Hollis-Eden Pharmaceuticals

Creating the Future

PRODUCTS FOR 21ST CENTURY GLOBAL MEDICINE

NEUMUNE™
HE2100

REVERSIONEX™
HE2200

IMMUNITIN™
HE2000

Annual Report 2002

HOLLISEDEN
PHARMACEUTICALS
Serving Humanity®

Hollis-Eden Pharmaceuticals

HORMONAL REGULATION OF GENES TO TREAT DISEASE

Hollis-Eden Pharmaceuticals is developing a series of proprietary Immune Regulating Hormones (IRHs) for the treatment of immune system and metabolic disorders. Our small molecule compounds are based on hormones found in the human body that are key components of the body's natural regulatory system. Unfortunately, levels of these hormones are depleted due to chronic infectious diseases, stress, trauma and aging. Hollis-Eden's therapeutic approach is designed to utilize these hormones as immune regulating drugs that re-establish proper function across a number of important signaling pathways, thus allowing the body to potentially mount an appropriate immune or metabolic response and control progression of a number of different diseases. Hollis-Eden's IRHs – Neumune™ (HE2100), Reversionex™ (HE2200) and Immunitin™ (HE2000) – have a very attractive safety profile to date, are cost-effective to manufacture, and are unlikely to induce drug-resistant strains of pathogens.

Creating the Future

PRODUCTS FOR 21ST CENTURY GLOBAL MEDICINE

+ In collaboration with the U.S. Department of Defense, Hollis-Eden is developing Neumune and Immunitin as medical countermeasures against radiological and biological weapons of mass destruction. These programs could offer a fast path to significant near-term market opportunities and provide a direct extension into the multi-billion dollar chemotherapy-induced neutropenia prevention market.

+ Major U.S. medical markets are being targeted with Reversionex for metabolic and cardiovascular diseases, such as high cholesterol, as well as immune senescence and prevention of chemotherapy-induced neutropenia. The Company plans to pursue these large market opportunities to drive future revenue growth by entering into collaborations with pharmaceutical companies.

+ Immunitin has shown activity against all three global infectious diseases identified by the World Health Organization as top priorities: HIV/AIDS, tuberculosis and malaria. The Company plans to develop and commercialize the compound for global infectious disease markets through public/private partnerships with governments and large employers.

+ Hollis-Eden's product development pipeline is deep and diversified, with additional compounds in preclinical programs for autoimmune disorders and diseases of the aging.

TO OUR VALUED SHAREHOLDERS

Thank you for your investment in our company. It is always a pleasure to provide you our annual report. The year 2002, from a product development viewpoint, was a year of dramatic progress, discoveries and drive to commercialization for Hollis-Eden. Although the world, it can be argued, has never known a more uncertain and dangerous environment both politically and economically – from the collapse of the stock market, to renewed fears of epidemic diseases, to new fears of recently evolved pathogens such as SARS and West Nile Virus, to the war on terrorism and weapons of mass destruction, to war in Iraq – you will be pleased to know that we have strategically positioned our company to succeed in these times. We are focused on advancing our fundamental technology into products that can play a vital role in Homeland Security by developing medical countermeasures against terrorist attacks with weapons of mass destruction. We have positioned our global infectious disease programs to play a major role around the world, and have strategically and rapidly accelerated product development into enormous market opportunities in both the cancer chemotherapy and cardiovascular arenas for corporate partnering collaborations.

"EDEN" sculpture by Judi Stickney

Richard B. Hollis
Founder, Chairman and CEO

Behind our product development strategy lies a fundamental technology that we believe is poised to make an enormous contribution to global medicine. Like other great breakthroughs in medical science, such as penicillin, our technology is elegantly simple, or basic, in its approach. As with penicillin, it was not so much the discovery of *penicillium notatum* that changed the world of medicine (since the mold

In wisdom we look at the whole, in ignorance we look at the parts. – PLATO

Opening sentence of Hollis-Eden's original business plan, dated 1994.

and its effects were well known), it was the deliberate investigation and pursuit of its therapeutic benefits that marked the real breakthrough. Similarly, the role of the human hormonal system in regulating other critical systems and functions in the body has been long- and well-accepted by science, but it was Hollis-Eden alone that chose to make its mission a full investigation and understanding of the role of key hormones in restoring immune and metabolic dysfunction, and to develop those immune regulating hormones (IRHs) as beneficial new therapeutic products. We have pursued that mission with unwavering energy and commitment, combining a spirit of entrepreneurship with social responsibility. As our investigation continues to yield findings and data that validate and illuminate the fundamental role and value of our IRH technology, Hollis-Eden is passionately driven with a consistency of purpose: to serve humanity by converting our technology into products strategicall positioned to play a major role in global health in the 21*st* century.

From day one, our vision at Hollis-Eden Pharmaceuticals has been to serve humanity by developing global products for medicine. By "global," we mean a therapeutic approach that is suitable for addressing the most important health issues facing the world today – be it global infectious diseases, diseases of the aging, or the threat of terrorist acts. But we also mean by "global" to describe the systems biology approach we have always taken in our drive for beneficial new therapies. Throughout our history, we have approached the human body as an integrated system, and have taken a therapeutic approach focused on rebalancing the "upstream" hormonal system in order to restore "downstream" functions, specifically immune and metabolic functions. While conventional wisdom has argued historically for a "single molecule, single target" approach, we have focused instead on re-regulating the dysregulated system as a whole.

As we have reported over the past year, important new collaborations for Hollis-Eden and multiple clinical and preclinical findings with our compounds in a variety of indications continue to substantiate the therapeutic and commercial potential of our approach. Among these, we:

+ announced NEUMUNE™ (HE2100) stimulates innate immunity in preclinical models of radiation injury, and formed a collaboration with the U.S. Department of Defense to develop NEUMUNE for protection of the military, first responders and civilians against the life-threatening effects of radiation injury;

HOLLIS-EDEN SCIENTIFIC MANAGEMENT TEAM
(left to right) Dwight R. Stickney, M.D., James M. Frincke, Ph.D. and Christopher L. Reading, Ph.D.

+ reported that NEUMUNE and REVERSIONEX™ (HE2200) increased both neutrophils and platelets in a primate model of chemotherapy-induced immune suppression;
+ presented additional Phase II data at the World AIDS Conference showing that, in addition to increasing innate and adaptive immunity, IMMUNITIN™ (HE2000) could also lower viral load in HIV patients;
+ presented data indicating that IMMUNITIN, when administered as a buccal tablet formulation, cleared malarial parasites and eliminated fever in infected patients;
+ presented preclinical data demonstrating that IMMUNITIN, when given as a monotherapy, was highly effective at reducing bacterial load in both the acute and chronic phases of tuberculosis;
+ reported Phase I results demonstrating that REVERSIONEX could lower cholesterol and improve cholesterol-to-HDL ratio, and initiated a Phase II study in this area;
+ initiated a Phase II clinical trial with REVERSIONEX for improving immunity in the elderly;
+ released data showing that REVERSIONEX had anti-inflammatory effects in a preclinical model of fatal lupus nephritis, building on previous preclinical findings demonstrating the anti-inflammatory effects of our class of IRHs in other autoimmune diseases such as arthritis, multiple sclerosis and inflammatory bowel disease;
+ announced issuance of new patents covering NEUMUNE in Europe and Japan and REVERSIONEX in Japan and receipt of notice of allowance from the U.S. Patent and Trademark Office for a new patent covering improvements to IMMUNITIN, including an improved crystal structure.

HOLLIS-EDEN BUSINESS MANAGEMENT TEAM
(left to right) Robert W. Weber, Robert L. Marsella, Eric J. Loumeau and Daniel D. Burgess

In addition to the internal milestones achieved by Hollis-Eden during 2002, we began to feel the wind more at our back during the year as "conventional wisdom" shifted in our direction on a number of fronts. These shifts included growing evidence that inflammation may be a root cause of many chronic diseases including cardiovascular disease and metabolic disorders; a growing recognition that anti-viral therapies for HIV and other infectious diseases are leading to drug resistance; and the initial signs of a shift in the scientific community from molecular biology (where the focus is on one gene or protein at a time) to systems biology (where the human body is considered as a whole).

At year-end 2002, our product focus included three immune regulating hormones – NEUMUNE, REVERSIONEX and IMMUNITIN – in development for radiation and chemotherapy protection; cholesterol lowering and improving immunity in the elderly; and infectious diseases including HIV, malaria and tuberculosis. Directed at 21*st* century global healthcare challenges, we believe our deep and diverse pipeline – much of which is at Phase II-stage development – holds considerable short- and long-term revenue generating opportunities. Among these, we believe our nearest pathway to commercialization lies in NEUMUNE as a radiation protection drug. Currently, NEUMUNE is the military's leading compound being developed for radiation protection. Preliminary results from our initial pilot study with NEUMUNE in non-human primates, released in April 2003, were very encouraging. Under a new rule finalized by the U.S. Food and Drug

Administration (FDA) for therapies against weapons of mass destruction, NEUMUNE could be approved after safety is shown in humans and efficacy is demonstrated in relevant animal studies. As a result, we do not expect to conduct lengthy and costly Phase II and III human clinical studies, and NEUMUNE could be approved for commercial use much more rapidly than through traditional drug development pathways.

In today's high-threat environment, we believe there is a critical need for a radiation protection drug. The government, through initiatives such as President Bush's Project BioShield, is expected to facilitate commercialization of beneficial new technologies that safeguard our troops and citizens against terrorist threats. To encourage investment in companies developing medical countermeasures to terrorism, the Project BioShield initiative includes authorization for the federal government to award advance contracts that guarantee orders and payment upon delivery of approved compounds that can be added to the National Pharmaceutical Stockpile. In early 2003, we addressed this opportunity by initiating an aggressive awareness effort in Washington with the goal of securing such an order for NEUMUNE. We believe similar opportunities may be available with governments of other countries in need of an effective radioprotectant for their populations.

In addition to the potential for generating significant revenues in radiation protection with NEUMUNE, there is a clear opportunity for market expansion into the $2 billion chemotherapy protection market. For this indication, we are also studying REVERSIONEX which, like NEUMUNE, has demonstrated an ability to stimulate neutrophils and platelets in a primate model of chemotherapy-induced immune suppression. REVERSIONEX is already being tested in humans in other indications with a favorable safety profile to date. These compounds could be well-positioned in the marketplace since an estimated 25% of chemotherapy patients are at risk for severe platelet deficiencies and currently available drug therapies do not stimulate both neutrophil and platelet production. In addition, we believe we will have a significant cost advantage compared to existing therapies. After further optimization in preclinical studies, we plan to file an Investigational New Drug application with the FDA for either NEUMUNE or REVERSIONEX and initiate a Phase II clinical study for chemotherapy-induced neutropenia.

A second large market opportunity that we are targeting with REVERSIONEX is lowering high cholesterol. Having demonstrated an ability to lower cholesterol in humans in two Phase I studies, we are now underway with a Phase II study that is expected to be completed mid-2003. The high cholesterol market exceeded $18 billion in 2000 and is predicted to grow to over $37 billion by 2008. In addition to its cholesterol-lowering properties, we believe based on preclinical studies that REVERSIONEX may have the ability to reduce inflammation and improve immunity. This profile may give us a competitive advantage over existing therapies.

During 2003, we plan to complete the Phase II cholesterol lowering study and complete another Phase II study underway to test REVERSIONEX for improving immune response to vaccines in the elderly. Given the potential size of the market opportunities for REVERSIONEX, we are seeking a partnership with a pharmaceutical company to fund further development of the compound.

In the area of global infectious diseases, we are developing IMMUNITIN for the epidemic-level indications of HIV, malaria and tuberculosis. IMMUNITIN is an attractive candidate for these indications because it is cost effective to manufacture, easy to distribute and use, and not likely to induce resistance. The compound also offers an attractive safety profile to date, and has been shown to be effective against numerous types of pathogens including viruses, parasites and bacteria. Clinical trials conducted to date with IMMUNITIN in infectious diseases have been highly encouraging. In malaria, for example, we have shown the ability to clear the parasite in human clinical trials conducted in Thailand. In HIV studies conducted in South Africa, we demonstrated the ability to have a positive anti-inflammatory effect on the patient, improve immune responses and reduce viral load. More recently, we demonstrated in preclinical models of tuberculosis an ability to significantly reduce the level of infection in an acute condition and a chronic phase of the disease. Through these studies we have learned that, with IMMUNITIN, we are reducing inflammation while improving innate and adaptive immunity, so that the patient's immune system can mount a more appropriate immune response.

Our commercial strategy for IMMUNITIN is to establish public/private partnerships with government agencies and large employers to develop and commercialize IMMUNITIN for the treatment of infectious diseases on a global scale. Given the growing prevalence of these epidemic-level infectious diseases, significant funds are now available from organizations such as the U.N. Global AIDS Fund, the World Bank and the Bill and Melinda Gates Foundation. Hollis-Eden is garnering the support of the South African Government and major employers in that country, and discussions are well underway on funding a Phase II/III clinical program with IMMUNITIN, which we believe can lead to commercialization of the compound.

A second commercial strategy for IMMUNITIN is the potential development of the compound as a countermeasure against biowarfare agents. Toward that end, Hollis-Eden is providing its IRHs to the Walter Reed Army Institute of Research to be tested for activity in preclinical models against a variety of bioterrorism agents. We believe that, for a number of these pathogens, if we show activity with IMMUNITIN, the compound may be eligible for review under the same new FDA rule we are pursuing with NEUMUNE for radiation protection. We are pleased that the government is recognizing the potential role our immune regulating hormones can play in Homeland Defense in the area of protecting against bioterrorism, and are eager to work toward the goal of meeting this national healthcare need.

