

NORTHFIELD LABORATORIES INC /DE/

Form 10-Q

January 09, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED November 30, 2007  
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER 0-24050  
NORTHFIELD LABORATORIES INC.  
(Exact name of registrant as specified in its charter)**

DELAWARE  
(State or other jurisdiction  
of incorporation or organization)

36-3378733  
(I.R.S. Employer  
Identification Number)

1560 SHERMAN AVENUE, SUITE 1000,  
EVANSTON,  
ILLINOIS

60201-4800  
(Zip Code)

(Address of principal executive offices)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (847) 864-3500

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 is a large accelerated filer, an accelerated filer or a non-accelerated filer.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 under the Exchange Act) Yes  No

As of November 30, 2007, Registrant had 26,958,516 shares of common stock outstanding.

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**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

This Quarterly Report contains forward-looking statements concerning, among other things, our prospects, clinical and regulatory developments affecting our potential product and our business strategies. These forward-looking statements are identified by the use of such terms as intends, expects, plans, estimates, anticipates, forecasts, believes and similar terms.

These forward-looking statements involve risks and uncertainties. Actual results may differ materially from those predicted by the forward-looking statements because of various factors and possible events, including those discussed under Risk Factors in our Annual Report on Form 10-K for our fiscal year ended May 31, 2007 which is filed with the Securities and Exchange Commission, and those matters discussed under Legal Proceedings in this Quarterly Report. Because these forward-looking statements involve risks and uncertainties, actual results may differ significantly from those predicted in these forward-looking statements. You should not place undue weight on these statements. These statements speak only as of the date of this document or, in the case of any document incorporated by reference, the date of that document.

All subsequent written and oral forward-looking statements attributable to Northfield or any person acting on our behalf are qualified by the cautionary statements in this section and in our Annual Report. We will have no obligation to revise these forward-looking statements.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

Northfield Laboratories Inc.:

We have reviewed the balance sheet of Northfield Laboratories Inc. (a company in the development stage) as of November 30, 2007, the related statements of operations for the three-month periods ended November 30, 2007 and November 30, 2006, and the related statements of operations and cash flows for the six-month periods ended November 30, 2007 and November 30, 2006 and for the period from June 19, 1985 (inception) through November 30, 2007. We have also reviewed the statements of shareholders' equity (deficit) for the six-month period ended November 30, 2007 and for the period from June 19, 1985 (inception) through November 30, 2007. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheet of Northfield Laboratories Inc. as of May 31, 2007, and the related statements of operations, shareholders' equity (deficit), and cash flows for the year then ended and for the period from June 19, 1985 (inception) through May 31, 2007 (not presented herein); and in our report dated August 14, 2007, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying balance sheet as of May 31, 2007 and in the accompanying statements of operations, cash flows and shareholders' equity (deficit) for the period from June 19, 1985 (inception) through May 31, 2007 is fairly stated, in all material respects, in relation to the statements from which it has been derived.

(signed) KPMG LLP

Chicago, IL

January 9, 2008

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(a company in the development stage)

Balance Sheets

November 30, 2007 and May 31, 2007

|  | <b>November 30,<br/>2007</b> | <b>May 31,<br/>2007</b> |
|--|------------------------------|-------------------------|
|  | (unaudited)                  |                         |
| <b>Assets</b>  |                              |                         |
| Current assets:  |                              |                         |
| Cash and cash equivalents  | \$ 19,510,843                | 23,224,026              |
| Restricted cash  | 1,685,222                    | 529,752                 |
| Marketable securities  | 10,188,484                   | 16,934,204              |
| Prepaid expenses   | 603,455                      | 673,192                 |
| Other current assets   | 64,838                       | 212,854                 |
| Total current assets   | 32,052,842                   | 41,574,028              |
| Property, plant, and equipment   | 19,801,473                   | 19,588,246              |
| Accumulated depreciation   | (11,388,034)                 | (11,063,080)            |
| Net property, plant, and equipment   | 8,413,439                    | 8,525,166               |
| Other assets   | 19,550                       | 19,550                  |
|  | \$ 40,485,831                | 50,118,744              |
| <b>Liabilities and Shareholders Equity</b>   |                              |                         |
| Current liabilities:   |                              |                         |
| Accounts payable   | \$ 1,313,130                 | 3,573,025               |
| Accrued expenses   | 122,891                      | 101,118                 |
| Accrued compensation and benefits  | 660,929                      | 565,709                 |
| Government grant liability   | 1,685,222                    | 529,752                 |
| Total current liabilities  | 3,782,172                    | 4,769,604               |
| Other liabilities  | 11,897                       | 7,431                   |
| Total liabilities  | 3,794,069                    | 4,777,035               |
| Shareholders equity:   |                              |                         |
| Preferred stock, \$.01 par value. Authorized 5,000,000 shares; none issued and outstanding   |                              |                         |
| Common stock, \$.01 par value. Authorized 60,000,000 shares; issued 26,960,233 at November 30, 2007 and 26,916,541 at May 31, 2007 | 269,602                      | 269,165                 |
| Additional paid-in capital   | 246,081,324                  | 244,905,543             |
| Deficit accumulated during the development stage   | (209,633,771)                | (199,807,606)           |

|  |               |            |
|--|---------------|------------|
|  | 36,717,155    | 45,367,102 |
| Less cost of common shares in treasury; 1,717 shares and 1,717 shares,<br>respectively | (25,393)      | (25,393)   |
| Total shareholders' equity   | 36,691,762    | 45,341,709 |
|  | \$ 40,485,831 | 50,118,744 |

See accompanying notes to financial statements and accountants' review report.

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(a company in the development stage)

## Statement of Operations

Three and six months ended November 30, 2007 and November 30, 2006 and for the period from June 19, 1985 (inception) through November 30, 2007

|   | <b>Three months ended<br/>November 30,</b> |             | <b>Six months ended<br/>November 30,</b> |              | <b>Cumulative<br/>from<br/>June 19, 1985<br/><br/>through<br/>November 30,<br/>2007</b> |
|---|--|-------------|--|--------------|---|
|   | <b>2007</b>                                | <b>2006</b> | <b>2007</b>                              | <b>2006</b>  |   |
|   | (unaudited)                                | (unaudited) | (unaudited)                              | (unaudited)  | (unaudited)   |
| Revenues license income   | \$   |             |  |              | 3,000,000   |
| Costs and expenses:   |  |             |  |              |   |
| Research and development  | 3,940,402                                  | 5,625,231   | 7,717,904                                | 11,451,344   | 176,558,720   |
| General and administrative  | 1,481,547                                  | 2,700,999   | 2,991,830                                | 5,264,648    | 67,642,125  |
|   | 5,421,949                                  | 8,326,230   | 10,709,734                               | 16,715,992   | 244,200,845   |
| Other income and expense:   |  |             |  |              |   |
| Interest income   | 401,241                                    | 723,175     | 883,569                                  | 1,550,363    | 31,725,229  |
| Interest expense  |  |             |  |              | 83,234  |
|   | \$ 401,241                                 | 723,175     | 883,569                                  | 1,550,363    | 31,641,995  |
| Net loss before cumulative effect of change in accounting principle | (5,020,708)                                | (7,603,055) | (9,826,165)                              | (15,165,629) | (209,558,850)   |
| Cumulative effect of change in accounting principle                 |  |             |  |              | 74,921  |
| Net loss  | \$ (5,020,708)                             | (7,603,055) | (9,826,165)                              | (15,165,629) | (209,633,771)   |
| Net loss per share basic and diluted                                | \$ (0.19)                                  | (0.28)      | (0.36)                                   | (0.57)       | (16.60)   |
| Shares used in calculation of per share data basic and diluted      | 26,938,461                                 | 26,800,028  | 26,925,310                               | 26,790,669   | 12,627,959  |

See accompanying notes to financial statements and accountants review report.





