Part I of this Annual Report under Item 1, "Business — Executive Officers."

### ITEM 11. *EXECUTIVE COMPENSATION*

The information required by this item is incorporated by reference to the sections captioned "Compensation of Executive Officers" and "Proposal No. 1 — Election of Directors" of the Proxy Statement for our 2012 Annual Meeting of Stockholders.

### ITEM 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

Certain information required by this item is incorporated by reference to the section captioned "Security Ownership of Certain Beneficial Owners and Management" of the Proxy Statement for our 2012 Annual Meeting of Stockholders.

**Securities Authorized For Issuance Under Equity Compensation Plans**

The following table summarizes our equity compensation plans, including individual compensation arrangements, under which equity securities are authorized for issuance as of December 31, 2011:

**Equity Compensation Plan Information**

| Plan Category | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 3,264,207 | $ 0.65 | 11,593,000 |
| Equity compensation plans not approved by security holders(1) | 1,226,269 | $ 1.00 | — |
| Total | 4,490,476 | $ 0.75 | 11,593,000 |

(1) Consists of warrants to purchase common stock issued to certain employees and consultants in connection with services rendered and to certain shareholders in connection with financing activities.

### ITEM 13. *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE*

The information required by this Item is incorporated by reference to the information contained in the sections captioned "Certain Relationships and Related Transactions" and "Proposal No. 1 — Election of Directors" of the Proxy Statement for our 2012 Annual Meeting of Stockholders.

### ITEM 14. *PRINCIPAL ACCOUNTING FEES AND SERVICES*

The information required by this item is incorporated by reference to the section captioned "Proposal No. 2 — Ratify Appointment of Independent Registered Public Accounting Firm" of the Proxy Statement for our 2012 Annual Meeting of Stockholders.

## ITEM 15. *EXHIBITS, FINANCIAL STATEMENT SCHEDULES*

(a). Financial Statements and Schedules. The financial statements are set forth under Item 8 of this Annual Report on Form 10-K, as indexed thereunder. Financial statement schedules have been omitted since they are not required, not applicable, or the information is otherwise included.

(b). Exhibits.