During this time of challenging global events, it is critical for emerging biotechnology companies to manage their resources both creatively and strategically. Throughout 2002, we carefully focused our research and development efforts in order to minimize our spending and conserve our cash. In early 2003, we completed a $10 million convertible note financing with institutional investors. This financing, led by SG Cowen Securities Corporation, was completed despite extremely difficult market conditions.

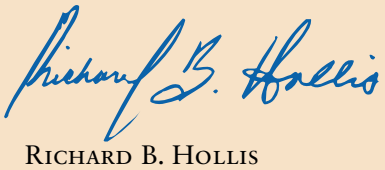
As we have pursued our goal of delivering products for global medicine, we have never deviated from our vision and values based on sound principles and science. While the world has changed around us, we have adapted and adjusted our strategy, but we have not jumped from one fad to the next. Rather, we have remained consistent and focused on achieving those milestones that served to confirm our vision and values. Over a period of years, that consistency in purpose breeds credibility and confidence on the part of others. As we look forward to 2003, we believe this will be a year of additional major milestones for the Company.

We believe we are well-positioned with near-term opportunities providing a clear pathway for commercial success, as well as large, global market opportunities to drive future revenues. With terrorist threats mounting both at home and abroad, with rising rates of infection on a global scale, and with a growing prevalence of chronic diseases associated with aging populations, we also believe that Hollis-Eden's IRHs provide the right therapeutic approach, at the right time and place.

We have demonstrated that our drug candidates stimulate both innate and adaptive immunity and that our IRHs re-establish the signaling pathways necessary for appropriate immune responses required by the host when confronted with pathogens. We believe that an effective, low-cost drug that allows the immune system to do its job could enable us to play a major role in addressing some of the most significant healthcare problems facing the world today. A company able to achieve this vision has the potential to treat millions of people worldwide, while generating significant profits for its shareholders.

I would once again like to thank our loyal shareholders for their investment in Hollis-Eden. At a time of distrust and concern for "Corporate America," we hope we have earned your trust and respect as a result of our consistency of focus and our diligent efforts to serve humanity by successfully developing and commercializing our promising IRH technology. I also extend my personal thanks to our dedicated employees who share our vision, some of whom are highlighted in this year's annual report. It is a pleasure and a privilege to work with such a talented group of individuals. Together we are determined to build a company that can make a difference in global health care in the 21*st* century, as well as reward its shareholders.

Sincerely,



Richard B. Hollis
Chairman and Chief Executive Officer

Creating the Future

PRODUCTS FOR 21ST CENTURY GLOBAL MEDICINE

Hollis-Eden currently has three drug candidates in advanced development:

NEUMUNE™ (HE2100)

Neumune is being co-developed with the U.S. Department of Defense for use in protecting the body from acute radiation injury. The compound is being developed pursuant to a new rule enacted by the U.S. Food and Drug Administration (FDA) under which approval may be granted on the basis of demonstrating efficacy in animals and safety in humans. In addition, Neumune has shown striking benefits in preclinical models of chemotherapy-induced immune suppression, and Hollis-Eden may also test this compound in Phase II clinical trials in this indication.

INDICATIONS	MARKET OPPORTUNITY
Radiation Injury	2 million U.S. military 8 million U.S. first responders All citizens at risk
Chemotherapy Protection	750,000 patients in U.S.

REVERSIONEX™ (HE2200)

Reversionex is currently being studied in Phase II clinical trials in cardiovascular disease and in improving immune responses in the elderly. In addition, like Neumune, Reversionex has shown striking benefits in preclinical models of chemotherapy-induced immune suppression, and Hollis-Eden may test this compound in Phase II clinical trials in this indication.

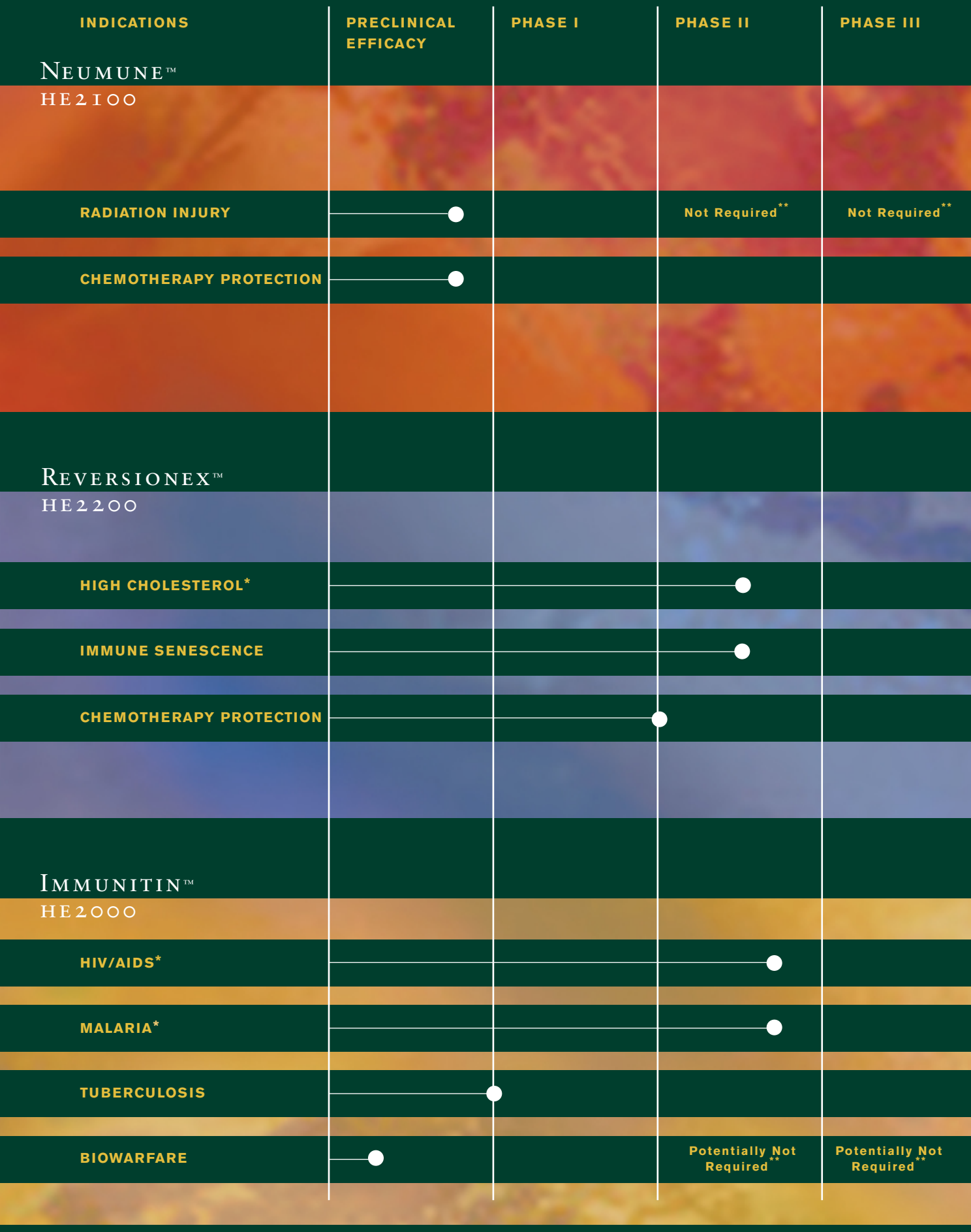
INDICATIONS	MARKET OPPORTUNITY
High Cholesterol	125 million people in U.S.
Immune Senescence	35 million people in U.S. over age 65
Chemotherapy Protection	750,000 patients in U.S.

IMMUNITIN™ (HE2000)

Immunitin, Hollis-Eden's infectious disease compound, has shown activity in Phase II clinical trials in malaria and HIV and preclinical benefit in a number of tuberculosis models. In addition, it has attributes that make it potentially useful on a global basis. The Company is pursuing public/private partnerships with a number of organizations that may provide funding to allow it to conduct a Phase II/III clinical trial with Immunitin in infectious disease. In addition, the U.S. military is screening Immunitin and other IRHs as countermeasures against a number of pathogens that could be used as biowarfare agents.

INDICATIONS	MARKET OPPORTUNITY
HIV/AIDS	Over 40 million people worldwide
Malaria	Over 300 million people worldwide
Tuberculosis	Over 3 million people worldwide
Biowarfare	Same as Radiation Injury above

PRODUCT DEVELOPMENT PIPELINE



*Evidence of activity in human studies
**FDA rule requires demonstration of safety in humans and efficacy in relevant animal species for approval

NEUMUNE™ HE2100

In light of recent world events, there is an urgent need for a practical radioprotectant that can be used on a widespread basis in the event of an act of terrorism such as the detonation of a nuclear device or "dirty bomb," or an attack on a nuclear power plant. While potassium iodide is currently available for use in the event of radiation exposure, it is only effective against the long-term risk of thyroid cancer and does not protect the body from the acute effects radiation has on the bone marrow, which can lead to rapid fatalities. Despite this limitation, potassium iodide has been stockpiled broadly for years in Europe and Japan for civilians living within close proximity to nuclear power plants, and the U.S. has recently begun purchasing millions of doses of the drug for stockpiling in this country.

RADIATION INJURY

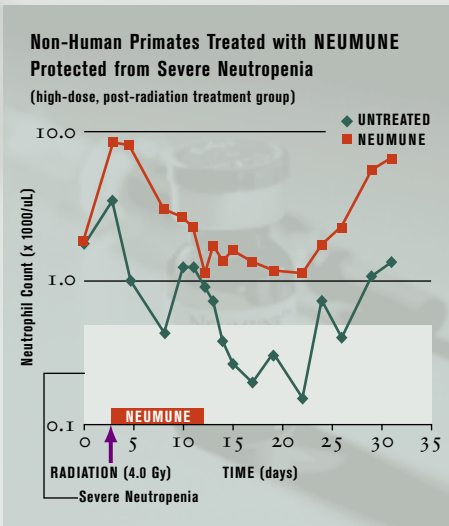
Hollis-Eden believes NEUMUNE™ (HE2100) may be able to provide protection from the acute effects of radiation on the bone marrow. The Company is developing NEUMUNE under a new U.S. Food and Drug Administration (FDA) rule, where it would be unethical to expose humans to life-threatening pathogens or events such as radiation in an effort to determine clinical efficacy. Under this new rule, marketing approval as a drug to provide protection from this exposure may be gained based on the demonstration of safety in humans and efficacy in relevant animal species.

In April 2003, the Company announced positive preliminary results from a pilot study in non-human primates demonstrating that NEUMUNE provides significant protection from the acute life-threatening effects of whole body radiation exposure. Preliminary results from the study indicated when NEUMUNE was given 2 to 4 hours after radiation exposure, a significant reduction in the occurrence of severe neutropenia – a severe loss of neutrophils (or key infection-fighting white blood cells) – was observed as compared to control animals not receiving the drug.

Four weeks after radiation, there was a 5-fold decrease in the percentage of days the animals in the post-radiation treatment group were at high risk for infection – the leading cause of mortality following whole body radiation.

Hollis-Eden is co-developing NEUMUNE with the Armed Forces Radiobiology Research Institute (AFRRI) – an agency within the U.S. Department of Defense and a leader in studying the short- and long-term effects of radiation injury. After screening thousands of compounds in an effort to find a radioprotectant suitable for widespread use, AFRRI selected NEUMUNE as its leading candidate for radioprotection based in part on its striking efficacy in earlier preclinical models conducted in mice. These studies showed that up to 100% of animals treated with NEUMUNE prior to being exposed to radiation survived versus up to 100% mortality in the animal group receiving no drug. Investigators conducting the studies attributed the survival advantage to NEUMUNE's ability to increase a number of cell types associated with immune protection, including neutrophils and platelets.

Following completion of several non-human primate pilot studies, Hollis-Eden plans to conduct a pivotal efficacy study with NEUMUNE in non-human primates, which the Company believes is comparable to a Phase III clinical trial to demonstrate efficacy of NEUMUNE under the new FDA rule. Given the accelerated potential development path for NEUMUNE and the significant and largely untapped market opportunity for compounds that can treat acute radiation injury, Hollis-Eden has made development



Key to successful product development is effective management of preclinical and clinical trial activities. Leading Hollis-Eden's preclinical activities for hematopoiesis is Charles Dowding, Ph.D., Scientific Investigator, Cellular Immunology (left). *Dr. Dowding brings significant biomedical research experience to Hollis-Eden, having joined the Company from Novartis, where he specialized in hematopoiesis. Hollis-Eden's radiation protection studies and clinical trial programs are being led by* Dwight Stickney, M.D., Medical Director. *In addition to substantial industry experience, Dr. Stickney is a practicing radiation oncologist with significant experience to bring to bear in the clinical development programs for* NEUMUNE *and other IRH compounds.*

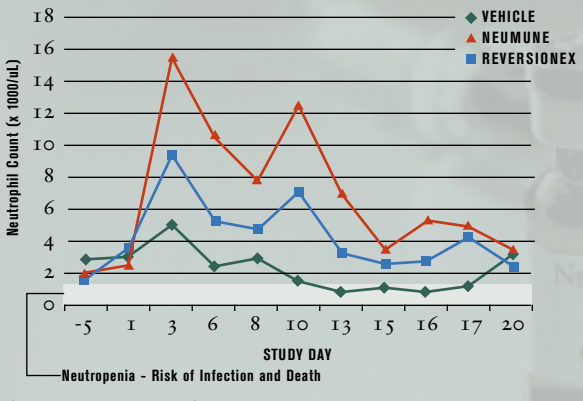
of NEUMUNE a top priority. The Company is collaborating with AFRRI to establish all of the manufacturing, toxicology and human safety data that will be needed to support an Investigational New Drug (IND) application and a New Drug Application (NDA) with the FDA.