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**NORTHFIELD LABORATORIES INC.**

(a company in the development stage)

Statements of Shareholders' Equity (Deficit)

Six months ended November 30, 2007 and the cumulative period from June 19, 1985 (inception) through November 30, 2007

|                  |                  |                  | Series A convertible |                  | Series B convertible |                  |                 | Deficit           |                |          |
|------------------|------------------|------------------|----------------------|------------------|----------------------|------------------|-----------------|-------------------|----------------|----------|
| Preferred stock  | Common stock     |                  | preferred stock      | preferred stock  | preferred stock      | preferred stock  | Additional      | during the        | Deferred       | Treasury |
| Number of shares | Number of shares | Aggregate amount | Number of shares     | Aggregate amount | Number of shares     | Aggregate amount | paid-in capital | development stage | compensation   | shares   |
| 7,               | \$ 3,500,000     | \$ 35,000        |                      | \$               |                      | \$               | \$ (28,000)     | \$                | \$             | \$       |
| 0                |                  |                  | 250,000              | 250,000          |                      |                  | 670,850         | (607,688)         |                |          |
| 6                | \$ 3,500,000     | \$ 35,000        | 250,000              | \$ 250,000       |                      | \$               | \$ 642,850      | \$ (607,688)      | \$ (2,429,953) | \$       |
| n                |                  |                  |                      |                  |                      |                  | 2,340,000       |                   | (2,340,000)    |          |
| k                |                  |                  |                      |                  |                      |                  |                 |                   | 720,000        |          |
| n                |                  |                  |                      |                  |                      |                  |                 |                   |                |          |
| 7                | \$ 3,500,000     | \$ 35,000        | 250,000              | \$ 250,000       | 200,633              | \$ 200,633       | \$ 2,982,850    | \$ (3,037,641)    | \$ (1,620,000) | \$       |
|                  |                  |                  |                      |                  |                      |                  | 6,882,502       |                   |                |          |

(3,057,254)

566,136

\$ 3,500,000 \$ 35,000 250,000 \$ 250,000 200,633 \$ 200,633 \$ 9,865,352 \$ (6,094,895) \$(1,053,864) \$

413,020 4,130

9,749,870

1,250,000 12,500 (250,000) (250,000)

237,500

1,003,165 10,032

(200,633) (200,633)

190,601

47,115 471

93,759

175,525 1,755  
87,760 878

4,976,855  
2,488,356

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7,443,118  
(791,206)

683,040 (683,040)

800,729

\$ 6,476,585 \$ 64,766 \$ \$ 35,728,451 \$ (6,886,101) \$ (936,175) \$ (3,490,394)

699,163 (699,163)

546,278

\$ 6,476,585 \$ 64,766 \$ \$ 36,427,614 \$ (10,376,495) \$ (1,089,060) \$ (5,579,872)

435,296

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|     |    |           |    |        |    |  |    |            |                |             |    |
|-----|----|-----------|----|--------|----|--|----|------------|----------------|-------------|----|
| 01  | \$ | 6,476,585 | \$ | 64,766 | \$ |  | \$ | 36,427,614 | \$(15,956,367) | \$(653,764) | \$ |
| nts |    | 90,000    |    | 900    |    |  |    | 503,100    | (7,006,495)    |             |    |
| n   |    |           |    |        |    |  |    |            |                | 254,025     |    |
| 02  | \$ | 6,566,585 | \$ | 65,666 | \$ |  | \$ | 36,930,714 | \$(22,962,862) | \$(399,739) | \$ |
| nts |    | 15,000    |    | 150    |    |  |    | 106,890    |                |             |    |
| ck  |    |           |    |        |    |  |    |            |                |             |    |
| r   |    |           |    |        |    |  |    |            |                |             |    |
| 93  |    |           |    |        |    |  |    |            |                |             |    |
| of  |    | 374,370   |    | 3,744  |    |  |    | 5,663,710  | (8,066,609)    |             |    |
| n   |    |           |    |        |    |  |    |            |                | 254,025     |    |
| 03  | \$ | 6,955,955 | \$ | 69,560 | \$ |  | \$ | 42,701,314 | \$(31,029,471) | \$(145,714) | \$ |
| ck  |    |           |    |        |    |  |    |            | (7,363,810)    |             |    |
| 04  |    |           |    |        |    |  |    |            |                |             |    |
| of  |    | 2,500,000 |    | 25,000 |    |  |    | 14,163,851 |                |             |    |
| n   |    |           |    |        |    |  |    | (85,400)   |                | 85,400      |    |
| n   |    |           |    |        |    |  |    |            |                | 267         |    |
| 04  | \$ | 9,455,955 | \$ | 94,560 | \$ |  | \$ | 56,779,765 | \$(38,393,281) | \$(60,047)  | \$ |
|     |    |           |    |        |    |  |    |            | (7,439,013)    |             |    |

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|               |            |    |               |                 |             |
|---------------|------------|----|---------------|-----------------|-------------|
| 375,000       | 3,750      |    | 2,261,250     |                 |             |
| 10,000        | 100        |    | 71,300        |                 |             |
| 187,570       | 1,875      |    | 373,264       |                 |             |
|               |            |    | (106,750)     |                 | 106,750     |
|               |            |    |               |                 | (67,892)    |
| \$ 10,028,525 | \$ 100,285 | \$ | \$ 59,378,829 | \$ (45,832,294) | \$ (21,189) |

See accompanying notes to financial statements and accountants' review report.

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(a company in the development stage)

Statements of Shareholders' Equity (Deficit)

Six months ended November 30, 2007 and the cumulative period  
from June 19, 1985 (inception) through November 30, 2007

|   | Preferred<br>stock<br>Number<br>of<br>shares | Common<br>stock<br>Number<br>of<br>shares | Series<br>A<br>convertible<br>preferred<br>stock<br>Number<br>of<br>shares | Series<br>B<br>convertible<br>preferred<br>stock<br>Number<br>of<br>shares | Additional<br>paid-in<br>capital | Deficit   |                               | Treasury<br>shares | Total<br>share-<br>holders<br>equity<br>(deficit) |
|---|--|---|--|--|----------------------------------|---|-------------------------------|--------------------|---|
|   |  |   |  |  |                                  | accumulated<br>during the<br>development<br>stage | Deferred<br>compen-<br>sation |                    |   |
| Net loss  | \$   | \$  | \$   | \$   | \$                               | \$ (4,778,875)                                    | \$                            |                    | \$ (4,778,875)                                    |
| Issuance of<br>common stock<br>at \$17.75 per<br>share on<br>August 9, 1995<br>(net of issuance<br>costs of<br>\$3,565,125)   |  | 2,925,000                                 | 29,250   |  | 48,324,374                       |   |                               |                    | 48,353,624  |
| Issuance of<br>common stock<br>at \$17.75 per<br>share on<br>September 11,<br>1995 (net of<br>issuance costs<br>of \$423,238) |  | 438,750                                   | 4,388  |  | 7,360,187                        |   |                               |                    | 7,364,575   |
| Exercise of<br>stock options at<br>\$2.00 per share   |  | 182,380                                   | 1,824  |  | 362,937                          |   |                               |                    | 364,761   |
| Exercise of<br>stock options at<br>\$6.38 per share   |  | 1,500                                     | 15   |  | 9,555                            |   |                               |                    | 9,570   |
| Exercise of<br>stock options at<br>\$7.14 per share   |  | 10,000                                    | 100  |  | 71,300                           |   |                               |                    | 71,400  |
| Cancellation of<br>stock options  |  |   |  |  | (80,062)                         |   | 80,062                        |                    |   |
| Amortization of<br>deferred<br>compensation   |  |   |  |  |                                  |   | (62,726)                      |                    | (62,726)  |
| Balance at<br>May 31, 1996  | \$   | 13,586,155                                | \$ 135,862   | \$   | \$                               | \$ 115,427,120                                    | \$ (50,611,169)               | \$ (3,853)         | \$ 64,947,960                                     |