| | | | Incorporated by Reference | | | |
|---|---|---|---|---|---|---|
| Exhibit Number | Exhibit Description | Filed Herewith | Form | Period Ending | Exhibit | Filing Date |
| 2.1 | Proposal for Approval of Reincorporation of Helix BioMedix, Inc., a Colorado corporation, from Colorado to Delaware | | 10-KSB | 12/31/00 | 2 | 4/16/01 |
| 3.1 | Certificate of Ownership and Merger of Helix BioMedix, Inc. a Delaware corporation and Helix BioMedix, Inc., a Louisiana corporation | | 10-KSB/A | 12/31/02 | 3.1 | 4/30/03 |
| 3.2 | Certificate of Incorporation of Helix BioMedix, Inc. | | 10-KSB/A | 12/31/00 | 3-A | 5/18/01 |
| 3.3 | Certificate of Amendment to the Certificate of Incorporation of Helix BioMedix, Inc. | | 10-KSB/A | 12/31/02 | 3.3 | 4/30/03 |
| 3.4 | Bylaws of Helix BioMedix, Inc. | | 10-KSB/A | 12/31/00 | 3-B | 5/18/01 |
| 4.1 | Rights Agreement dated August 21, 2003 | | 10-KSB | 12/31/03 | 10.27 | 3/26/04 |
| 4.2 | Acceptance and Acknowledgement of Appointment dated January 4, 2004 | | 10-KSB | 12/31/03 | 10.28 | 3/26/04 |
| 10.1† | Helix BioMedix, Inc. Amended and Restated 2000 Stock Option Plan | | 10-KSB/A | 12/31/02 | 10.5 | 4/30/03 |
| 10.1(a)† | Form of Helix BioMedix, Inc. Stock Option Agreement for Purchase of Stock (2000 Stock Option Plan) | | 10-KSB/A | 12/31/02 | Annex A to 10.5 | 4/30/03 |
| 10.1(b)† | Helix BioMedix, Inc. 2011 Stock Option Plan | | 10-K | 12/31/10 | 10.1(b) | 3/24/11 |
| 10.1(c)† | Form of Helix BioMedix, Inc. Incentive Stock Option Agreement (2011 Stock Option Plan) | | 10-K | 12/31/10 | 10.1(c) | 3/24/11 |
| 10.1(d)† | Form of Helix BioMedix, Inc. Nonqualified Stock Option Agreement (2011 Stock Option Plan) | | 10-K | 12/31/10 | 10.1(d) | 3/24/11 |
| 10.2† | Employment Agreement dated September 24, 2003, effective July 1, 2003, between the Company and R. Stephen Beatty | | 10-KSB | 12/31/03 | 10.9 | 3/26/04 |
| 10.2(a)† | Amendment to Employment Agreement dated December 10, 2003 between the Company and R. Stephen Beatty | | 10-KSB | 12/31/03 | 10.13 | 3/26/04 |
| 10.2(b)† | Second Amendment to Employment Agreement dated effective as of June 30, 2006 between the Company and R. Stephen Beatty | | 10-QSB | 9/30/06 | 10.9(a) | 11/9/06 |
| 10.2(c)† | Third Amendment to Employment Agreement dated effective as of June 15, 2007 between the Company and R. Stephen Beatty | | 10-QSB | 9/30/07 | 10.9(b) | 11/8/07 |
| 10.3† | Employment Letter Agreement dated October 8, 2007 between the Company and Robin L. Carmichael | | 10-QSB | 9/30/07 | 10.28 | 11/8/07 |
| 10.3(a)† | First Amendment to Employment Letter Agreement dated effective as of November 15, 2007 between the Company and Robin L. Carmichael | | 10-K | 12/31/07 | 10.5(a) | 3/21/08 |
| 10.3(b)† | Second Amendment to Employment Letter Agreement dated effective as of June 30, 2008 between the Company and Robin L. Carmichael | | 10-Q | 6/30/08 | 10.5(b) | 7/30/08 |
| 10.4 | Lease between the Company and Teachers Insurance & Annuity Association of America, Inc. dated August 14, 2001 | | 10-KSB | 12/31/01 | 10.11 | 4/1/02 |
| 10.4(a) | First Amendment to Lease between the Company and Teachers Insurance and Annuity Association of America, Inc. dated December 6, 2005 | | 10-KSB | 12/31/05 | 10.17(a) | 3/27/06 |
| 10.4(b) | Second Amendment to Lease between the Company and Teachers Insurance and Annuity Association of America, Inc. dated October 4, 2006 | | 10-KSB | 12/31/06 | 10.17(b) | 3/26/07 |