The market opportunity for a drug that reduces the effects of acute radiation injury could be significant. Because the window of opportunity to treat radiation injury is short, any drug to treat this condition would likely need to be stockpiled on a local level to be appropriately available for high-risk populations. Such high-risk areas may include any military installation or theater of operations, any urban or metropolitan area that is at risk of a radiological attack, and a 10- to 50-mile radius around any nuclear power plant or spent fuel facility. In the U.S., this could total more than 20 million people. In addition, the Company believes similar market opportunities exist in Europe and Asia.

CHEMOTHERAPY

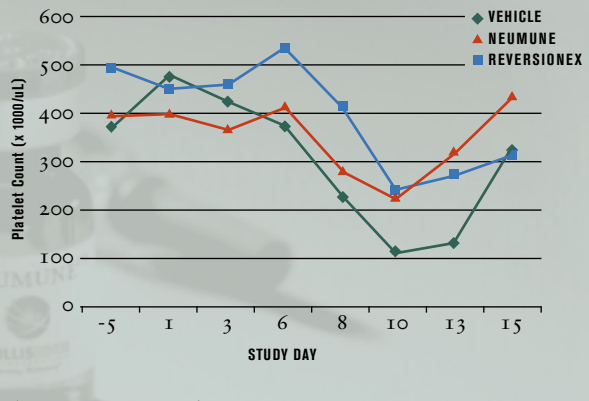
Successful results in the setting of radiation exposure could represent a pathway to the $2 billion market for preventing chemotherapy-induced neutropenia (or significant loss of neutrophils). Preclinical studies with NEUMUNE, and also with REVERSIONEX™ (HE2200), generated positive data on neutrophil recovery and platelet protection in a primate model of chemotheapy-induced immune suppression. Loss of platelets is a leading cause of bleeding complications. Based on these results, Hollis-Eden may conduct a Phase II clinical trial with one or both of these compounds in this setting.

IRHs Induced Recovery of Neutrophils after Exposure to Chemotherapy in Primate Model



(Dosing days 1 through 10)

Unlike Existing Drugs for Neutropenia, NEUMUNE and REVERSIONEX also Appear to Protect Platelets in Chemotherapy Model



(Dosing days 1 through 10)

REVERSIONEX™ HE2200

REVERSIONEX™ (HE2200) is being developed by Hollis-Eden to address the large market opportunities in metabolic and cardiovascular disorders, age-induced immune suppression and chemotherapy protection. To date, the compound has demonstrated promise relative to its ability to restore immune function in various preclinical experiments involving immune dysfunction, including the ability to restore immune function in models of both chemotherapy- and age-induced immune suppression, and to reduce inflammation in a number of models of autoimmunity. Two placebo controlled Phase I safety studies, which tested both an injectable and a buccal tablet formulation of REVERSIONEX, indicated that the drug was well-tolerated, providing the demonstration of human safety necessary to proceed to Phase II studies.

HIGH CHOLESTEROL

In both of these Phase I trials, it was observed that human volunteers receiving Reversionex experienced a sharp drop in total and LDL cholesterol and an improvement in the total cholesterol-to-HDL ratio, despite the fact that volunteers received the compound for only three or five days. Given that the U.S. market for cholesterol-lowering drugs is anticipated to exceed $37 billion in 2008, Hollis-Eden has chosen to undertake a placebo controlled Phase II clinical trial in patients with high cholesterol. This study is now underway. The fact that Reversionex has also shown an ability in preclinical studies to lower inflammation and improve immune response may differentiate the compound from existing cholesterol-lowering drugs. This may be particularly beneficial, as inflammation has recently been shown to be an independent predictor, in addition to cholesterol levels, in assessing risk of adverse cardiac events.

IMMUNE SENESCENCE

Hollis-Eden is conducting a Phase II study with Reversionex in the elderly to determine if patients receiving Reversionex respond better to vaccine than those receiving placebo. Preclinical studies with the compound have demonstrated an ability to increase antibody production to a vaccine and to correct the depressed cell-mediated immunity of aged animals. With aging, the immune system does not respond as quickly or efficiently as it did when younger. For example, the U.S. Centers for Disease Control reports that people over the age of 65 who are given a flu vaccine receive on average only 40% of the benefit of that vaccine since their immune system does not produce sufficient antibodies. Given the ability of IRHs to restore immunity in a variety of models of immune dysregulation, Hollis-Eden believes Reversionex could be useful in addressing the deficit of the aging immune system, known as immune senescence.

CHEMOTHERAPY

Hollis-Eden is also developing Reversionex for chemotherapy-induced neutropenia (or the significant loss of neutrophils). Neutrophils are white blood cells that are part of the body's key defense mechanism against infections. Neutrophils can be depleted as a result of a number of conditions of immune suppression, including radiation injury, chemotherapy or radiation therapy for cancer, and diseases such as HIV. Neutrophil depletion can lead to life threatening infections and death.

Currently marketed drugs that only stimulate neutrophils in chemotherapy-induced neutropenia generate revenues in excess of $2 billion per year. Up to 25% of chemotherapy patients are also estimated to experience severe platelet depletion without effective drug therapies currently available. Preclinical studies with Reversionex in a primate model of chemotherapy-induced immune suppression generated positive data

Hollis-Eden implements a partially integrated business model appropriate for today's market environment, enabling the Company to outsource key drug development functions ranging from preclinical and clinical pharmacokinetics and toxicology through product quality assurance and manufacturing. Leading these efforts for the Company is Clarence N. Ahlem, Director, Product Development. *During his 19 years of product development experience with companies such as Hybritech and SyStemix, he has held positions with a broad range of scientific and managerial responsibilities encompassing product concept development and evaluation, establishment of technical bases for product specifications and quality control, pharmacological evaluations and pilot manufacturing.*

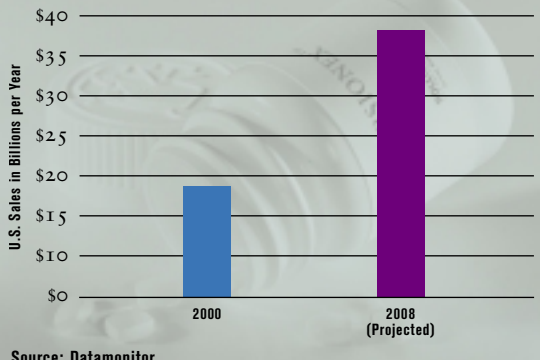
on neutrophil recovery as well as platelet protection. REVERSIONEX also offers the potential advantages of significantly lower drug manufacturing costs and the potential ability to stimulate cell-mediated immunity. Based on these attributes and its study results to date, Hollis-Eden may conduct a Phase II clinical trial with either REVERSIONEX or NEUMUNE™ (HE2100) in this setting.

DEVELOPMENT STRATEGY

In addition to potentially commencing a Phase II study in chemotherapy-induced neutropenia, Hollis-Eden's plan for REVERSIONEX in 2003 is to complete the cholesterol lowering study now underway in patients with high cholesterol and to complete the immune enhancement study now underway in elderly patients. The Company is currently in discussions with several pharmaceutical companies about the potential to collaborate on the future development of REVERSIONEX in these potential indications.

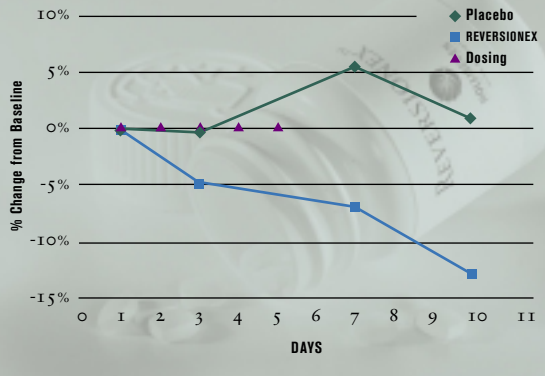
Phase I Safety Study Note:
Hollis-Eden has initiated a Phase II trial in patients with high cholesterol based on encouraging findings from a Phase I safety study of REVERSIONEX in healthy volunteers that showed a sharp drop in LDL cholesterol despite the fact that volunteers received the compound for only five days.

Cholesterol-Lowering Drugs Annual Sales

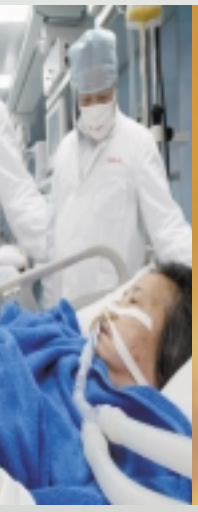


Source: Datamonitor

Phase I Safety Study (See Note Above)
Significant Reduction in LDL Cholesterol, REVERSIONEX vs. Placebo (p=0.03)
High-Dose Buccal Tablet (100 mg)



IMMUNITIN™ HE2000



Hollis-Eden's immune regulating hormones have a number of attributes that may make them especially useful in addressing the serious rise in global infectious diseases such as HIV, malaria and tuberculosis. Among these attributes are the potential broad-spectrum activity of IRHs in multiple infectious diseases, their attractive safety profile to date, the low likelihood of inducing resistant strains of pathogen, the relatively low cost of manufacture and ease of administration. Hollis-Eden's drug candidate for global infectious diseases is IMMUNITIN™ (HE 2000). Hollis-Eden is working actively to form public/private partnerships with governments, industry and international relief agencies to advance development of IMMUNITIN for infectious diseases, foremost in South Africa where the Company has conducted promising clinical trials in HIV-infected patients.

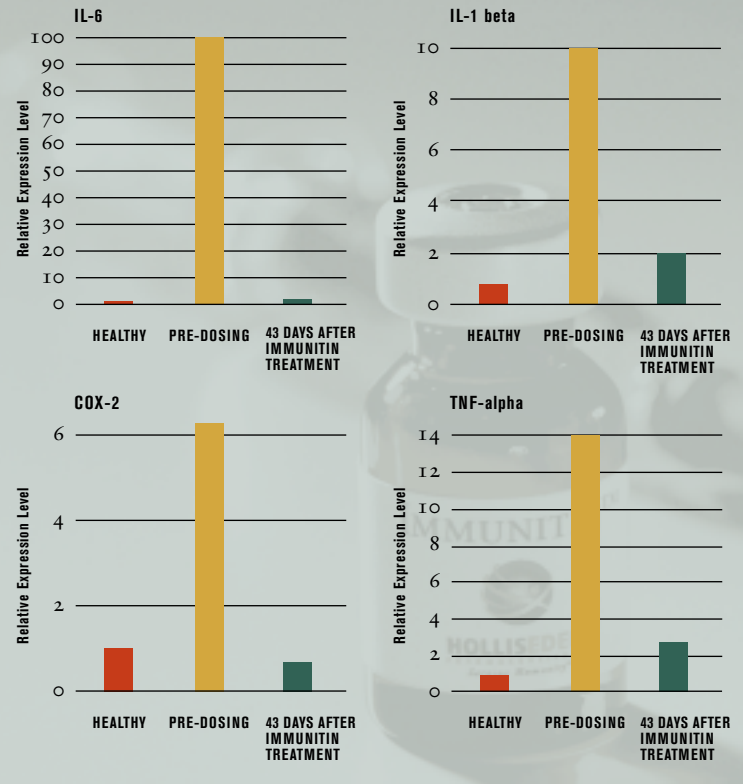
HIV/AIDS

Hollis-Eden believes that Immunitin has the potential to play an important role in treating HIV in the developing world, where more than 40 million people are estimated to be infected with HIV, as well as in developed-world markets such as the U.S. and Europe, where more than one million people are believed to carry the virus. If Hollis-Eden is successful in demonstrating clinically that Immunitin restores or improves immune system activity, the compound may be useful for long-term control of viral replication and delaying or preventing the progression to AIDS, as well as preventing or clearing opportunistic infections.

Immunitin has been tested in a series of Phase I/II and Phase II clinical trials in HIV/AIDS patients in the U.S. and South Africa. In addition to assessing the safety profile of Immunitin in these trials, Hollis-Eden is assessing the effects of Immunitin on a wide variety of immune and inflammatory markers that are associated with disease progression.