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|  |               |            |    |                |                 |             |       |               |
|--|---------------|------------|----|----------------|-----------------|-------------|-------|---------------|
| Net loss                                       |               |            |    |                |                 | (4,245,693) |       | (4,245,693)   |
| Exercise of stock options at \$0.20 per share  | 263,285       | 2,633      |    | 50,025         |                 |             |       | 52,658        |
| Exercise of stock options at \$2.00 per share  | 232,935       | 2,329      |    | 463,540        |                 |             |       | 465,869       |
| Exercise of stock options at \$7.14 per share  | 10,000        | 100        |    | 71,300         |                 |             |       | 71,400        |
| Amortization of deferred compensation          |               |            |    |                |                 |             | 2,569 | 2,569         |
| Balance at May 31, 1997                        | \$ 14,092,375 | \$ 140,924 | \$ | \$ 116,011,985 | \$ (54,856,862) | \$ (1,284)  |       | \$ 61,294,763 |
| Net loss                                       |               |            |    |                | (5,883,378)     |             |       | (5,883,378)   |
| Exercise of stock options at \$7.14 per share  | 5,000         | 50         |    | 35,650         |                 |             |       | 35,700        |
| Amortization of deferred compensation          |               |            |    |                |                 |             | 1,284 | 1,284         |
| Balance at May 31, 1998                        | \$ 14,097,375 | \$ 140,974 | \$ | \$ 116,047,635 | \$ (60,740,240) | \$          |       | \$ 55,448,369 |
| Net loss                                       |               |            |    |                | (7,416,333)     |             |       | (7,416,333)   |
| Non-cash compensation                          |               |            |    | 14,354         |                 |             |       | 14,354        |
| Exercise of stock options at \$7.14 per share  | 17,500        | 175        |    | 124,775        |                 |             |       | 124,950       |
| Exercise of stock warrants at \$8.00 per share | 125,000       | 1,250      |    | 998,750        |                 |             |       | 1,000,000     |
| Balance at May 31, 1999                        | \$ 14,239,875 | \$ 142,399 | \$ | \$ 117,185,514 | \$ (68,156,573) | \$          |       | \$ 49,171,340 |
| Net loss                                       |               |            |    |                | (9,167,070)     |             |       | (9,167,070)   |
| Non-cash compensation                          |               |            |    | 57,112         |                 |             |       | 57,112        |
| Exercise of stock options at \$13.38 per share | 2,500         | 25         |    | 33,425         |                 |             |       | 33,450        |
| Balance at May 31, 2000                        | \$ 14,242,375 | \$ 142,424 | \$ | \$ 117,276,051 | \$ (77,323,643) | \$          |       | \$ 40,094,832 |
| Net loss                                       |               |            |    |                | (10,174,609)    |             |       | (10,174,609)  |



|  |               |            |    |                |                  |    |               |
|--|---------------|------------|----|----------------|------------------|----|---------------|
| Non-cash compensation  |               |            |    |                |                  |    |               |
| Exercise of stock options at \$6.38 per share  | 6,000         | 60         |    | 38,220         |                  |    | 38,280        |
| Exercise of stock options at \$10.81 per share   | 17,500        | 175        |    | 189,000        |                  |    | 189,175       |
| Balance at May 31, 2001  | \$ 14,265,875 | \$ 142,659 | \$ | \$ 117,503,271 | \$ (87,498,252)  | \$ | \$ 30,147,678 |
| Net loss   |               |            |    |                | (10,717,360)     |    | (10,717,360)  |
| Balance at May 31, 2002  | \$ 14,265,875 | \$ 142,659 | \$ | \$ 117,503,271 | \$ (98,215,612)  | \$ | \$ 19,430,318 |
| Net loss   |               |            |    |                | (12,250,145)     |    | (12,250,145)  |
| Balance at May 31, 2003  | \$ 14,265,875 | \$ 142,659 | \$ | \$ 117,503,271 | \$ (110,465,757) | \$ | \$ 7,180,173  |
| Issuance of common stock at \$5.60 per share on July 28, 2003 (net of costs of issuance of \$909,229)      | 1,892,857     | 18,928     |    | 9,671,843      |                  |    | 9,690,771     |
| Issuance of common stock to directors at \$6.08 per share on October 30, 2003                              | 12,335        | 123        |    | 74,877         |                  |    | 75,000        |
| Deferred compensation related to stock grants  | 25,500        | 255        |    | 190,995        | (191,250)        |    |               |
| Amortization of deferred compensation  |               |            |    |                | 35,630           |    | 35,630        |
| Issuance of common stock at \$5.80 per share on January 29, 2004 (net of costs of issuance of \$1,126,104) | 2,585,965     | 25,860     |    | 13,846,633     |                  |    | 13,872,493    |
|  | 237,008       | 2,370      |    | 1,255,853      |                  |    | 1,258,223     |

|  |               |            |    |                |                  |              |          |               |
|--|---------------|------------|----|----------------|------------------|--------------|----------|---------------|
| Issuance of common stock at \$5.80 per share on February 18, 2004 (net of costs of issuance of \$116,423)  |               |            |    |                |                  |              |          |               |
| Issuance of common stock at \$5.80 per share on April 15, 2004 (net of costs of issuance of \$192,242)     | 409,483       | 4,095      |    | 2,178,664      |                  |              |          | 2,182,759     |
| Issuance of common stock at \$12.00 per share on May 18, 2004 (net of costs of issuance of \$1,716,831.36) | 1,954,416     | 19,544     |    | 21,716,616     |                  |              |          | 21,736,160    |
| Exercise of stock options at \$6.38 per share  | 15,000        | 150        |    | 95,550         |                  |              |          | 95,700        |
| Net loss   |               |            |    |                |                  | (14,573,798) |          | (14,573,798)  |
| Balance at May 31, 2004  | \$ 21,398,439 | \$ 213,984 | \$ | \$ 166,534,302 | \$ (125,039,555) | \$ (155,620) |          | \$ 41,553,111 |
| Deferred compensation related to stock grants  | 5,500         | 55         |    | 71,055         |                  | (71,110)     |          |               |
| Amortization of deferred compensation  |               |            |    |                |                  | 122,121      |          | 122,121       |
| Exercise of stock options between \$5.08 and \$14.17 per share   | 167,875       | 1,679      |    | 1,739,585      |                  |              |          | 1,741,264     |
| Cost of shares in treasury, 1,717 shares   |               |            |    |                |                  |              | (25,393) | (25,393)      |
| Issuance of common stock to directors at \$12.66 per   | 5,925         | 59         |    | 74,941         |                  |              |          | 75,000        |