| Exhibit Number | Exhibit Description | Filed Herewith | Incorporated by Reference | | | |
|---|---|---|---|---|---|---|
| | | | Form | Period Ending | Exhibit | Filing Date |
| 10.4(c) | Third Amendment to Lease entered into on July 29, 2009 between the Company and Teachers Insurance and Annuity Association of America, Inc. | | 10-Q | 9/30/09 | 10.10(c) | 11/5/09 |
| 10.5 | University of British Columbia License Agreement dated October 1, 2001 | | 10-KSB | 12/31/01 | 10.5 | 4/1/02 |
| 10.6* | License Agreement dated August 16, 2007 between the Company and Goldschmidt GmbH | | 10-QSB | 9/30/07 | 10.27 | 11/8/07 |
| 10.6(a) | First Amendment to License Agreement dated as of December 10, 2010 between the Company and Goldschmidt GmbH | | 10-K | 12/31/10 | 10.11(a) | 3/24/11 |
| 10.6(b)* | Second Amendment to License Agreement dated as of January 27, 2011 between the Company and Goldschmidt GmbH | | 10-Q | 3/31/11 | 10.11(b) | 5/5/11 |
| 10.7* | License Agreement dated August 27, 2008 between the Company and Rodan & Fields, LLC | | 10-Q | 9/30/08 | 10.18 | 11/5/08 |
| 10.7(a) | First Amendment to License Agreement dated February 25, 2009 between the Company and Rodan & Fields, LLC | | 10-Q | 3/31/09 | 10.18(a) | 5/7/09 |
| 10.7(b) | Second Amendment to License Agreement dated as of August 25, 2011 between the Company and Rodan & Fields, LLC | | 10-Q | 9/30/11 | 10.12(b) | 11/3/11 |
| 10.8* | Manufacturing and Supply Agreement dated as of January 9, 2008 between the Company and Peptisyntha, Inc. | | 10-Q | 3/31/08 | 10.16 | 5/15/08 |
| 10.9* | International Distribution Agreement dated as of March 3, 2010 between the Company and RubyDerm Bio Inc. | | 10-Q | 3/31/10 | 10.17 | 5/6/10 |
| 10.9(a)* | International Distribution Agreement dated as of December 16, 2010 between the Company and Dermopia Inc. | | 10-K | 12/31/10 | 10.17(a) | 3/24/11 |
| 10.10 | Membership Interest Agreement dated as of July 1, 2010 among the Company, Camden Street Partners, LLC, NuGlow Cosmaceuticals, LLC and Steven Sheiner | | 10-Q | 6/30/10 | 10.18 | 8/5/10 |
| 10.11* | Amended and Restated Operating Agreement of NuGlow Cosmaceuticals, LLC dated as of July 1, 2010 among the Company, Camden Street Partners, LLC and NuGlow Cosmaceuticals, LLC | | 10-Q | 6/30/10 | 10.19 | 8/5/10 |
| 10.11(a) | First Amendment dated September 1, 2011 to Amended and Restated Operating Agreement of NuGlow Cosmaceuticals, LLC and Supply Agreement among the Company, NuGlow Cosmaceuticals, LLC and Camden Street Partners, LLC | | 10-Q | 9/30/11 | 10.19(a) | 11/3/11 |
| 10.12* | Supply Agreement dated as of July 1, 2010 between the Company and NuGlow Cosmaceuticals, LLC | | 10-Q | 6/30/10 | 10.20 | 8/5/10 |
| 23.1 | Consent of KPMG LLP | X | | | | |
| 31.1 | Certification of the Company's Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 | X | | | | |
| 31.2 | Certification of the Company's Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 | X | | | | |
| 32.1 | Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350 | X | | | | |
| 32.2 | Certification of the Company's Chief Financial Officer pursuant to 18 U.S.C. Section 1350 | X | | | | |
| 101.INS | XBRL Instance Document | X | | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Document | X | | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | X | | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | X | | | | |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | X | | | | |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | X | | | | |

† Indicates a management contract or compensatory plan or arrangement.

* Pursuant to a request for confidential treatment, portions of this Exhibit have been redacted from the publicly-filed document and have been furnished separately to the Securities and Exchange Commission as required by Rule 24b-2 under the Securities Exchange Act of 1934, as amended.

## SIGNATURES

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

HELIX BIOMEDIX, INC.
(Registrant)

By: /s/ R. Stephen Beatty

R. Stephen Beatty
*President, Chief Executive Officer and Acting Chief Financial Officer (principal executive officer, principal financial officer and principal accounting officer)*

Date: March 27, 2012

## POWER OF ATTORNEY

Each person whose signature appears below hereby constitutes and appoints R. Stephen Beatty his or her true and lawful attorney-in-fact and agent, with full power to act, and with full power of substitution and resubstitution, to execute in his or her name and on his or her behalf, individually and in each capacity stated below, any and all amendments and supplements to this Annual Report, and any and all other instruments necessary or incidental in connection herewith, and to file the same with the Securities and Exchange Commission.

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

| Signature | Title | Date |
|---|---|---|
| /s/ R. STEPHEN BEATTY<br>R. Stephen Beatty | President, Chief Executive Officer,<br>Acting Chief Financial Officer and Director | March 27, 2012 |
| /s/ RANDALL L-W. CAUDILL, PH.D.<br>Randall L-W. Caudill, Ph.D. | Director | March 27, 2012 |
| /s/ JOHN F. CLIFFORD<br>John F. Clifford | Director | March 27, 2012 |
| /s/ RICHARD M. COHEN<br>Richard M. Cohen | Director | March 27, 2012 |
| /s/ LAWRENCE BLAKE JONES<br>Lawrence Blake Jones | Director | March 27, 2012 |
| /s/ JEFFREY A. MILLER, PH.D.<br>Jeffrey A. Miller, Ph.D. | Director | March 27, 2012 |
| /s/ BARRY L. SEIDMAN<br>Barry L. Seidman | Director | March 27, 2012 |

**Supplemental Information to be Furnished With Reports Filed Pursuant to Section 15(d) of the Act by Registrants Which Have Not Registered Securities Pursuant to Section 12 of the Act**

No annual report, proxy statement, form of proxy or other proxy soliciting material covering the registrant's last fiscal year has been sent to security holders of the registrant. The registrant's annual report and proxy soliciting material will be furnished to security holders in connection with the registrant's 2012 annual meeting of stockholders, and such material will be furnished to the Securities and Exchange Commission when it is sent to security holders.