Results from a study employing intermittent subcutaneous dosing of Immunitin in South African HIV patients were presented at the World AIDS Conference in July 2002. After dosing with Immunitin, HIV patients experienced statistically significant declines in transcripts of inflammatory mediators to levels close to those seen in healthy volunteers. Those levels remained significantly reduced for the entire treatment course despite only intermittent dosing. Increases in inflammatory cytokines can lead to a progressive loss of innate

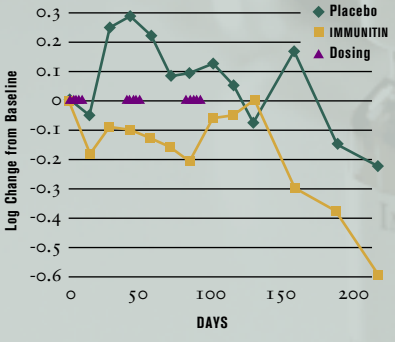
IMMUNITIN Normalizes Inflammatory Cytokine Genes in HIV-Infected Patients



Managing the regulatory approval process through all phases of clinical development is essential to successful product commercialization. Since 1998, Nanette Onizuka-Handa, Director, Regulatory Affairs, has led the regulatory activities for Hollis-Eden, from spearheading the first clinical trials for IMMUNITIN *in HIV in South Africa, to filing the Company's IND for* REVERSIONEX *in the United States for lowering cholesterol. Prior to joining Hollis-Eden, she was Associate Director of Regulatory Affairs at Gilead Sciences, where she participated in the development of antiviral agents for the treatment of HIV and chronic hepatitis B virus infections. Her 22 years of industry experience also includes management positions with SyStemix, Genentech and Syntex.*

and cell-mediated immunity. This inflammatory dysregulation and loss of immunity is believed to ultimately accelerate the progression of HIV to AIDS and the life-threatening opportunistic infections, cancers, wasting and dementia that compromise the patient. By quieting down this rampant systemic inflammation, Hollis-Eden believes that IMMUNITIN has the potential to induce the immune system to mount appropriate innate and adaptive cell-mediated immune responses that will keep the virus in check and slow or prevent the progression to AIDS-related conditions. In the South African clinical study, Hollis-Eden also observed significant increases relative to placebo treated patients in a wide variety of immune cell types that have been associated with delaying disease progression towards AIDS. In addition, patients receiving IMMUNITIN in this trial experienced a fall in virus levels over the course of the study, which reached a 0.6 log drop in the most effective dose group at the end of the 8-month monitoring period.

IMMUNITIN Decreased HIV Plasma Viral Load When Given as a Monotherapy
(50 mg Subcutaneous IMMUNITIN Dose; p<0.01)



IMMUNITIN in Malaria Clinical Trials
Parasite Clearance and Fever Clearance Time

N=21 Per Study	Buccal Tablet Administration	Intramuscular Administration
Median Time to 50% Parasite Clearance	6 hr	6 hr
Median Time to 90% Parasite Clearance	24 hr	12 hr
Median Time to 100% Parasite Clearance	42 hr	36 hr
Number of Patients who Cleared Parasites by Day 7	15/21	16/21
Median Time to Normal Temperature	12 hr	24 hr
Number of Patients who Cleared Fever by Day 7	18/21	8/8

MALARIA

The ability of IMMUNITIN to reduce inflammation while stimulating innate and adaptive cell-mediated immunity seen in the HIV clinical trials has possible implications for a number of other infectious diseases, including malaria. In two Phase II clinical trials conducted in malaria patients in Thailand, results indicated that IMMUNITIN was very successful at reducing parasite count and cleared malarial parasites in most patients within seven days when the compound was delivered either by injection or as a buccal tablet. Based on these favorable results, the Company is now exploring opportunities to examine the potential benefit of IMMUNITIN when used in combination with other anti-malarial drugs, a well as potentially a prophylactic agent.

Market research indicates that 300-500 million people per year suffer from malaria. This parasite is responsible for more than one million deaths annually, most of them children. Most cases of malaria occur in the developing world, but, as a result of increased global travel and other factors, the incidence of malaria in the developed world is increasing. Recent strains of malaria have

Hollis-Eden has built an impressive intellectual property estate covering its class of immune regulating hormones. The Company currently owns or has obtained a license to over 80 issued U.S. and foreign patents and over 130 pending U.S. and foreign patent applications. Leading Hollis-Eden's IP program is Daryl Muenchau, Ph.D., J.D., Director, Intellectual Property. *Prior to joining Hollis-Eden, Dr. Muenchau was a patent agent and attorney for six years with Gilead Sciences. Previously he worked in Dr. W. French Anderson's lab at the NIH, earning his Ph.D. During 2002 Dr. Muenchau was responsible for strengthening Hollis-Eden's IP position in a number of critical areas. Most notably, this year Hollis-Eden received new allowable claims from the U.S. Patent and Trademark Office for a new crystal structure of* IMMUNITIN *that is expected to provide protection until 2020.*

developed that are resistant to commonly used treatments such as chloroquine, making these drugs ineffective in many parts of the world. As a result, finding new approaches to the treatment of malaria has become a major priority of the U.S. military and health officials in many countries.

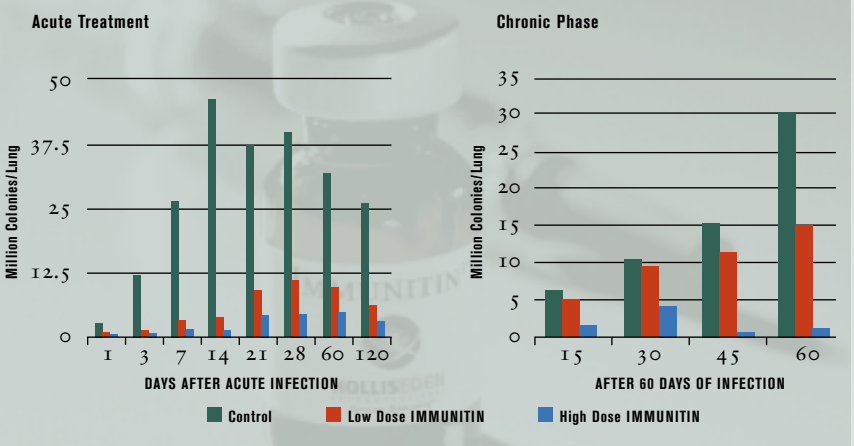
TUBERCULOSIS

A series of preclinical studies completed with IMMUNITIN in models of tuberculosis indicate that the compound is effective when given as a monotherapy in both acute and chronic tuberculosis. In addition, IMMUNITIN appears to have a synergistic effect when combined with the current three-drug regimen of antibiotic treatment in this model system. As part of Hollis-Eden's efforts to obtain collaborative funding for its infectious disease program, the Company is discussing opportunities to conduct clinical trials in tuberculosis. Like HIV and malaria, tuberculosis has reached epidemic proportions in the developing world, and antibiotic-resistant tuberculosis is increasingly being seen in both the developed and developing world. Tuberculosis is also a common opportunistic infection experienced by AIDS patients.

BIOWARFARE

Given the potential use by terrorists of biological agents designed to be resistant to all known antibiotics, the U.S. government is interested in developing compounds that are capable of boosting host immunity rather than attacking a specific pathogen. IMMUNITIN could be such a compound since it appears to boost both innate and adaptive host immunity, has shown broad-spectrum activity against viral, parasitic and bacterial pathogens and is suitable for large-scale pharmaceutical stockpiling. Because of these features, the Walter Reed Army Institute of Research has asked to screen IMMUNITIN and other IRHs against a series of pathogens that may be used as biowarfare agents. If these results are favorable, government grants and incentives may be available to fund further development in these indications. In addition, President Bush's proposed Project BioShield legislation may provide guaranteed purchase contracts upon delivery of an approved product.

In Preclinical Studies, IMMUNITIN Has a Significant Effect on Both Acute and Chronic Tuberculosis



MANAGEMENT'S DISCUSSION AND ANALYSIS

The forward-looking comments contained in the following discussion involve risks and uncertainties. Our actual results may differ materially from those discussed here. Factors that could cause or contribute to such differences can be found in the following discussion and elsewhere throughout this Annual Report.

General Hollis-Eden Pharmaceuticals, Inc., a development-stage pharmaceutical company, is engaged in the discovery, development and commercialization of products for the treatment of immune system disorders and other conditions resulting from hormonal imbalances. Our initial technology development efforts are focused on a series of potent hormones and hormone analogs that we believe are key components of the body's natural regulatory system. We believe these compounds can be used as a hormone replacement therapy to reestablish balance to the immune system in situations of dysregulation.

We have been unprofitable since our inception and we expect to incur substantial additional operating losses for at least the next few years as we increase expenditures on research and development and begin to allocate significant and increasing resources to clinical testing and other activities. In addition, during the next few years, we may have to meet the substantial new challenge of developing the capability to market products. Accordingly, our activities to date are not as broad in depth or scope as the activities we must undertake in the future, and our historical operations and financial information are not indicative of the future operating results or financial condition or ability to operate profitably as a commercial enterprise when and if we succeed in bringing any drug candidates to market.

On March 26, 1997, Hollis-Eden, Inc., a Delaware corporation, was merged with and into us, then known as Initial Acquisition Corp. ("IAC"), a Delaware corporation. Upon consummation of the merger of Hollis-Eden, Inc. with IAC (the "Merger"), Hollis-Eden, Inc. ceased to exist, and IAC changed its name to Hollis-Eden Pharmaceuticals, Inc.

Results of Operations We have not generated any revenues for the period from August 15, 1994 (inception of Hollis-Eden) through December 31, 2002. We have devoted substantially all of our resources to the payment of research and development expenses, licensing fees plus general and administrative expenses. From inception until December 31, 2002, we have incurred expenses of approximately $56.7 million in research and development and $32.4 million in general and administrative expenses, which have been partially offset by $7.7 million in net interest income resulting in a loss of $81.4 million for the period.

Research and development expenses were $13.1 million, $11.9 million and $17.9 million in 2002, 2001 and 2000, respectively. The research and development expenses relate primarily to the ongoing development, preclinical testing, and clinical trials for HE2000, HE2001 and HE2200, as well as our investment in Aeson Therapeutics, which has been expensed as in-process R&D. Research and development expenses increased $1.2 million in 2002 compared to 2001 due to increased staffing, license fees and clinical trials expenses, which was offset by reduced expenditures for preclinical work. Research and development expenses decreased $6.0 million in 2001 compared to 2000. This decrease is due to the $6.5 million (of which $4.5 million was non-cash) expense that was related to the acquisition of technology and in-process research and development during 2000. There were no comparable expenses in 2001. Unless we enter into agreements that provide us with funding for additional programs, we expect research and development expenses to decrease in 2003 as a result of more focused development efforts.

General and administrative expenses decreased $0.3 million in 2002 compared to 2001 due to decreased consulting fees and legal expenses that were partially offset by an increase in facilities and investor relations expenses. General and administrative expenses increased $0.9 million in 2001 compared to 2000 due to increased consulting fees, travel expenses, legal fees and annual report expenses. We expect general and administrative expenses for 2003 to remain generally consistent with figures for 2001 and 2002.

Liquidity and Capital Resources We have financed our operations since inception primarily through the sale of shares of common stock. During the year ended December 31, 1995, we received cash proceeds of $250,000 from the sale of securities. In May 1996, we completed a private placement of shares of common stock, from which we received aggregate gross proceeds of $1.3 million. In March 1997, the Merger of IAC and Hollis-Eden, Inc. provided us with $6.5 million in cash and other receivables. In May 1998, we completed a private placement of common stock and warrants, from which we received gross proceeds of $20 million. During January 1999, we completed two private placements of common stock raising approximately $25 million. In December 2001, we completed a private placement of common stock and warrants, from which we received gross proceeds of $11.5 million. In addition, we have received a total of $13 million from the exercise of warrants and stock options from inception.

On February 25, 2003, we completed a private placement in which we issued $10.0 million aggregate principal amount of three-year convertible debentures, Debentures, bearing interest at 7.5% per year, and warrants to purchase 701,760 shares of common stock. The Debentures are convertible into common stock at a price of $5.70 per share, which represented a premium to the average price of our common stock over several days prior to the closing. The conversion price of the Debentures is subject to limited anti-dilution adjustments under certain circumstances. The warrants issued with the Debentures have two exercise prices with one-half having an exercise price of $6.17 per share and the other half having an exercise price of $6.71 per share. The warrants are exercisable until February 25, 2007.

The Debentures mature on February 25, 2006. We are required to make quarterly interest payments on the Debentures while they remain outstanding. We are entitled to issue common stock, in lieu of cash, as payment of interest on the Debentures, subject to certain limitations. If our stock is trading below certain price levels when interest payments on the Debentures are due, we will not be permitted to issue shares of common stock in lieu of interest on the Debentures unless we have first obtained stockholder approval. We are entitled to force conversion of the Debentures into common stock in the event our common stock price exceeds $14.25 per share for 15 consecutive trading days or in the event we complete a public offering of our common stock of at least $20.0 million at a price equal to at least $11.40 per share.

Our net proceeds from the sale of the Debentures was approximately $9.2 million, after the payment of $800,000 as fees and expenses relating to the offering. In addition, in connection with the offering, we issued to out placement agent a warrant to purchase 73,684 shares of our common stock having an exercise price of $5.99 per share. This warrant is exercisable from August 25, 2003 through February 25, 2008.

Our operations to date have consumed substantial capital without generating any revenues, and we will continue to require substantial and increasing amounts of funds to conduct necessary research and development and preclinical and clinical testing of our drug candidates, and to market any drug candidates that receive regulatory approval. In addition, because of our recent debt financing, we will also require liquidity to service our debt obligations. We do not expect to generate revenue from operations for the foreseeable future, and our ability to meet our cash obligations as they become due and payable is expected to depend for at least the next several years on our ability to sell securities, borrow funds or some combination thereof. Based upon our current plans, we believe that our existing capital resources, together with interest thereon, will be sufficient to meet our operating expenses and capital requirements at least into the second half of 2004. We have recently streamlined our operations and focused our research and development expenditures, and we are developing further contingency plans that we believe will allow our existing resources to meet our needs into 2005 in the event we are unable to raise additional funds before that time. However, changes in our research and development plans or other events affecting our operating expenses may result in the expenditure of such cash before that time. We may not be successful in raising necessary funds.