|   |               |            |    |                |                  |              |          |    |              |
|---|---------------|------------|----|----------------|------------------|--------------|----------|----|--------------|
| share on<br>September 21,<br>2004   |               |            |    |                |                  |              |          |    |              |
| Issuance of<br>common stock<br>at \$15.00 per<br>share on<br>February 9,<br>2005 (net of<br>costs of<br>issuance of<br>\$4,995,689) | 5,175,000     | 51,750     |    | 72,577,561     |                  |              |          |    | 72,629,311   |
| Net loss  |               |            |    |                |                  | (20,321,456) |          |    | (20,321,456) |
| Balance at<br>May 31, 2005  | \$ 26,752,739 | \$ 267,527 | \$ | \$ 240,997,444 | \$ (145,361,011) | \$ (104,609) | (25,393) | \$ | 95,773,958   |
| Amortization of<br>deferred<br>compensation   |               |            |    |                |                  |              | 95,550   |    | 95,550       |
| Exercise of<br>stock options at<br>\$7.13 and<br>\$10.66 per<br>share   | 2,875         | 29         |    | 29,295         |                  |              |          |    | 29,324       |
| Issuance of<br>common stock<br>to directors at<br>\$13.05 per<br>share on<br>September 29,<br>2005                                  | 5,750         | 57         |    | 74,943         |                  |              |          |    | 75,000       |
| Issuance of<br>common stock<br>to director at<br>\$13.21 per<br>share on<br>October 3,<br>2005                                      | 1,135         | 12         |    | 14,988         |                  |              |          |    | 15,000       |
| Issuance of<br>common stock<br>to director at<br>\$10.67 per<br>share on<br>February 24,<br>2006                                    | 1,406         | 14         |    | 14,986         |                  |              |          |    | 15,000       |
| Exercise of<br>stock options at<br>\$10.66, \$5.15<br>and \$11.09 per<br>share  | 8,000         | 80         |    | 65,075         |                  |              |          |    | 65,155       |
|   | 2,750         | 28         |    | 26,640         |                  |              |          |    | 26,668       |

|  |               |            |    |                |                  |    |         |              |               |
|--|---------------|------------|----|----------------|------------------|----|---------|--------------|---------------|
| Exercise of stock options at \$10.66 and \$7.13 per share                        |               |            |    |                |                  |    |         |              |               |
| Exercise of stock options at \$5.15 and \$7.13 per share                         | 3,000         | 30         |    | 16,905         |                  |    |         | 16,935       |               |
| Net loss   |               |            |    |                | (26,775,418)     |    |         | (26,775,418) |               |
| Balance at May 31, 2006  | \$ 26,777,655 | \$ 267,777 | \$ | \$ 241,240,276 | \$ (172,136,429) | \$ | (9,059) | (25,393)     | \$ 69,337,172 |
| Eliminate remaining deferred compensation  |               |            |    | (9,059)        |                  |    | 9,059   |              |               |
| Exercise of stock options at \$5.15 and \$7.13 per share                         | 2,750         | 28         |    | 17,105         |                  |    |         | 17,133       |               |
| Exercise of stock options at \$7.13 per share                                    | 750           | 7          |    | 5,348          |                  |    |         | 5,355        |               |
| Issuance of common stock to directors at \$13.03 per share on September 20, 2006 | 6,912         | 69         |    | 89,931         |                  |    |         | 90,000       |               |
| Exercise of stock options at \$11.44 per share                                   | 10,000        | 100        |    | 114,300        |                  |    |         | 114,400      |               |
| Exercise of stock options at \$5.15, \$11.92 and \$13.21 per share               | 3,125         | 31         |    | 24,646         |                  |    |         | 24,677       |               |
| Exercise of stock options at \$5.08 and \$6.08 per share                         | 15,000        | 150        |    | 81,050         |                  |    |         | 81,200       |               |
| Exercise of stock options at \$5.15 per share                                    | 3,000         | 30         |    | 15,420         |                  |    |         | 15,450       |               |
| Exercise of stock options at \$11.92 per share                                   | 375           | 4          |    | 4,466          |                  |    |         | 4,470        |               |
|  | 96,974        | 969        |    | 666,211        |                  |    |         | 667,180      |               |

|   |    |            |            |    |           |                |                  |    |                        |
|---|----|------------|------------|----|-----------|----------------|------------------|----|------------------------|
| Exercise of warrants at \$6.88 per share  |    |            |            |    |           |                |                  |    |                        |
| Share-based compensation  |    |            |            |    | 2,655,849 |                |                  |    | 2,655,849              |
| Net loss  |    |            |            |    |           | (27,671,177)   |                  |    | (27,671,177)           |
| Balance at May 31, 2007   | \$ | 26,916,541 | \$ 269,165 | \$ | \$        | \$ 244,905,543 | \$ (199,807,606) | \$ | (25,393) \$ 45,341,709 |
| Share-based compensation (unaudited)  |    |            |            |    | 1,086,218 |                |                  |    | 1,086,218              |
| Issuance of common stock to directors at \$2.06 per share on September 25, 2007 |    |            |            |    |           |                |                  |    |                        |
| (unaudited)   |    | 43,692     | 437        |    | 89,563    |                |                  |    | 90,000                 |
| Net loss (unaudited)  |    |            |            |    |           |                | (9,826,165)      |    | (9,826,165)            |
| Balance at November 30, 2007 (unaudited)  | \$ | 26,960,233 | \$ 269,602 | \$ | \$        | \$ 246,081,324 | \$ (209,633,771) | \$ | (25,393) \$ 36,691,762 |

See accompanying notes to financial statements and accountants' review report.

**Table of Contents****NORTHFIELD LABORATORIES INC.**

(a company in the development stage)

Statements of Cash Flows

Six months ended November 30, 2007 and November 30, 2006

and the cumulative period from June 19, 1985

(inception) through November 30, 2007

|   | <b>Six months ended November<br/>30,</b> |                  | <b>Cumulative<br/>from<br/>June 19, 1985<br/><br/>through<br/>November 30,<br/>2007</b> |
|---|--|------------------|---|
|   | <b>2007</b>                              | <b>2006</b>      |   |
|   | (unaudited)                              | (unaudited)      | (unaudited)   |
| Cash flows from operating activities:                                       |  |                  |   |
| Net loss  | \$ (9,826,165)                           | (15,165,629)     | (209,633,771)   |
| Adjustments to reconcile net loss to net cash used in operating activities: |  |                  |   |
| Marketable security amortization  | (335,685)                                | (696,573)        | (3,847,752)   |
| Depreciation and amortization   | 324,954                                  | 245,815          | 19,758,616  |
| Stock based compensation  | 1,176,218                                | 1,801,503        | 7,983,091   |
| Loss of sale of equipment   |  |                  | 86,088  |
| Changes in assets and liabilities:  |  |                  |   |
| Restricted cash   | (1,155,470)                              | 699,034          | (625,718)   |
| Prepaid expenses  | 69,737                                   | 30,770           | (812,666)   |
| Other current assets  | 148,016                                  |                  | (1,961,089)   |
| Other assets  |  | 11,262           | 55,791  |
| Accounts payable  | (2,259,895)                              | (840,227)        | 1,313,130   |
| Accrued expenses  | 21,773                                   | (40,136)         | 122,891   |
| Government grant liability  | 1,155,470                                | (699,034)        | 625,718   |
| Accrued compensation and benefits   | 95,220                                   | 244,374          | 660,929   |
| Other liabilities   | 4,466                                    | (243,559)        | 11,897  |
| <br>Net cash used in operating activities                                   | <br>(10,581,361)                         | <br>(14,652,400) | <br>(186,262,845)   |
| <br>Cash flows from investing activities:                                   |  |                  |   |
| Purchase of property, plant, equipment, and capitalized engineering costs   | (213,227)                                | (7,638,247)      | (28,116,395)  |
| Proceeds from sale of land and equipment                                    |  |                  | 1,863,023   |
| Proceeds from matured marketable securities                                 | 35,946,753                               | 58,000,000       | 741,593,105   |
| Proceeds from sale of marketable securities                                 |  |                  | 7,141,656   |
| Purchase of marketable securities   | (28,865,348)                             | (44,417,129)     | (755,081,273)   |
| <br>Net cash provided by (used in) investing activities                     | <br>6,868,178                            | <br>5,944,624    | <br>(32,599,884)  |

|   |               |             |              |
|---|---------------|-------------|--------------|
| Cash flows from financing activities:                         |               |             |              |
| Proceeds from issuance of common stock                        |               | 242,765     | 237,055,000  |
| Payment of common stock issuance costs                        |               |             | (14,128,531) |
| Proceeds from issuance of preferred stock                     |               |             | 6,644,953    |
| Proceeds from sale of stock options to purchase common shares |               |             | 7,443,118    |
| Proceeds from issuance of notes payable                       |               |             | 1,500,000    |
| Repayment of notes payable                                    |               |             | (140,968)    |
| Net cash provided by financing activities                     |               | 242,765     | 238,373,572  |
| Net increase (decrease) in cash                               | (3,713,183)   | (8,465,011) | 19,510,843   |
| Cash at beginning of period                                   | 23,224,026    | 39,304,602  |              |
| Cash at end of period   | \$ 19,510,843 | 30,839,591  | 19,510,843   |

Supplemental Schedule of Noncash Financing

Activities :

Exercise of stock option, 5,000 shares in exchange for 1,717 treasury shares

\$

25,393

See accompanying notes to financial statements and accountants' review report.