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## Corporate Information

### Board of Directors

**R. Stephen Beatty**
President, Chief Executive Officer & Acting Chief Financial Officer, Helix BioMedix, Inc.

**Randall L-W. Caudill, D.Phil.**
President, Dunsford Hill Capital Partners, Inc.; Director, Ramgen Power Systems, Inc. Former: Managing Director of Prudential Securities M&A; Co-Head of Prudential Investment Bank; Executive Director & Co-head of M&A, Morgan Grenfell, Inc.

**John F. Clifford**
Former: President & CEO, ProCyte Corporation; and President, Orthofix, Inc. U.S.

**Richard M. Cohen, CPA**
President, Richard M. Cohen Consultants, Inc.; Director, Rodman & Renshaw Capital Group, Inc; and Director and Interim Chairman, CorMedix, Inc.

**Lawrence Blake Jones, J.D.**
Managing Partner, Scheuermann & Jones, LLC; Director, First NBC Bank, First Commerce Bank and St. Jude's Ranch for Children

**Jeffrey A. Miller, Ph.D**
President & CEO, Capital Markets Research, Inc., Gas -Lock Advisors LLC and NewArc Investments; Director, Think-a-Move Ltd. Consultant to early stage companies; and contributing writer for various investment and business websites

**Barry L. Seidman**
Director, Performance, Inc. and Think-a-Move Ltd. Former: Chairman, Pax Holding Corporation; President & COO, First Options of Chicago; and Partner, Spears, Leeds & Kellogg

### Management Team

**R. Stephen Beatty**
President, Chief Executive Officer & Acting Chief Financial Officer

**Robin L. Carmichael**
Vice President & Chief Operating Officer

### Company Headquarters

Helix BioMedix, Inc.
22118 20th Ave. SE, Suite 204, Bothell, WA 98021 USA
Phone: 425-402-8400 Fax: 425-806-2999
www.helixbiomedix.com

### Legal Counsel

Summit Law Group, PLLC
315 Fifth Ave. South, Suite 1000, Seattle, WA 98104 USA

### Independent Registered Public Accountant Firm

KPMG LLP
801 Second Ave., Suite 900, Seattle, WA 98104 USA

### Transfer Agent

American Stock Transfer & Trust Company, LLC
US postal mail address:
59 Maiden Lane, Plaza Level, New York, NY 10038
Overnight/express delivery:
6201 15th Avenue, Brooklyn, NY 11219
Toll free: 800-937-5449 • Phone: 718-921-8124

### Annual Meeting

8:00 a.m. Pacific Time on May 23, 2012
Hilton Garden Inn, 22600 Bothell-Everett Hwy
Bothell, WA 98021

### Investor Relations

Stock Symbol: HXBM quoted on the OTCQB
The investing public, securities analysts and shareholders seeking information about our company should visit the Investor Information section of our corporate website at www.helixbiomedix.com, or contact Matt Kreps of Shelton Group at: 972-239-5119 x125.

### Forward-Looking Statements

This Annual Report contains forward-looking statements regarding Helix BioMedix, Inc. (statements which are not historical facts) within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements regarding activities, events or developments that Helix BioMedix, Inc. expects, believes or anticipates may occur in the future, including statements related to its potential growth, product development and commercialization and revenue. A number of factors could cause actual results to differ from those indicated in the forward-looking statements, including the company's ability to successfully raise additional capital, continue its research and development efforts, including pre-clinical and clinical studies, continue developing marketable peptide-based products and general economic conditions. Additional assumptions, risks and uncertainties are described in detail in the company's reports and other filings with the Securities and Exchange Commission. Such filings are available on the Helix BioMedix, Inc. website or at www.sec.gov. Readers are cautioned that such forward-looking statements are not guarantees of future performance and that actual results or developments may differ materially from those set forth in the forward-looking statements. Helix BioMedix, Inc. undertakes no obligation to publicly update or revise forward-looking statements to reflect subsequent events or circumstances.

HELIX BIOMEDIX

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