Our future capital requirements will depend upon many factors, including progress with preclinical testing and clinical trials, the number and breadth of our programs, the time and costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other proprietary rights, the time and costs involved in obtaining regulatory approvals, competing technological and market developments, and our ability to establish collaborative arrangements, effective commercialization, marketing

activities and other arrangements. Our future capital requirements will also depend on whether our Debentures are converted into shares of common stock prior to their maturity and whether we are able to pay accrued interest under the Debentures in shares of our common stock. We expect to continue to incur increasing negative cash flows and net losses for the foreseeable future. We intend to seek additional funding through public or private financing or through collaborative arrangements with strategic partners.

Critical Accounting Policies Our significant accounting policies, which have been consistently applied in all material respects, are more fully described in Note 2 to our Notes to Financial Statements. Certain of our accounting policies require the application of judgment and estimates by management, which may be affected by different assumptions and conditions. These estimates are typically based on historical experience, terms of existing contracts, trends in the industry and information available from other outside sources, as appropriate. We believe the estimates and judgments associated with our reported amounts are appropriate in the circumstances. Actual results could vary from those estimates under different assumptions or conditions. Given the nature of our current operations, there are no other critical accounting policies that affect us.

Impact of Recently Issued Accounting Pronouncements In July 2002, the Financial Accounting Standards Board issued FASB Statements No. 146, *Accounting for Restructuring Costs* (SFAS 146). SFAS No. 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts, and relocating plant facilities or personnel. Under SFAS No. 146, a company will record a liability for a cost associated with an exit or disposal activity when that liability is incurred and can be measured at fair value. SFAS No. 146 will require a company to disclose information about its exit and disposal activities, the related costs, and changes in those costs in the notes to the interim and annual financial statements that include the period in which an exit activity is initiated and in any subsequent period until the activity is completed. SFAS No. 146 is effective prospectively for exit or disposal activities initiated after December 31, 2002. Under SFAS No. 146, a company may not restate its previously issued financial statements and the new Statement grandfathers the accounting for liabilities that a company had previously recorded under Emerging Issues Task Force Issue 94-3. The adoption of this statement is not expected to effect the our financial condition.

In December 2002, the FASB issued SFAS No.148 "Accounting for Stock-Based Compensation—Transition and Disclosure." This Statement amends SFAS No. 123 "Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of this Statement are effective for fiscal years ending after December 15, 2002. We have elected to continue using the intrinsic value method and have incorporated these expanded disclosures into our Notes To Financial Statements.

In November 2002, the FASB issued Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("Interpretation 45"). Interpretation 45 requires a guarantor to include disclosure of certain obligations, and if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The recognition requirement is effective for guarantees issued or modified after December 31, 2002 and is not expected to have a material impact on us. We have no obligations regarding Interpretation No. 45.

In January 2003, the FASB issued Interpretation No. 46 "Consolidation of Variable Interest Entities" ("Interpretation 46"). Interpretation 46 clarifies the application of Accounting Research Bulletin No. 51 "Consolidated Financial Statements", and applies immediately to any variable interest entities created after January 31, 2003 and to variable interest entities in which an interest is obtained after that date. We hold no interest in variable interest entities.

Hollis-Eden Pharmaceuticals, Inc. (A Development Stage Company)

BALANCE SHEETS

(in thousands)	December 31, 2002	2001
Assets:		
Current Assets:		
Cash and cash equivalents	$ 13,087	$ 30,567
Prepaid expenses	123	169
Deposits	87	27
Total current assets	13,297	30,763
Property and equipment, net of accumulated depreciation of $327 and $335	398	422
Receivable from related party (Note 4)	274	277
Other receivable	13	–
Total assets	$ 13,982	$ 31,462
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Accounts payable and accrued expenses	$ 2,950	$ 3,602
Total current liabilities	2,950	3,602
Commitments and contingencies (Notes 6, 11, 12)		
Stockholders' Equity: (Notes 3, 7, 8, 9, 10)		
Preferred stock, no par value, 10,000 shares authorized; no shares outstanding	–	–
Common stock, $.01 par value, 50,000 and 30,000 shares authorized respectively; 12,972 and 12,896 shares issued and outstanding, respectively	130	129
Paid-in capital	92,322	91,649
Deficit accumulated during development stage	(81,420)	(63,918)
Total stockholders' equity	11,032	27,860
Total liabilities and stockholders' equity	$ 13,982	$ 31,462

The accompanying notes are an integral part of these financial statements.

Hollis-Eden Pharmaceuticals, Inc. (A Development Stage Company)

STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)	For the year ended December 31, 2002	2001	2000	Period from Inception (Aug. 15, 1994) to December 31, 2002
Operating Expenses:				
Research and development				
R&D operating expenses	$ 13,017	$ 11,774	$ 13,407	$ 51,381
R&D costs related to common stock and stock option grants for collaborations and technology purchases	66	96	4,526	5,342
Total research and development	13,083	11,870	17,933	56,723
General and administrative				
G&A operating expenses	4,523	4,804	4,157	22,314
G&A costs related to options/warrants granted	264	287	–	10,041
Total general and administrative	4,787	5,091	4,157	32,355
Total operating expenses	17,870	16,961	22,090	89,078
Other Income (expense):				
Gain/loss on disposition of assets	(21)	–	–	(21)
Interest income	389	1,199	2,575	7,729
Interest expense	–	–	–	(50)
Total other income	368	1,199	2,575	7,658
Net loss	$(17,502)	$(15,762)	$(19,515)	$(81,420)
Net loss per share, basic and diluted	$ (1.35)	$ (1.35)	$ (1.74)	
Weighted average number of common shares outstanding	12,932	11,654	11,240	

The accompanying notes are an integral part of these financial statements.

Hollis-Eden Pharmaceuticals, Inc. (A Development Stage Company)

STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

Contribution by stockholder
Common stock issued for cash
Common stock issued a consideration for the license agreements (Note 6)
Net loss

Balance at December 31, 1994
Common stock issued for cash
Common stock issued a consideration for amendments to the license agreements (Note 6)
Net loss

Balance at December 31, 1995
Common stock issued in conversion of debt (Note 7)
Common stock issued for cash, net of expenses (Note 7)
Common stock issued as consideration for termination of a finance agreement
Warrants issued to consultants for services rendered
Net loss

Balance at December 31, 1996
Recapitalization of Company upon the merger with Initial Acquisition Corp. (Note 3)
Warrants issued to a certain director upon the successful closure of the merger (Note 3)
Exercise of warrants, net of expenses
Deferred compensation – stock options (Note 9)
Amortization of deferred compensation
Exercise of stock options
Net loss

Balance at December 31, 1997
Exercise of warrants
Exercise of stock options
Private Placement, net of expenses (Note 7)
Warrants issued for services in lieu of cash (Note 10)
Stock issued for license fee (Note 6)
Stock issued for services in lieu of cash
Options issued for services in lieu of cash (Note 9)
Amortization of deferred compensation
Net Loss

Balance at December 31, 1998

Preferred Stock at Par Value		Common Stock at Par Value		Capital in Excess of Par Value	Deferred Compensation	Deficit Accumulated During Development Stage	Total
Shares	Amount	Shares	Amount				
–	$ –	–	$ –	$ 103	$ –	$ –	$ 103
–	–	2,853	–	25	–	–	25
–	–	543	–	5	–	–	5
–	–	–	–	–	–	(1,277)	(1,277)
–	–	3,396	–	133	–	(1,277)	(1,144)
–	–	679	–	250	–	–	250
–	–	76	–	28	–	–	28
–	–	–	–	–	–	(672)	(672)
–	–	4,151	–	411	–	(1,949)	(1,538)
–	–	165	–	371	–	–	371
–	–	580	–	1,234	–	–	1,234
–	–	15	–	34	–	–	34
–	–	–	–	24	–	–	24
–	–	–	–	–	–	(692)	(692)
–	–	4,911	–	2,074	–	(2,641)	(567)
–	–	883	58	6,213	–	–	6,271
–	–	–	–	570	–	–	570
–	–	978	10	5,619	–	–	5,629
–	–	–	–	1,848	(1,848)	–	–
–	–	–	–	–	282	–	282
–	–	–	–	1	–	–	1
–	–	–	–	–	–	(5,253)	(5,253)
–	–	6,772	68	16,325	(1,566)	(7,894)	6,933
–	–	399	4	1,196	–	–	1,200
–	–	53	1	155	–	–	156
4	–	1,329	13	19,877	–	–	19,890
–	–	–	–	408	–	–	408
–	–	33	–	500	–	–	500
–	–	6	–	95	–	–	95
–	–	–	–	240	–	–	240
–	–	–	–	–	308	–	308
–	–	–	–	–	–	(5,427)	(5,427)
4	$ –	8,592	$ 86	$38,796	$ (1,258)	$(13,321)	$24,303

Hollis-Eden Pharmaceuticals, Inc. (A Development Stage Company)

STATEMENTS OF STOCKHOLDERS' EQUITY Continued

(in thousands)
Balance at December 31, 1998
Exercise of warrants
Exercise of stock options
Private Placement, net of expenses (Note 7)
Preferred Stock Conversion (Note 7,8)
Deferred compensation – Option forfeited (Note 9)
Amortization of non-employee options
Warrants issued for services in lieu of cash (Note 10)
Options accelerated vesting (Note 9)
Net Loss
Balance at December 31, 1999
Exercise of warrants
Exercise of stock options
Common Stock issued for 401k/401m plan
Common Stock issued for In-Process R & D (Note 6)
Options granted for license fee
Amortization of non-employee options
Common Stock issued for purchase of technology
Net Loss
Balance at December 31, 2000
Exercise of stock options
Common Stock issued for 401k/401m plan
Private Placement, net of expenses (Note 7)
Warrants issued for services in lieu of cash (Note 10)
Amortization of non-employee options
Warrants issued for services
Net Loss
Balance at December 31, 2001
Exercise of stock options
Common Stock issued for 401k/401m plan
Common Stock issued for sublicense agreement (Note 6)
Common Stock issued to consultatnts
Amortization of non-employee options
Warrants issued for services
Net Loss
Balance at December 31, 2002

The accompanying notes are an integral part of these financial statements.

Preferred Stock at Par Value		Common Stock at Par Value		Capital in Excess of Par Value	Deferred Compensation	Deficit Accumulated During Development Stage	Total
Shares	Amount	Shares	Amount				
4	$ –	8,592	$ 86	$38,796	$ (1,258)	$(13,321)	$24,303
–	–	755	8	5,136	–	–	5,144
–	–	10	–	75	–	–	75
–	–	1,368	14	24,759	–	–	24,773
(4)	–	346	3	(3)	–	–	–
–	–	–	–	(1,207)	1,258	–	51
–	–	–	–	559	–	–	559
–	–	–	–	2,140	–	–	2,140
–	–	–	–	4,900	–	–	4,900
–	–	–	–	–	–	(15,320)	(15,320)
–	–	11,071	111	75,155	–	(28,641)	46,625
–	–	133	2	758	–	–	760
–	–	1	–	5	–	–	5
–	–	6	–	63	–	–	63
–	–	209	2	1,998	–	–	2,000
–	–	38	–	598	–	–	598
–	–	–	–	79	–	–	79
–	–	132	1	1,847	–	–	1,848
–	–	–	–	–	–	(19,515)	(19,515)
–	–	11,590	116	80,503	–	(48,156)	32,463
–	–	10	–	22	–	–	22
–	–	16	–	96	–	–	96
–	–	1,280	13	10,644	–	–	10,657
–	–	–	–	80	–	–	80
–	–	–	–	96	–	–	96
–	–	–	–	208	–	–	208
–	–	–	–	–	–	(15,762)	(15,762)
–	–	12,896	129	91,649	–	(63,918)	27,860
–	–	–	–	2	–	–	2
–	–	26	–	137	–	–	137
–	–	50	1	204	–	–	205
–	–	–	–	17	–	–	17
–	–	–	–	66	–	–	66
–	–	–	–	247	–	–	247
–	–	–	–	–	–	(17,502)	(17,502)
–	$ –	12,972	$ 130	$92,322	$ –	$(81,420)	$11,032

Hollis-Eden Pharmaceuticals, Inc. (A Development Stage Company)

STATEMENTS OF CASH FLOWS

(in thousands)	2002	2001	2000	Period from Inception (Aug. 15, 1994) to December 31, 2002
Cash Flows from Operating Activities:				
Net loss	$(17,502)	$(15,762)	$(19,515)	$(81,420)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation	122	131	107	458
Deposal of assets	21	–	–	28
Common stock issued for 401k/401m plan	137	96	63	296
Common stock issued as consideration for amendments to the license agreements	–	–	–	33
Common stock issued as consideration for termination of a finance agreement	–	–	–	34
Common stock and options issued as consideration for license fees and services	271	176	677	2,140
Expense related to warrants issued as consideration to consultants	247	208	–	2,595
Expense related to warrants issued to a director for successful closure of merger	–	–	–	570
Expense related to stock options issued	17	–	–	5,157
Expense related to common stock issued for the purchase of technology	–	–	1,848	1,848
Common stock issued as consideration for In-Process R&D	–	–	2,000	2,000
Deferred compensation expense related to options issued	–	–	–	1,210
Changes in Assets and Liabilities:				
Prepaid expenses	46	(73)	19	(123)
Deposits	(60)	–	–	(87)
Other receivable	(13)	–	–	(13)
Loan receivable from related party	3	(21)	(12)	(274)
Accounts payable and accrued expenses	(372)	1,407	916	2,730
Wages payable	(280)	(81)	81	220
Net cash used in operating activities	$(17,363)	$(14,279)	$(13,816)	$(62,598)