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**Northfield Laboratories Inc.**  
**(a company in the development stage)**  
**Notes to the Financial Statements**  
**November 30, 2007**  
**(unaudited)**

**(1) BASIS OF PRESENTATION**

The interim financial statements presented are unaudited but, in the opinion of management, have been prepared in conformity with accounting principles generally accepted in the United States of America applied on a basis consistent with those of the annual financial statements. Such interim financial statements reflect all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full fiscal years. The interim financial statements should be read in connection with the audited financial statements for the year ended May 31, 2007.

**(2) RECLASSIFICATIONS**

Certain amounts included in the previous quarter and year-end financial statements have been reclassified to conform to the three and six months ended November 30, 2007 financial statement presentation.

**(3) USE OF ESTIMATES**

Our management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

**(4) COMPUTATION OF NET LOSS PER SHARE**

Basic earnings per share is based on the weighted average number of shares outstanding and excludes the dilutive effect of unexercised common stock equivalents. Diluted earnings per share is based on the weighted average number of shares outstanding and includes the dilutive effect of unexercised common stock equivalents. Because we reported net losses for all periods presented, basic and diluted per share amounts are the same. As of November 30, 2007, we have 2,051,957 options and 115,418 warrants that were excluded from the net loss per share calculation because their inclusion would have been anti-dilutive.

**(5) SHARE-BASED COMPENSATION**

The Company's Nonqualified Stock Option Plan for Outside Directors (the Directors Plan) lapsed on May 31, 2004. Following the termination of the plan, all options outstanding prior to plan termination may be exercised in accordance with their terms. As of November 30, 2007, options to purchase a total of 60,000 shares of the Company's common stock at prices between \$4.09 and \$13.38 per share were outstanding under the Directors Plan. These options expire between 2008 and 2012, ten years after the date of grant.

With an effective date of October 1, 1996, the Company established the Northfield Laboratories Inc. 1996 Stock Option Plan (the 1996 Option Plan). This plan provides for the granting of stock options to the Company's directors, officers, key employees, and consultants. Stock options to purchase a total of 500,000 shares of common stock are available under the 1996 Option Plan. During the quarters ended November 30, 2007 and 2006, the Company did not grant any options from this plan. As of November 30, 2007, options to purchase a total of 154,500 shares of the Company's common stock at prices between \$10.66 and \$15.41 were outstanding under the 1996 Option Plan. These options expire between 2008 and 2010, ten years after the date of grant.

With an effective date of June 1, 1999, the Company established the Northfield Laboratories Inc. 1999 Stock Option Plan (the 1999 Option Plan). This plan provides for the granting of stock options to the Company's directors, officers, key employees, and consultants. Stock options to purchase a total of 500,000 shares of common stock are available under the 1999 Option Plan. During the quarters ended November 30, 2007 and November 30, 2006, the Company did not grant any options to purchase shares of common stock under this plan. As of November 30, 2007, options to purchase a total of 281,375 shares of the Company's common stock at prices between \$3.62 and \$14.17 per share were outstanding under the 1999 Option Plan. These options expire between 2011 and 2013, ten years after the date of grant.





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With an effective date of January 1, 2003, the Company established the New Employee Stock Option Plan (the New Employee Plan ). This plan provides for the granting of stock options to the Company's new employees. Stock options to purchase a total of 350,000 shares are available under the New Employee Plan. During the quarters ended November 30, 2007 and November 30, 2006, the Company did not grant any options to purchase shares of common stock under this plan. As of November 30, 2007, options to purchase a total of 55,000 shares of the Company's common stock at prices between \$3.62 and \$18.55 per share were outstanding under the New Employee Plan. These options expire between 2013 and 2016, ten years after the date of grant.

With an effective date of September 17, 2003, the Company established and shareholders approved the 2003 Equity Compensation Plan with 750,000 available share awards. This plan provides for the granting of stock, stock options and various other types of equity compensation to the Company's employees, non-employee directors and consultants. On September 29, 2005, the number of available share awards was increased to 2,250,000 by shareholder approval. During the quarter ended November 30, 2007, the Company granted 60,000 options to purchase shares of common stock at a price of \$2.06 per share. During the quarter ended November 30, 2006, the Company granted 62,500 options to purchase shares of common stock at prices between \$13.03 and \$14.68. At November 30, 2007, options to purchase a total of 1,616,500 shares of the Company's common stock at prices between \$1.36 and \$18.55 were outstanding under this plan. These options expire between 2013 and 2017, ten years after the date of grant.

The service period for option plans is generally four years, with shares vesting at a rate of 25% each year. The 475,000 options granted on July 12, 2007 to the company officers have a two year vesting period with shares vesting at a rate of 50% each year. Options granted to the outside directors on September 25, 2007 vested immediately upon grant. Additionally, all outside directors were granted 43,692 shares on September 25, 2007 which also vest immediately.

The Company issued shares from authorized but un-issued common shares upon share option exercises and restricted stock grants.

The Company adopted Financial Accounting Standards Board ( FASB ) Statement No. 123 (revised), Share-Based Payment ( SFAS 123R ) in June, 2006. Among its provisions, SFAS 123R requires us to recognize compensation expense for equity awards over the vesting period based on their grant-date fair value. Prior to the adoption of SFAS 123R, we utilized the intrinsic-value based method of accounting under APB Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations, and adopted the disclosure requirements of SFAS No. 123,

Accounting for Stock-Based Compensation ( SFAS 123 ). Under the intrinsic-value based method of accounting, compensation expense for stock options granted to our employees was measured as the excess of the fair value of the Company's common stock at the grant date over the amount the employee must pay for the stock.

We adopted SFAS 123R in the first quarter of fiscal 2007 using the modified prospective approach. Under this transition method, the measurement and our method of amortization of costs for share-based payments granted prior to, but not vested as of June 1, 2006, is based on the same estimate of the grant-date fair value and the same amortization method that was previously used in our SFAS 123 pro forma disclosure. Results for prior periods have not been restated as provided for under the modified prospective approach. For equity awards granted after the date of adoption, we amortize share-based compensation expense on a straight-line basis over the vesting term.

Compensation expense is recognized only for share-based payments expected to vest. We estimate forfeitures at the date of grant based on our historical experience and future expectations. Prior to the adoption of SFAS 123R, the effect of forfeitures on the pro forma expense amounts was recognized based on actual forfeitures.

The Company does not recognize a tax benefit related to share based compensation due to the historical net operating loss and related valuation allowance.

The impact of the share-based compensation expenses on basic earnings per share for the three and six months ended November 30, 2007 was \$.02 and \$.04, respectively, and the related charge associated with share-based compensation expense recognized in the Statement of Operations for the three and six months ended November 30, 2007 was \$569,000 and \$1,176,000, respectively.

As of November 30, 2007, there was approximately \$2,673,219 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the incentive plans. That cost is expected to be recognized over a weighted-average period of 1.72 years.



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The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The table below outlines the weighted average assumptions for options granted during the three and six months ended November 30, 2007 and November 30, 2006.

|                         | Three Months Ended |                   | Six Months Ended  |                   |
|-------------------------|--------------------|-------------------|-------------------|-------------------|
|                         | November 30, 2007  | November 30, 2006 | November 30, 2007 | November 30, 2006 |
| Fair value              | \$ 98,800          | \$ 580,000        | \$ 681,500        | \$ 1,090,890      |
| Expected volatility     | 96.47%             | 72.6%             | 95.9%             | 73.1%             |
| Risk-free interest rate | 4.22%              | 5.0%              | 4.82%             | 5.0%              |
| Dividend yield          | 6.2                |                   | 6.29              |                   |
| Expected lives          | years              | 6.7 years         | years             | 6.8 years         |

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on historical volatility of the Company's stock. The risk-free interest rate is based on the implied yield available on U.S. Treasury zero-coupon issues with equivalent remaining term.

On June 14, 2007, the Company issued 52,500 options to purchase shares of common stock to 14 individuals at a price of \$1.43 per share. On July 12, 2007, the Company issued 475,000 options to purchase shares of common stock to 8 individuals at a price of \$1.36 per share. The Company will expense share-based compensation over the vesting period of the option which is four years for the June 14, 2007 grant and two years for the July 12, 2007 grant. On September 25, 2007 the Company issued 60,000 options to purchase shares of common stock to six individuals at a price of \$2.06 per share. The options granted on September 25, 2007, vested immediately. On September 25, 2007, the Company issued 43,692 share grants to six individuals at \$2.06 per share. These share grants vested immediately.

The weighted average grant-date fair value of options granted during the three months ended November 30, 2007 and November 30, 2006 was \$1.65 per share and \$9.28 per share, respectively. The weighted average grant-date fair value of options granted during the six months ended November 30, 2007 and November 30, 2006 was \$1.16 per share and \$8.55 per share, respectively.

The following table summarizes the Company's option activity during the six months ended November 30, 2007:

|                                | Shares    | Range of Exercise Prices | Weighted Average Exercise Price | Weighted Average Remaining Contractual Terms (years) | Aggregate Intrinsic Value |
|--------------------------------|-----------|--------------------------|---------------------------------|--|---------------------------|
| Outstanding at May 31, 2007    | 1,681,375 | \$ 3.61 \$18.55          | \$ 11.08                        |  |                           |
| Granted at Fair Value          | 527,500   | \$ 1.36 \$1.43           | \$ 1.37                         |  |                           |
| Exercised                      | 0         |                          |                                 |  |                           |
| Expired                        | 10,000    | \$ 9.56                  | \$ 9.56                         |  |                           |
| Cancelled                      | 77,000    | \$ 7.57 \$13.05          | \$ 11.18                        |  |                           |
| Outstanding at August 31, 2007 | 2,121,875 | \$ 1.36 \$18.55          | \$ 8.67                         | 7.24   | 154,575                   |
|                                | 1,096,625 | \$ 3.62 \$18.55          | \$ 10.29                        | 5.70   | 0                         |

Exercisable at August 31,  
2007

|                                     |           |    |      |         |      |      |      |
|-------------------------------------|-----------|----|------|---------|------|------|------|
| Granted at Fair Value               | 60,000    | \$ | 2.06 | \$      | 2.06 |      |      |
| Exercised                           | 0         |    |      |         |      |      |      |
| Expired                             | 0         |    |      |         |      |      |      |
| Cancelled                           | 14,500    | \$ | 7.13 | \$13.21 | \$   | 8.97 |      |
| Outstanding at November 30,<br>2007 | 2,167,375 | \$ | 1.36 | \$18.55 | \$   | 8.48 | 5.72 |
|                                     |           |    |      |         |      |      | 0    |
| Exercisable at November 30,<br>2007 | 1,196,750 | \$ | 2.06 | \$18.55 | \$   | 9.90 | 5.05 |
|                                     |           |    |      |         |      |      | 0    |

The aggregate intrinsic value in the table above is before taxes and based on a weighted average exercise price of \$8.48 for options outstanding at November 30, 2007 and \$9.90 for options exercisable at November 30, 2007. The total intrinsic value of options exercised during the three months ended November 30, 2007 and November 30, 2006 was \$0 and \$195,541, respectively. The total intrinsic value of options exercised during the six months ended November 30, 2007 and November 30, 2006 was \$0 and \$201,911, respectively. The total fair value of options vested during the three months ended November 30, 2007 and November 30, 2006 was \$494,552 and \$1,108,658, respectively. The total fair value of options vested during the six months ended November 30, 2007 and November 30, 2006 was \$623,851 and \$1,702,442, respectively.

#### **(6) RESTRICTED CASH**

As of November 30, 2007, the Company had \$1.7 million in restricted cash from a government grant. All funds are used in accordance with the terms of the grant. The Company accounts for the lapse in restriction when grant expenditures are incurred. The Company recognizes the funds as a contra-expense or a reduction in the asset carrying value based on the type of grant expenditure incurred.

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**(7) MARKETABLE SECURITIES**

The Company, at November 30, 2007, is invested in high grade commercial paper. The Company has the intent and ability to hold these securities until maturity and all securities have a maturity of three months or less.

The fair market value of the Company's marketable securities was \$10,186,280 at November 30, 2007, which included gross unrealized holding losses of \$2,204. The fair market value of the Company's marketable securities was \$16,934,479 at May 31, 2007, which included gross unrealized holding gains of \$275. All of these marketable securities are scheduled to mature in less than three months.

**(8) PROPERTY, PLANT & EQUIPMENT**

Property, plant and equipment are recorded at cost and are depreciated using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized using the straight-line method over the lesser of the life of the asset or the term of the lease, generally five years.

**(9) INCOME TAXES**

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48) in the first quarter of fiscal 2008. At the adoption date and as of November 30, 2007, the Company had no material unrecognized tax benefits and no adjustment to liabilities, retained earnings, loss from continuing operations, or net loss were required. It is the Company's policy to include interest and/or penalties related to uncertain tax positions in income tax expense. No interest and/or penalties were recognized upon FIN 48 adoption. Tax years 1992 through 2006 remain open to examination by the major taxing jurisdictions to which the Company reports. The adoption of FIN 48 had no effect on the Company's basic and diluted earnings per share.

**(10) LEGAL PROCEEDINGS**

On March 17, 2006 and May 15, 2006, ten separate complaints were filed, each purporting to be on behalf of a class of the Company's shareholders, against the Company and Dr. Steven A. Gould, the Company's Chief Executive Officer, and Richard DeWoskin, the Company's former Chief Executive Officer. Those putative class actions were consolidated in a case pending in the United States District Court for the Northern District of Illinois Eastern Division. The Consolidated Amended Class Action Complaint was filed on September 8, 2006, and alleged, among other things, that during the period from March 19, 2001 through March 20, 2006, the named defendants made or caused to be made a series of materially false or misleading statements and omissions about the Company's elective surgery clinical trial and business prospects in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act. Plaintiffs alleged that those allegedly false and misleading statements and omissions caused the purported class to purchase the Company's common stock at artificially inflated prices. As relief, the complaint sought, among other things, a declaration that the action be certified as a proper class action, unspecified compensatory damages (including interest) and payment of costs and expenses (including fees for legal counsel and experts). The Company and the individual defendants filed a motion to dismiss the complaint, and on September 25, 2007, the court granted that motion, finding that the plaintiffs failed to state a claim. The court dismissed the complaint without prejudice and on November 20, 2007, the plaintiffs filed a Consolidated Second Amended Class Action Complaint. The Company intends to file a motion to dismiss the new complaint. The putative class action is at an early stage and it is not possible to predict the outcome.