Hollis-Eden Pharmaceuticals, Inc. (A Development Stage Company)

STATEMENTS OF CASH FLOWS Continued

(in thousands)	2002	2001	2000	Period from Inception (Aug. 15, 1994) to December 31, 2002
Cash Flows Provided by Investing Activities:				
Purchase of property and equipment	$ (119)	$ (132)	$ (137)	$ (883)
Net cash used in investing activities	(119)	(132)	(137)	(883)
Cash Flows from Financing Activities:				
Contributions from stockholder	–	–	–	104
Net proceeds from sale of preferred stock	–	–	–	4,000
Net proceeds from sale of common stock	–	10,657	–	52,829
Proceeds from issuance of debt	–	–	–	371
Net proceeds from recapitalization	–	–	–	6,271
Net proceeds from warrants/options exercised	2	23	765	12,993
Net cash from financing activities	2	10,680	765	76,568
Net increase (decrease) in cash and equivalents	(17,480)	(3,731)	(13,188)	13,087
Cash and equivalents at beginning of period	30,567	34,298	47,486	–
Cash and equivalents at end of period	$ 13,087	$ 30,567	$ 34,298	$ 13,087
Supplemental Disclosure of Cash Flow Information:				
Interest paid	$ –	$ –	$ –	$ 50
Conversion of debt to equity	–	–	–	371
Warrants issued to consultants in lieu of cash, no vesting	247	288	–	559
Warrants issued in lieu of cash, commissions on private placement	–	–	–	733

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

1. The Company

Hollis-Eden Pharmaceuticals, Inc. ("Hollis-Eden" or the "Company"), a development stage pharmaceutical company, is engaged in the discovery, development and commercialization of products for the treatment of immune system disorders and hormonal imbalances. From inception (August 15, 1994) through March 1997, the Company's efforts were directed toward organizing, licensing technology and preparing for offerings of shares of its common stock. Since 1997, the Company has been expanding its intellectual property, developing its lead drug candidates, performing preclinical tests and has entered into multiple Phase II clinical studies. Our initial technology development efforts are focused on a series of potent hormones and hormone analogs that we believe are key components of the body's natural regulatory system. We believe these immune regulating hormones can be used to reestablish host immunity in situations of dysregulation. To date, the Company has not developed commercial products or generated sales for the period since inception (August 15, 1994) through December 31, 2002.

2. Summary of Accounting Policies

Cash Equivalents The Company considers any liquid investments with a maturity of three months or less when purchased to be cash equivalents. Because of the short maturities of these investments, the carrying amount is a reasonable estimate of fair value. At December 31, 2002, the Company's cash equivalents are approximately $13.1 million and are deposited primarily in a money market mutual fund with a large financial institution.

Property and Equipment Property and equipment is stated at cost and depreciated over the estimated useful lives of the assets (five and seven years) using the straight-line method.

Research and development Research and development costs consist of license fee expenses related to license agreements, preclinical and clinical trial expenses, as well as research and development expenses with related parties. Such amounts paid to related parties aggregated $11.5 million in the form of cash and stock for the period from inception (August 15, 1994) to December 31, 2002 (see Note 6, "Colthurst, Edenland and Mr. Prendergast" and "Aeson Therapeutics"). Such expenses are recognized as incurred.

In August 2002, the Company entered into a Sublicense Agreement with Pharmadigm, Inc (see Note 6, "Pharmadigm"). Under the agreement, Hollis-Eden obtained exclusive worldwide rights to certain intellectual property of Pharmadigm and the University of Utah and the Company agreed to make aggregate payments of $0.9 million in cash or in shares of Hollis-Eden common stock, at the Company's option, over the next year.

Accounting for Stock-Based Compensation During 1995, the Financial Accounting Standards Board issued SFAS 123, Accounting for Stock-Based Compensation, which defines a fair-value-based method of accounting for stock compensation plans. However, it also allows an entity to continue to measure compensation cost related to stock compensation plans using the method of accounting prescribed by the Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees. Entities electing to follow APB 25 must make pro forma disclosures of net income, as if the fair-value-based method of accounting defined in SFAS had been applied (see below and Note 9, "Pro Forma Disclosures of Net Income").

If the Company had accounted for stock options issued to employees and directors in accordance with SFAS 123, the Company's net loss would have been reported as follows (in thousands, except per share amounts):

	Year ended December 31,		
	2002	2001	2000
Net loss - As reported	$(17,502)	$(15,762)	$(19,515)
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards	$ (5,570)	$ (767)	$ (5,104)
Net loss - Pro forma	$(23,072)	$(16,529)	$(24,619)
Basic and diluted net loss per share - As reported	$ (1.35)	$ (1.35)	$ (1.74)
Basic and diluted net loss per share - Pro forma	$ (1.78)	$ (1.42)	$ (2.19)

Income Taxes The Company provides for income taxes under the principles of Statement of Financial Accounting Standards No. 109 (SFAS 109) which requires that provision be made for taxes currently due and for the expected future tax effects of temporary differences between book and tax bases of assets and liabilities.

Financial instruments The Company's financial instruments consist primarily of cash, other receivables and accounts payable. These financial instruments are stated at their respective carrying values, which approximate their fair values.

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

Net loss per share Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed in a manner consistent with basic net loss per share after giving effect to potentially dilutive securities. Diluted net loss per share for the years ended December 31, 2002, 2001 and 2000 excludes the assumed conversion of the outstanding common stock equivalents because their effect on net loss per share is anti-dilutive.

Recent accounting pronouncements In July 2002, the Financial Accounting Standards Board issued FASB Statements No. 146, *Accounting for Restructuring Costs* (SFAS 146). SFAS No. 146 applies to costs associated with an exit activity (including restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts, and relocating plant facilities or personnel. Under SFAS No. 146, a company will record a liability for a cost associated with an exit or disposal activity when that liability is incurred and can be measured at fair value. SFAS No. 146 will require a company to disclose information about its exit and disposal activities, the related costs, and changes in those costs in the notes to the interim and annual financial statements that include the period in which an exit activity is initiated and in any subsequent period until the activity is completed. SFAS No. 146 is effective prospectively for exit or disposal activities initiated after December 31, 2002. Under SFAS No. 146, a company may not restate its previously issued financial statements and the new Statement grandfathers the accounting for liabilities that a company had previously recorded under Emerging Issues Task Force Issue 94-3. The adoption of this statement is not expected to affect the Company's financial statements.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation" Transition and Disclosure." This Statement amends SFAS No.123 "Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of this Statement are effective for fiscal years ending after December 15, 2002. The Company has elected to continue using the intrinsic value method and has incorporated these expanded disclosures into these Notes.

In November 2002, the FASB issued Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("Interpretation 45"). Interpretation 45 requires a guarantor to include disclosure of certain obligations, and if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The recognition requirement is effective for guarantees issued or modified after December 31, 2002 and is not expected to have a material impact on the Company. The Company has no obligations regarding Interpretation No. 45.

In January 2003, the FASB issued Interpretation No. 46 "Consolidation of Variable Interest Entities" ("Interpretation 46"). Interpretation 46 clarifies the application of Accounting Research Bulletin No. 51 "Consolidated Financial Statements", and applies immediately to any variable interest entities created after January 31, 2003 and to variable interest entities in which an interest is obtained after that date. The Company holds no interest in variable interest entities.

3. Recapitalization

During March 1997, Hollis-Eden Inc. was merged (the "Merger") with and into the Company (then known as Initial Acquisition Corp. (IAC)). Upon consummation of the Merger, Hollis-Eden Inc. ceased to exist, and IAC changed its name to Hollis-Eden Pharmaceuticals, Inc. IAC (now called Hollis-Eden Pharmaceuticals, Inc.) remains

the continuing legal entity and registrant for Securities and Exchange Commission reporting purposes. The Merger was accounted for as a recapitalization of Hollis-Eden Inc. by an exchange of Common Stock of Hollis-Eden Inc., for the net assets of IAC, consisting primarily of $6.5 million in cash and other receivables.

Under the terms of the merger agreement, each share of Hollis-Eden Inc. Common Stock outstanding converted into one share of Common Stock of Hollis-Eden Pharmaceuticals, Inc. Common Stock ("Company Common Stock"), and all warrants and options to purchase Hollis-Eden Inc. Common Stock outstanding converted into the right to receive the same number of shares of Company Common Stock.

Upon the consummation of the Merger, pursuant to an agreement, the Company issued warrants to purchase an aggregate of 50,000 shares of Company Common Stock at an exercise price of $0.10 per share to a director and former officer. Additional paid-in capital was increased by $570,000 with an offsetting $570,000 charge recorded to operations during the three months ended March 31, 1997.

4. Note Receivable from Related Party

On April 23, 2001, the Company entered into a promissory note with a stockholder/officer in the amount of $16,875. Interest is at 4.5% per annum. A third of the note was paid by the due date in April 2002 and the remaining equal payments are due and payable on April 23 of 2003 and 2004.

On May 22, 1998, the Company entered into a promissory note with a stockholder/officer in the amount of $200,000. Interest is at 5.5% per annum. The note is due and payable in full on May 22, 2003.

5. Income Taxes

The Company has available a net operating loss carryforward of approximately $66 million at December 31, 2002 which may be carried forward as an offset to taxable income, if any, in future years through its expiration in 2012 to 2022. The Company has a net deferred tax asset of approximately $25 million at December 31, 2002 comprised of capitalized start-up costs, research and development credits, and the net operating loss carryforward. The net deferred tax asset has been fully reserved due to the uncertainty of the Company being able to generate taxable income under the more likely than not criteria of SFAS 109. If certain substantial changes in the Company's ownership should occur, there would potentially be an annual limitation on the amount of the carryforwards, which could be utilized in a tax year.

6. Related Party Licenses and other Agreements and Contingencies

Colthurst, Edenland and Mr. Prendergast During 1994, the Company entered into two license agreements and one research, development and option agreement as discussed in the following paragraphs.

Pursuant to a license agreement dated May 18, 1994 ("Colthurst License Agreement") with related parties, Patrick T. Prendergast, a significant stockholder at the time, and with Colthurst Limited, a company controlled by Mr. Prendergast, the Company acquired the exclusive worldwide rights of Mr. Prendergast's patent rights, know-how and background technology relating to the treatment of human/animal immunodeficiency. The agreement was amended on August 11, 1995 to change the license fee payment terms as discussed below in paragraph four of this Note. Per the license agreement, the Company agreed to pay royalties on product revenues.

On August 25, 1994, the Company entered into a license agreement ("Edenland License Agreement") with a related party, Edenland Inc., a company controlled by Mr. Prendergast, for the exclusive worldwide rights of Mr. Prendergast's patent rights, know-how and background technology related to the substance tradenamed HE317 and to any other pharmaceutical product that became subject to the license agreement under the research, development and option agreement discussed below. The agreement was amended on August 11, 1995 to change the license fee payment terms as discussed in the following paragraph. Per the Edenland License Agreement, the Company agreed to pay royalties on product revenues.

Effective August 11, 1995, Edenland, Inc., Colthurst Limited and the Company entered into amendments concerning the license fee payment terms to the two agreements described above. Under this amendment, the Company agreed to pay a license fee by April 28, 1996 plus additional license fees within 24 months of April 1996. The balances of these fees were paid in full by May 1997. As consideration for entering into certain amendments, the Company issued 75,472 shares of the Company's common stock to Edenland, Inc. and Colthurst Limited.

Per the amended Colthurst License Agreement, a renewal annual license fee was payable commencing May 1998. The Company paid this fee in 1998 by issuing shares of its common stock and, in 1999, paid in cash.

In August 1994, the Company entered into a Research, Development and Option Agreement, with Edenland, Inc. and Mr. Prendergast. The agreement provided for the development of HE317 to a certain stage of development and granted the Company the right of first option on new products developed by Edenland, Inc. The agreement committed the Company to pay for certain development costs up to the amount of $3.0 million with certain contingencies for funding. In October 1996, the Company and Edenland, Inc. entered into an amendment, which accelerated the date that the $3.0 million payment for HE317 or other product development costs was to be made. The Company paid $2.7 million during 1997 and the remaining $300,000 in April 1998.

During November 1999, the Company filed two separate requests for arbitration with Mr. Prendergast, Colthurst and Edenland. The first arbitration sought clarification of certain operational issues with respect to roles and responsibilities set forth in the license agreement covering HE2000. The second arbitration sought to rescind both of the agreements with Edenland covering future potential drug candidates other than HE2000.

On January 20, 2000, Hollis-Eden reached a settlement on its pending arbitrations with Mr. Prendergast, Colthurst and Edenland. The Settlement and Mutual Release Agreement completely disposed of all of the matters that were at issue in the pending arbitrations. In addition, the parties entered into two new technology agreements, the Technology Assignment Agreement and the Sponsored Research and License Agreement.