On March 13, 2006, the SEC notified the Company that it was conducting an informal inquiry, and requested that the Company voluntarily provide the SEC with certain categories of documents from 1998 to 2006 primarily relating to the Company's public disclosures concerning the clinical development of PolyHeme. The SEC then sent the Company additional requests for documents and information, and modified its initial requests. The Company cooperated with the SEC, and on August 21, 2007, the SEC informed the Company that it has completed its investigation and does not intend to recommend any enforcement action against the Company.

On March 17, 2006, the Company also received a letter from Senator Charles E. Grassley, then Chairman of the Senate Finance Committee, requesting that the Company provide certain categories of documents relating to the Phase III clinical trauma trial as well as documents relating to correspondence with FDA. Subsequently, the Company produced documents to the Committee, and the Committee requested additional documents which were also provided.

On September 11, 2007, the Company received a second letter from Senator Charles E. Grassley, Ranking Member of the Senate Finance Committee, requesting that the Company provide additional information to the Committee. The Company is complying with that request.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

**RECENT DEVELOPMENTS**

We are presently preparing a Biologics License Application, or BLA, for our PolyHeme® red blood cell substitute, for submission to the Food and Drug Administration, or FDA. Our goal is to submit our BLA to FDA during the first half of calendar 2008. We also plan to submit a request for priority review of our BLA. We believe PolyHeme satisfies the stated criteria for priority review based on its potential to address an unmet medical need.

Since Northfield's incorporation in 1985, we have devoted substantially all of our efforts and resources to the research, development and clinical testing of PolyHeme. We have incurred operating losses during each year of our operations since inception and expect to incur substantial additional operating losses for the next several years. From Northfield's inception through November 30, 2007, we have incurred operating losses totaling \$209,634,000.

We will be required to prepare and submit a BLA to FDA and obtain regulatory approval from FDA before PolyHeme can be sold commercially. The FDA regulatory process is subject to significant risks and uncertainties. We therefore cannot at this time reasonably estimate the timing of any future revenues from the commercial sale of PolyHeme. The costs incurred by Northfield to date and during each period presented in connection with our development of PolyHeme are described in the Statements of Operations in our financial statements.

Our success will depend on several factors, including our ability to obtain FDA regulatory approval of PolyHeme and our manufacturing facilities, obtain sufficient quantities of blood to manufacture PolyHeme in commercial quantities, manufacture and distribute PolyHeme in a cost-effective manner, enforce our patent positions and raise sufficient capital to fund these activities. We have experienced significant delays in the development and clinical testing of PolyHeme. We cannot ensure that we will be able to achieve these goals or that we will be able to realize product revenues or profitability on a sustained basis or at all.

**RESULTS OF OPERATIONS**

We reported no revenues for the three and six month periods ended November 30, 2007 or 2006. From Northfield's inception through November 30, 2007, we have reported total revenues of \$3,000,000, all of which were derived from licensing fees.

**OPERATING EXPENSES**

Operating expenses for our second fiscal quarter ended November 30, 2007 totaled \$5,422,000, a decrease of \$2,904,000 from the \$8,326,000 reported in the second quarter of fiscal 2007. Measured on a percentage basis, second quarter fiscal 2008 operating expenses were less than second quarter fiscal 2007 expenses by 34.9%. The decrease was primarily driven by a reduction in spending for site-related clinical expenses in connection with our Phase III trial, which completed patient enrollment in the first fiscal quarter of 2007. The decrease is also driven by government grant funding used to offset the cost of specified operating activities.

Research and development expenses during the second quarter of fiscal 2008 totaled \$3,940,000, a decrease from the \$5,625,000 reported in the second quarter of fiscal 2007. The decrease was primarily driven by a reduction in spending for site-related clinical expenses in connection with our Phase III trial. The decrease was also driven by \$744,000 in government grant funding used to offset the cost of specified operating activities at our manufacturing facility in preparation for FDA review.

We anticipate a continued high level of research and development spending for the remainder of fiscal 2008. We continue the significant task of data verification, assembly, analysis and report preparation for FDA. Preparing the BLA for PolyHeme to be submitted to FDA will continue through fiscal 2008. At the same time, we will continue an extensive process of preparation for FDA's review of our manufacturing facility. Northfield's internal research and development resources will be focused on these tasks and we will continue the use of external resources to complete the tasks in a timely manner.

General and administrative expenses in the second quarter of fiscal 2008 totaled \$1,482,000, which is a decrease of \$1,219,000, or 46.0%, from the \$2,701,000 of general and administrative expenses reported in the second quarter of fiscal 2007. The decreased expenses were primarily due to a reduction in professional service fees related to our ongoing legal proceedings. The SEC informed us that it had completed its investigation and does not intend to recommend any enforcement action against Northfield. We have reached the retention level on our insurance policy



covering our current civil litigation and we expect all further expenses relating to this litigation to be fully covered by our insurance policies, subject to applicable policy limits. This decrease was also driven by a reduction in share-based compensation.

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**INTEREST INCOME**

Interest income for the three-month period ended November 30, 2007 totaled \$401,000, a decrease of \$322,000 from the \$723,000 in interest income reported in the three-month period ended November 30, 2006. We had a lower level of cash and marketable securities available to invest during the current fiscal quarter.

Interest income for the six-month period ended November 30, 2007 totaled \$884,000, a decrease of \$666,000 from the \$1,550,000 in interest income reported in the six-month period ended November 30, 2006. We had a significantly lower level of cash and marketable securities available to invest during the current fiscal year.

**NET LOSS**

Our net loss for the three-month period ended November 30, 2007 totaled \$5,021,000, or \$0.19 per share, compared to a net loss of \$7,603,000, or \$0.28 per share, for the three-month period ended November 30, 2006. In dollar terms, the loss decreased by \$2,582,000, or 34.0%. The decrease was driven by a reduction in spending for site-related clinical expenses in connection with our Phase III trial. The decrease was also driven by \$744,000 in government grant funding used to offset the cost of specified operating activities at our manufacturing facility in preparation for FDA review.

Our net loss for the six-month period ended November 30, 2007 totaled \$9,826,000, or \$0.36 per share, compared to a net loss of \$15,166,000, or \$0.57 per share, for the six-month period ended November 30, 2006. In dollar terms, the loss decreased by \$5,340,000, or 35.2%. The decrease was primarily driven by a reduction in spending for site-related clinical expenses in connection with our Phase III trial. The decrease was also driven by \$1,736,000 in government grant funding used to offset the cost of operating activities at our manufacturing facility in preparation for FDA review. Additionally, the decrease was driven by a reduction in professional service fees and share-based compensation expense.

**LIQUIDITY AND CAPITAL RESOURCES**

From Northfield's inception through November 30, 2007, we have used cash in operating activities and for the purchase of property, plant, equipment and engineering services in the amount of \$214,379,000. For the six months ended November 30, 2007 and 2006, these cash expenditures totaled \$10,795,000 and \$22,291,000, respectively. The previous fiscal year six-month cash utilization reflects the purchase of our previously leased manufacturing facility for \$6,731,000.

We have financed our research and development and other activities to date through the public and private sale of equity securities and, to a more limited extent, through the license of product rights. As of November 30, 2007, we had cash and marketable securities totaling \$31,385,000. As previously reported, we have been successful in securing a \$1,400,000 federal appropriation as part of the Defense Appropriation Bill in 2005 and a \$3,500,000 federal appropriation as part of the Fiscal 2006 Defense Appropriation Bill. As of November 30, 2007, we have received all of these funds.

We are currently utilizing our cash resources at a rate of approximately \$26 million per year. We anticipate maintaining spending at this rate through the submission of our BLA. No significant capital expenditures are planned for the near term.

Based on our current estimates, we believe our existing capital resources should be sufficient to permit us to conduct our operations, including the preparation and submission of a BLA to FDA, for approximately 13 to 15 months. As of the date of this report, a decision to launch our planned manufacturing facility construction project and expansion of our manufacturing, sales, marketing and distribution capabilities, has been deferred until we have sufficient resources to fund these activities.