The Technology Assignment Agreement replaces the Colthurst License Agreement. Pursuant to the Technology Assignment Agreement, Mr. Prendergast and Colthurst assigned to Hollis-Eden ownership of all patents, patent applications and current or future improvements of the technology under the Colthurst License Agreement, including HE2000, Hollis-Eden's lead clinical compound. The annual license fee of $500,000 and the royalty obligations under the Colthurst License Agreement were eliminated. In consideration for the foregoing, Hollis-Eden agreed to issue to Colthurst 660,000 shares of Common Stock and a warrant to purchase an aggregate of 400,000 shares of Common Stock at $25 per share. Only 132,000 of such shares of Common Stock were issued in 2000, with the remaining 528,000 shares to be issued over the next four years conditioned on continued compliance with the agreement and, in particular, satisfaction of the Conditions (as defined below). In addition, all of the shares under the warrant vest over four years conditioned on continued compliance with the agreement and, in particular, satisfaction of the Conditions (as defined below). The Sponsored Research and License Agreement replaces the Edenland License Agreement and the Research, Development and Option Agreement. Pursuant to the Sponsored Research and License Agreement, Edenland exclusively licensed to Hollis-Eden a number of compounds, together with all related patents and patent applications, and Hollis-Eden agreed to fund additional preclinical research projects conducted by Edenland. Hollis-Eden will also have exclusive license rights to all results of such research and will have royalty obligations to Edenland on sales of new products, if any, resulting from such research.

As stated above, the issuance of the additional shares of Common Stock and the vesting of the warrant was dependent upon the satisfaction of certain conditions (the "Conditions"), including (i) support of Hollis-Eden's actions by Mr. Prendergast and Colthurst, by voting their shares of Hollis-Eden stock in favor of management and (ii) Mr. Prendergast and his affiliated companies not conducting research and development activities relating to the transferred technology. In accordance with Emerging Issues Task Force No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," these future events could not be determined at the date of the agreements (January 2000). Accordingly, the shares and warrants are accounted for as they vest or are issued. During 2000, the Company recorded a research and development charge for $1.9 million representing the fair value of the 132,000 shares issued under the agreement.

Because all of the Conditions have not been satisfied, Hollis-Eden has not issued any additional shares to Colthurst and believes it has no obligation to issue any additional shares and that the warrant will not vest as to any shares of Common Stock. While Hollis-Eden is confident in its analysis, if any dispute should arise in this matter, Hollis-Eden cannot guarantee that, as a result of such dispute, additional equity will not be issued or that an additional accounting charge will not be made.

Aeson Therapeutics In October 2000, the Company acquired a 21% equity stake in Aeson Therapeutics Inc. ("Aeson") for approximately $4 million and an exclusive worldwide sublicense to three issued patents in the area of adrenal steroids in exchange for $2.0 million in cash and 208,672 shares of Common Stock valued at $2 million.

The cash and shares were expensed as in-process R&D during the fourth quarter of 2000. As part of the transaction, Aeson and its shareholders have granted the Company an exclusive option to acquire the remainder of Aeson at a predetermined price.

In March 2002, the Company amended certain of its agreements with Aeson. Under the amendments, the Company paid Aeson $1.2 million, which extended the initial date by which the Company could exercise its option to acquire the remainder of Aeson to September 30, 2002. Hollis-Eden also received additional equity securities as a result of its $1.2 million payment and now has approximately a 25% equity stake in Aeson. The $1.2 million payment was expensed as in-process R&D.

Hollis-Eden elected not to exercise the option to acquire the remainder of Aeson by September 30, 2002. Accordingly, the option to acquire Aeson has now expired. The Company continues to hold a 25% equity interest in Aeson.

Pharmadigm In August 2002, the Company entered into a Sublicense Agreement with Pharmadigm, Inc. Under the agreement, Hollis-Eden obtained exclusive worldwide rights to certain intellectual property of Pharmadigm and the University of Utah and the Company agreed to make aggregate payments of $0.9 million in cash or in shares of Hollis-Eden common stock, at the Company's option, over the next year. The $0.9 million payment to Pharmadigm is comprised of: a $50,000 up front payment; 50,000 shares valued at $205,000 issued during the fourth quarter; and the remainder will be paid during 2003 in shares of Hollis-Eden common stock. The $0.9 million payment was expensed as in-process R&D during the third quarter 2002. Hollis-Eden will also make additional milestone and royalty payments to Pharmadigm if the Company meets specified development and commercialization milestones for products covered by the patents that it licensed under the agreement. The principal patents licensed under the agreement, originally licensed to Pharmadigm from the University of Utah, relate to inventions by Dr. Raymond Daynes and Dr. Barbara A. Areneo. Dr. Daynes is currently a scientific consultant to Hollis-Eden.

7. Common Stock

Reverse Stock Splits During February 1995, there was a 3 for 5 reverse stock split of the Company's common stock and in March 1996, a 1 for 2.65 reverse stock split of the Company's common stock. Both reverse stock splits have been retroactively reflected for all periods presented.

Common Stock Financings In January 1996, the Company completed a $367,522 round of debt financing with a group of private investors. These notes, with an 8% interest rate, were due on or before the earlier of (i) January 21, 1997 or (ii) the closing of a private or public offering of securities. During April 1996, the debt financing, plus accrued interest, was converted into 164,962 shares of common stock at a price of $2.25 per share. In April 1996, the Company privately issued 580,005 shares of the Company's common stock at an offering price of $2.25 per share. Total proceeds from this offering aggregated $1,234,499.

During May 1998, the Company completed a private financing totaling $20.6 million in gross proceeds. The Company issued 1,329,201 shares of common stock, (of which 192,061 shares were subject to adjustment based on future average stock price ("Adjustable Common Stock")), 4,000 shares of 5% Series A Convertible Preferred Stock and warrants to purchase 1,437,475 shares of common stock in the financing. The warrants entitled the holders to purchase up to a total of 1,437,475 shares of common stock at a price of $17.00 per share.

The Convertible Preferred Stock had an initial conversion price of $20.30 for the first seven months, after which it could be adjusted, either up or down, based on the future stock prices of the Company's common stock. The Convertible Preferred Stock was converted to common stock in January 1999 (See Note 8).

In January 1999, the Company completed two private placements of an aggregate of 1,367,868 shares of common stock at prices ranging from $18.00 to $18.50 per share. In connection with the private placements, the Company issued warrants to purchase an aggregate of 90,000 shares of the Company's common stock, with an exercise price of $18.25 per share, as a finder's fee. The Company raised approximately $25.0 million in gross proceeds.

During December 2001, the Company raised $11.5 million in gross proceeds from the sale of 1.28 million shares of newly issued common stock in a private placement at a price of $9.00 per share. The investors were a group of qualified institutional buyers and institutional accredited investors. The Company also issued warrants to purchase up to 128,000 shares of common stock having an exercise price of $12.00 per share to investors. As a finders fee, the Company issued o its placement agent two warrants for a total of 112,640 shares of common stock, one warrant with an exercise price of $9.00 and the other with an exercise price of $12.00.

8. Preferred Stock

During May 1998, as part of a private placement, the Company issued 4,000 shares of Convertible Preferred Stock for proceeds of $4.0 million. The proceeds of the offering is included in the proceeds to the May 1998 financing described in Note 7, above.

During January 1999, the Company issued 346,127 shares of common stock in connection with the conversion of the Series A Convertible Preferred Stock and additional shares relating to the Adjustable Common Stock. The Adjustable Common Stock was issued during the private placement of May 1998 and was subject to adjustment based on the future average stock price of the Company's common stock as described in Note 7. Upon conversion, all outstanding Preferred shares and Adjustable Common shares were eliminated.

In November 1999, the Company adopted a Shareholders Rights Plan in which Preferred Stock purchase rights ("Rights") were distributed as a dividend at the rate of one Right for each share of common stock held as of the close of business on November 29, 1999. Each right entitles stockholders to buy, upon certain events, one one-hundredth of a share of a new Series B junior participating preferred stock of the Company at an exercise price of $100.00. The Rights are designed to guard against partial tender offers and other abusive tactics that might be used in an attempt to gain control of the Company or to deprive stockholders of their interest in the long-term value of the Company. The Rights are exercisable only if a person or group acquires 15% or more of the Company's common stock or announces a tender offer of which the consummation would result in ownership by a person or group of 15% or more of the Company's common stock. The Rights are redeemable for one cent per Right at the option of the Board of Directors prior to this event occurring. The Rights expire on November 14, 2009.

9. Stock Options

1997 Stock Option Plan The 1997 Stock Option Plan (the "Plan") was approved by the Company's stockholders in 1997. Under the Plan, 3,750,000 shares of common stock have been reserved for issuance to employees, officers, directors, and consultants of the Company and provides for the grant of incentive and nonstatutory stock options. The Board of Directors determines terms of the stock option agreements, including vesting requirements. The exercise price of incentive stock options must equal at least the fair market value on the date of grant. The options expire not later than ten years from the date of the grant and become exercisable immediately or generally are exercisable ratably over a three-year or four-year period beginning one-year from the date of the grant. The following table summarizes stock option activity under the Plan for 1997 through 2002 (in thousands, except per share amounts):

		Price Per Share	
	Shares	Range	Weighted Average
1997 Granted	518	$ 6.75 – 8.70	$ 7.13
Outstanding, December 31, 1997	518	6.75 – 8.70	7.13
1998 Granted	341	13.25 – 16.75	14.52
1998 Cancelled	100	8.70	8.70
Outstanding, December 31, 1998	759	6.75 – 16.75	10.24
1999 Granted	776	10.56 – 16.63	12.70
1999 Cancelled	61	14.06 – 14.63	14.63
Outstanding, December 31, 1999	1,474	6.75 – 16.75	11.36
2000 Granted	774	6.50 – 15.06	8.18
2000 Exercised	1	6.75	6.75
2000 Cancelled	24	6.75 – 15.13	14.22
Outstanding, December 31, 2000	2,223	6.50 – 16.75	10.22
2001 Granted	170	3.53 – 11.84	6.13
2001 Cancelled	65	5.09 – 16.63	13.31
Outstanding, December 31, 2001	2,328	3.53 – 16.75	9.80
2002 Granted	696	5.15 – 10.10	9.48
2002 Cancelled	55	5.13 – 13.13	8.17
Outstanding, December 31, 2002	2,969	$ 3.53 – 16.75	$10.98

The Company entered into stock option agreements with certain directors, officers and consultants. These options became exercisable according to a schedule of vesting as determined by the Board of Directors. During 2000 and 2002 the Company granted options to certain consultants and directors, and will recognize $166,000 and $17,000, respectively, in expense related to these options over the vesting periods. Expenses related to options for consultants and directors were $79,000, $96,000 and $66,000 in 2000, 2001 and 2002, respectively. The remaining $45,000 charge for these options will be expensed during 2003.

Non-Plan Options During 1995 and 1996, the Company granted non-statutory stock options to purchase a total of 608,000 shares to directors, officers and consultants. As of December 31, 2002, options to purchase 415,000 shares were outstanding.

In February 1997, as part of an employment agreement, the Company granted a non-statutory stock option to an executive to purchase 2,400,000 shares of the Company's common stock at a price of $5.00 per share, which option vested ratably over a six-year period. The intrinsic value of the options was $1,848,000. As a result, the Company recorded as deferred compensation a non-cash charge of $1,848,000, which was being amortized ratably over the six-year vesting period. Through February 1999, the Company had amortized a total of $641,333. In March 1999, the Company announced the resignation of this executive, at which time the Company and the executive agreed that the option would remain outstanding for a total of 1,200,000 shares, including the acceleration of vesting of 300,000 shares. This acceleration is considered to be a new grant of options and, as such, the Company took a one-time non-cash charge of $4.9 million during the first quarter of 1999.

In March 1999, the Company granted a non-statutory stock option to purchase 300,000 shares to an officer.

The following table summarizes stock option activity not pursuant to the Plan for 1995 through 2002 (in thousands, except per share amounts):

		Price Per Share	
	Shares	Range	Weighted Average
1995 Granted	38	$2.65 – 7.95	$ 4.64
Outstanding, December 31, 1995	38	2.65 – 7.95	4.64
1996 Granted	570	2.25	2.25
Outstanding, December 31, 1996	608	2.25 – 7.95	2.40
1997 Granted	2,400	5.00	5.00
1997 Cancelled	50	2.25	2.25
Outstanding, December 31, 1997	2,958	2.25 – 7.95	4.51
1998 Exercised	53	2.25 – 5.30	2.93
1998 Cancelled	50	2.25	2.25
Outstanding, December 31, 1998	2,855	2.25 – 7.95	4.58
1999 Granted	300	16.63	16.63
1999 Exercised	10	7.95	7.95
1999 Cancelled	1,220	2.25 – 5.00	4.95
Outstanding, December 31, 1999	1,925	2.25 – 16.63	6.16
Outstanding, December 31, 2000	1,925	2.25 – 16.63	6.16
2001 Exercised	10	2.25	2.25
Outstanding, December 31, 2001	1,915	2.25 – 16.63	6.23
Outstanding, December 31, 2002	1,915	$2.25 – 16.63	$ 6.23

For various price ranges, weighted average characteristics of outstanding stock options at December 31, 2002 were as follows:

	Outstanding Options			Exercisable Options	
Range of Exercise Prices	Shares	Remaining Life (years)	Weighted Average Price	Shares	Weighted Average Price
$ 2.25 – $ 4.99	447,916	3.6	$ 2.40	427,126	$ 2.31
$ 5.00 – $ 8.99	2,322,428	6.6	5.74	1,937,964	5.62
$ 9.00 – $12.99	1,165,948	8.2	10.33	583,806	10.58
$13.00 – $16.99	947,800	6.2	15.30	912,696	15.26

Pro Forma Disclosures of Net Income The Company has elected to account for its stock-based compensation plans under APB 25; however, for pro forma disclosure purposes, the Company has computed the value of all options granted to employees during 2000 through 2002, using the Black-Scholes option pricing model with the following weighted average assumptions:

	2002	2001	2000
Risk free interest rate	4.25%	4.66%	5.45%
Expected dividend yield	0%	0%	0%
Expected lives	5 years	5 years	5 years
Expected volatility	122%	93%	137%

The stock options are assumed to be exercised in five years. Adjustments are made for options forfeited prior to vesting. The total value of warrants and options was computed to be the following approximate amounts, which would be amortized on the straight-line basis over the vesting period of the options (in thousands):

Year ended December 31, 2000	$5,104
Year ended December 31, 2001	$ 767
Year ended December 31, 2002	$5,570

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's options.