We may in the future issue additional equity or debt securities or enter into collaborative arrangements with strategic partners, which could provide us with additional funds or absorb expenses we would otherwise be required to pay. We are also pursuing potential sources of additional government funding. Any one or a combination of these sources may be utilized to raise additional capital. We believe our ability to raise additional capital or enter into a collaborative arrangement with a strategic partner will depend primarily on the results of our BLA submission to FDA, as well as general conditions in the business and financial markets.

Our capital requirements may vary materially from those now anticipated because of the timing of final results of our clinical testing of PolyHeme, the establishment of relationships with strategic partners, changes in the scale,

timing or cost of our planned commercial manufacturing facility, competitive and technological advances, the FDA regulatory process, changes in our marketing and distribution strategy and other factors.

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**Table of Contents****CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein. We believe the following critical accounting policy reflects our more significant judgments and estimates used in the preparation of our financial statements.

**NET DEFERRED TAX ASSETS VALUATION**

We record our net deferred tax assets in the amount that we expect to realize based on projected future taxable income. In assessing the appropriateness of our valuation, assumptions and estimates are required, such as our ability to generate future taxable income. In the event we were to determine that it was more likely than not we would be able to realize our deferred tax assets in the future in excess of their carrying value, an adjustment to recognize the deferred tax assets would increase income in the period such determination was made. As of November 30, 2007, we have recorded a 100% percent valuation allowance against our net deferred tax assets.

**CONTRACTUAL OBLIGATIONS**

The following table reflects a summary of our contractual cash obligations as of November 30, 2007:

|  |                     | <b>LESS<br/>THAN</b> | <b>1-3<br/>YEARS</b> |
|--|---------------------|----------------------|----------------------|
| <b>Contractual Obligations</b>           | <b>TOTAL</b>        | <b>ONE YEAR</b>      |                      |
| Lease Obligations (1)                    | \$ 548,333          | \$ 363,578           | \$ 184,755           |
| Other Obligations (2)                    | \$ 1,266,900        | \$ 1,266,900         |                      |
| <b>Total Contractual Cash Obligation</b> | <b>\$ 1,815,233</b> | <b>\$ 1,630,478</b>  | <b>\$ 184,755</b>    |

(1) The lease for our Evanston headquarters is cancelable with six months notice combined with a termination payment equal to three months base rent at any time after February 14, 2009. If the lease is cancelled as of February 15, 2009, unamortized broker commissions of \$17,470 would also be due.

(2)

Represents payments required to be made upon termination of employment agreements with two of our executive officers. The employment contracts renew automatically unless terminated.

Figures shown represent compensation payable upon the termination of the employment agreements for reasons other than death, disability, cause or voluntary termination of employment by the executive officer other than for good reason.

Additional payments may be required under the employment agreements in connection with a termination of employment of the executive officers following a change in control of Northfield.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

We currently do not have any foreign currency exchange risk. We invest our cash and cash equivalents in government securities, certificates of deposit and money market funds. We also invest in commercial paper which is

shown as marketable securities. These investments are subject to interest rate risk. However, due to the nature of our short-term investments, we believe that the financial market risk exposure is not material. A one percentage point decrease in the interest rate received on our cash and marketable securities of \$31,385,000 at November 30, 2007 would decrease interest income by \$314,000 on an annual basis.

**ITEM 4. CONTROLS AND PROCEDURES.**

Based on their evaluation as of the end of the period covered by this report, our Chief Executive Officer and Vice President Finance have concluded that Northfield's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**Part II**  
**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

On March 17, 2006 and May 15, 2006, ten separate complaints were filed, each purporting to be on behalf of a class of the Company's shareholders, against the Company and Dr. Steven A. Gould, the Company's Chief Executive Officer, and Richard DeWoskin, the Company's former Chief Executive Officer. Those putative class actions were consolidated in a case pending in the United States District Court for the Northern District of Illinois Eastern Division. The Consolidated Amended Class Action Complaint was filed on September 8, 2006, and alleged, among other things, that during the period from March 19, 2001 through March 20, 2006, the named defendants made or caused to be made a series of materially false or misleading statements and omissions about the Company's elective surgery clinical trial and business prospects in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act. Plaintiffs alleged that those allegedly false and misleading statements and omissions caused the purported class to purchase the Company's common stock at artificially inflated prices. As relief, the complaint sought, among other things, a declaration that the action be certified as a proper class action, unspecified compensatory damages (including interest) and payment of costs and expenses (including fees for legal counsel and experts). The Company and the individual defendants filed a motion to dismiss the complaint, and on September 25, 2007, the court granted that motion, finding that the plaintiffs failed to state a claim. The court dismissed the complaint without prejudice and on November 20, 2007, the plaintiffs filed a Consolidated Second Amended Class Action Complaint. The Company intends to file a motion to dismiss the new complaint. The putative class action is at an early stage and it is not possible to predict the outcome.

On March 13, 2006, the SEC notified the Company that it was conducting an informal inquiry, and requested that the Company voluntarily provide the SEC with certain categories of documents from 1998 to 2006 primarily relating to the Company's public disclosures concerning the clinical development of PolyHeme. The SEC then sent the Company additional requests for documents and information, and modified its initial requests. The Company cooperated with the SEC, and on August 21, 2007, the SEC informed the Company that it has completed its investigation and does not intend to recommend any enforcement action against the Company.

On March 17, 2006, the Company also received a letter from Senator Charles E. Grassley, then Chairman of the Senate Finance Committee, requesting that the Company provide certain categories of documents relating to the Phase III clinical trauma trial as well as documents relating to correspondence with FDA. Subsequently, the Company produced documents to the Committee, and the Committee requested additional documents which were also provided.

On September 11, 2007, the Company received a second letter from Senator Charles E. Grassley, Ranking Member of the Senate Finance Committee, requesting that the Company provide additional information to the Committee. The Company is complying with that request.

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

Our annual meeting of stockholders was held on September 25, 2007 for the purpose of electing directors and ratifying the appointment of KPMG LLP as our independent registered public accounting firm. Proxies for the meeting were solicited pursuant to Section 14(a) of the Securities Exchange Act of 1934 and there was not solicitation in opposition to management's solicitation. Each of the management's nominees for directors, as listed in the proxy statement, was elected with the number of votes set forth below.

| Nominee               | For        | Withheld  |
|-----------------------|------------|-----------|
| Steven A. Gould, M.D. | 21,199,460 | 1,699,994 |
| John F. Bierbaum      | 21,352,505 | 1,546,949 |
| Bruce S. Chelberg     | 21,391,921 | 1,507,533 |
| Alan L. Heller        | 21,391,550 | 1,507,904 |
| Paul M. Ness, M.D.    | 20,230,500 | 2,668,954 |
| David A. Savner       | 21,351,541 | 1,547,913 |
| Edward C. Wood, Jr.   | 21,391,342 | 1,508,112 |





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The aforesaid nominees have been elected as Directors.

The results of other matters voted upon at the annual meeting are as follows:

| Proposal   | For        | Against | Abstain | Non-Votes |
|--|------------|---------|---------|-----------|
| The proposal to ratify the appointment of KPMG LLP as the independent registered public accounting firm of the Company to serve for the Company's 2008 fiscal year was approved. | 22,223,910 | 473,607 | 201,937 |           |

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**SIGNATURES**

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 Company in the capacities indicated on January 9, 2008.

| <b>Signature</b>            | <b>Title</b>                    |
|-----------------------------|---------------------------------|
| /s/ Steven A. Gould, M.D.   | Chairman of the Board and Chief |
| Steven A. Gould, M.D.       | Executive Officer               |
| /s/ Donna O Neill-Mulvihill | Vice President of Finance       |
| Donna O Neill-Mulvihill     |                                 |