The weighted average, estimated fair values of employee stock options granted during fiscal 2002, 2001 and 2000 were $8.00, $4.50 and $6.59 per share, respectively.

10. Common Stock Purchase Warrants

Series A warrants During April 1996, in accordance with anti-dilution privileges triggered by an offering in March 1995, the Company issued 1,018,866 Series A Warrants to all stockholders of record as of March 1995 to purchase the same number of shares of common stock at a price of $11.02 per share. The warrants expired January 2002, except for one warrant for 393,250 shares, which expires January 7, 2006.

IAC Management Warrants During April 1994, the Company issued warrants, to existing shareholders and management, to purchase 160,000 units (the "Units") at $10.00 per Unit, each unit to be identical to the Units issued as part of its initial public offering. Each Unit consists of (i) one share of common stock, $.01 par value per share and (ii) one Class A Warrants entitling the holder to purchase one share of common stock at a price of $9.00 per share. The warrants have expired except for one warrant to purchase 50,000 units, which expires March 18, 2005.

Representatives warrants In connection with the Company's initial public offering, the Company issued warrants to the underwriters for 60,000 Units at an exercise price of $11.00 per Unit and 24,000 Class B Warrants at an exercise price of $5.775 per warrant and were exercisable until May 2000. Each Class B Warrant entitled the holder to purchase one Unit (i.e. one share of common stock and one Class A Warrant). The unexercised warrants have expired.

Investor Relations Warrants During February 1998, as part of payment for services relating to investor relations, the Company issued warrants to purchase 150,000 shares with an exercise price of $14.75 per share and an expiration date of February 1999. The warrants were estimated to have a value of $408,000, which was expensed in 1998. These warrants have been exercised.

1998 Private Placement Warrants In connection with the May 1998 private placement, the Company issued warrants to purchase 1,437,475 shares of common stock at an exercise price of $17.00 per share. The warrants were exercisable until May 2001. Of the warrants issued, 157,000 were issued as finders fees, and 1,280,475 were issued to the private placement investors. These warrants have expired.

1999 Agent Warrants In connection with the January 1999, private placement, the Company issued warrants as a finders fee to purchase 90,000 shares of common stock at an exercise price of $18.25 per shares. The warrants expired January 2002.

1999 Consulting Warrants During March 1999, the Company entered into a three-year agreement with a financial consulting organization affiliated with a director of the Company. The Company agreed to issue as compensation for services, warrants to purchase 500,000 shares of common stock with an exercise price of $20.50 per share and an expiration date of March 2002. The warrants are not subject to any vesting provisions. The warrants were estimated to have a value of approximately $2.1 million, which was expensed as a non-cash charge during the first quarter of 1999. During 2001, the expiration date for these warrants was extended to March 2003. The warrant extension did not result in an additional non-cash charge.

2001 Consulting Warrants During April 2001, the Company issued warrants to purchase 25,000 shares of common stock at an exercise price of $3.09. The warrants expire April 30, 2006. During July 2001, the Company issued warrants to purchase 25,000 shares of common stock at an exercise price of $6.225. These warrants are exercisable until July 31, 2006. These warrants, collectively, were issued for compensation for services and were estimated to have a combined value of approximately $208,000, which was expensed as a non-cash charge. These warrants have not been exercised.

During the fourth quarter of 2001, the Company issued three-year warrants to purchase 16,870 shares of common stock with exercise prices ranging from $4.72 to $10.10. The warrants have no vesting period, an estimated value of approximately $80,000, and were issued in lieu of cash for services. These warrants have not been exercised.

2001 Private Placement Warrants In connection with the December 2001 private placement, the Company issued warrants to purchase 128,000 shares of common stock to investors with an exercise price of $12.00. These warrants expire December 11, 2003. As a finders fee, the Company issued two warrants with an expiration date of December 11, 2006 to the placement agent for a total of 112,640 shares of common stock. One warrant has an exercise price of $9.00 and the other an exercise price of $12.00. The value ascribed to these warrants based on the Black-Scholes pricing model was $1.5 million and was included as a charge to equity. These warrants have not been exercised.

2002 Consulting Warrants In March 2002, the Company agreed to issue a three-year warrant to a consultant, Dr. Joseph Hollis, to purchase up to 60,000 shares of common stock at an exercise price of $11.00 per share. Dr. Hollis is the brother of Richard B. Hollis.

During the fourth quarter of 2002, the Company issued a three-year warrant to purchase up to 10,000 shares of common stock at exercise price of $4.54 per share. The warrants were issued in lieu of cash for consulting services performed for the Company.

All of the 2002 warrants were valued at $247,000 using the Black-Scholes pricing model. The value of the warrants was expensed and is included in the 2002 operating expenses.

The following table summarizes stock warrant activity for 2000 through 2002 (in thousands, except per share amounts):

		Price Per Share	
	Shares	Range	Weighted Average
Outstanding, December 31, 1999	3,390	$ 2.48–20.50	$14.91
2000 Issued	400	25.00	25.00
2000 Exercised	133	2.48– 9.50	5.71
2000 Cancelled	123	6.03–15.90	11.51
Outstanding, December 31, 2000	3,534	9.00–25.00	16.52
2001 Issued	308	3.09–12.00	9.48
2001 Cancelled	1,837	17.00–25.00	18.74
Outstanding, December 31, 2001	2,005	3.09–20.50	13.40
2002 Issued	70	4.54–11.00	10.08
2002 Cancelled	704	11.02–18.25	11.94
Outstanding, December 31, 2002	1,371	$ 3.09–20.50	$13.97

For various price ranges, the following table summarizes the weighted average prices of outstanding warrants as of December 31, 2002 (in thousands, except per share amounts):

	Outstanding Warrants		Exercisable Warrants	
Range of Exercise Prices	Shares	Weighted Average Price	Shares	Weighted Average Price
$ 3.00 – $ 5.00	43	$ 3.73	43	$ 3.73
$ 5.01 – $10.00	234	8.84	234	8.84
$10.01 – $15.00	594	11.24	594	11.24
$15.01 – $20.00	-	-	-	-
$20.01 – $25.00	500	20.50	500	20.50

11. Employment Agreement

Pursuant to an employment agreement between Hollis-Eden and Mr. Richard B. Hollis entered into in November 1996 (the "Hollis Employment Agreement"), Mr. Hollis' annual base salary was increased to $225,000 upon the consummation of the Merger, with bonuses, future salary increases and equity compensation as determined by the Hollis-Eden Pharmaceuticals Board of Directors. On January 1, 2002, Mr. Hollis' base salary was increased from $400,000 to $440,000. If Mr. Hollis' employment is terminated "without cause," "for insufficient reason" or pursuant to a "change in control" (as such terms are defined in the Hollis Employment Agreement), Mr. Hollis will receive as severance (i) an amount equal to five times his then current annual base salary plus five times the amount of the bonus awarded to him in the prior calendar year, (ii) immediate vesting of all unvested stock options of Hollis-Eden Pharmaceuticals (or the Surviving Corporation, if applicable) held by him and (iii) continued benefits under all employee benefit plans and programs for a period of three years. All of such payments are to be made in one lump sum within 30 days of termination. If Mr. Hollis' employment is terminated "with cause" or if Mr. Hollis resigns other than for "sufficient reason," Mr. Hollis' compensation and benefits will cease immediately and Mr. Hollis will not be entitled to severance benefits.

12. Leases

Rental expenses for principally leased facilities under operating leases were approximately $644,000, $435,000, and $431,000 for 2002, 2001 and 2000 respectively. Future minimum payments for operating leases are as follows (in thousands):

	Operating Leases
2003	$ 829
2004	631
2005	0
2006	0
Total minimum lease payments	$1,460

13. Subsequent Event

On February 25, 2003, the Company completed a private placement in which the Company issued $10.0 million aggregate principal amount of three-year convertible debentures ("Debentures") bearing interest at 7.5% per year, and warrants to purchase 701,760 shares of common stock. The Debentures are convertible into common stock at a price of $5.70 per share, which represented a premium to the average price of the Company's common stock over several days prior to the closing. The conversion price of the Debentures is subject to limited anti-dilution adjustments under certain circumstances. In addition, the Company can require the holders of the Debentures to convert the outstanding Debentures to common stock under specified conditions. The warrants have two exercise prices with one-half having an exercise price of $6.17 per share and the other half having an exercise price of $6.71 per share. The warrants are exercisable until February 25, 2007.

SG Cowen Securities Corporation acted as placement agent and will receive a cash fee of $550,000 and a warrant to purchase 73,684 shares of common stock having an exercise price of $5.99 per share. This warrant is exercisable from August 25, 2003 through February 25, 2008. In addition, A.G. Edwards & Sons, Inc. will receive a cash fee of $150,000 for services in connection with the private placement.

The Debentures mature on February 25, 2006. We are required to make quarterly interest payments on the Debentures while they remain outstanding. We are entitled to issue common stock, in lieu of cash, as payment of interest on the Debentures, subject to certain limitations. If our stock is trading below certain price levels when interest payments on the Debentures are due, we will not be permitted to issue shares of common stock in lieu of interest on the Debentures unless we have first obtained stockholder approval. We are entitled to force conversion of the Debentures into common stock in the event our common stock price exceeds $14.25 per share for 15 consecutive trading days or in the event we complete a public offering of our common stock of at least $20.0 million at a price equal to at least $11.40 per share.

Supplementary Financial Data

Interim Financial Information (Unaudited)

	Quarter				Total
	Mar	Jun	Sep	Dec	Year
Year ended December 31, 2001					
R&D expenses	$ 2,916	$ 4,462	$ 3,572	$ 2,067	$13,017
G&A expenses	1,180	1,245	995	1,103	4,523
Non-cash charges (1)	238	17	31	44	330
Net loss	4,218	5,616	4,515	3,153	17,502
Net loss per share	(0.33)	(0.43)	(0.35)	(0.24)	(1.35)
Cash and cash equivalents	$25,523	$20,484	$16,441	$13,087	$13,087
Year ended December 31, 2001					
R&D expenses	$ 2,716	$ 2,942	$ 2,714	$ 3,402	$11,774
G&A expenses	1,265	1,242	991	1,306	4,804
Non-cash charges	24	24	232	103	383
Net loss	3,531	3,878	3,694	4,659	15,762
Net loss per share	(0.30)	(0.33)	(0.32)	(0.40)	(1.35)
Cash and cash equivalents	$30,529	$27,465	$23,244	$30,567	$30,567

To the Board of Directors and Stockholders of
Hollis-Eden Pharmaceuticals, Inc.:
San Diego, CA

We have audited the accompanying balance sheets of Hollis-Eden Pharmaceuticals, Inc. (a development stage company) as of December 31, 2002 and 2001 and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2002 and for the period from inception (August 15, 1994) to December 31, 2002. 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 auditing standards generally accepted in the 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 Hollis-Eden Pharmaceuticals, Inc. as of December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002 and for the period from inception (August 15, 1994) to December 31, 2002, in conformity with accounting principles generally accepted in the United States.

BDO Seidman, LLP

BDO Seidman, LLP

New York, NY
January 27, 2003 (except for Note 13 which is as of February 25, 2003)

BOARD OF DIRECTORS

Richard B. Hollis
Founder, Chairman and CEO

Paul Bagley III
Managing Partner
Stone Pine Companies

Leonard Makowka, M.D.,
Ph.D., FRCS (C), FACS

Brendan R. McDonnell
Partner, Preston Gates & Ellis, LLP

Thomas C. Merigan, Jr., M.D.
Becker Professor of Medicine and
Director of the Center for AIDS Research
Stanford University School of Medicine

William H. Tilley
Chairman and CEO
The Jacmar Companies

Salvatore Zizza
Former Chairman and President
Initial Acquisition Corporation

MANAGEMENT

Richard B. Hollis
Founder, Chairman and CEO

Daniel D. Burgess
Chief Operating Officer
Chief Financial Officer

James M. Frincke, Ph.D.
Chief Scientific Officer

Eric J. Loumeau
Vice President
General Counsel

Robert L. Marsella
Vice President
Business Development

Thomas C. Merigan, Jr., M.D.
Scientific Advisor
Infectious Diseases

Christopher L. Reading, Ph.D.
Executive Vice President
Scientific Development

Dwight R. Stickney, M.D.
Medical Director
Oncology

Robert W. Weber
Vice President
Chief Accounting Officer

SENIOR SCIENTIFIC STAFF

Clarence N. Ahlem
Director, Product Development

Dominick Auci, Ph.D.
Scientific Investigator, Autoimmunity

Charles R. Dowding, Ph.D.
Scientific Investigator,
Cellular Immunology

Jaime Flores-Riveros, Ph.D.
Vice President, Endocrinology
and Metabolism

Armando Garsd, Ph.D.
Director, Biostatistics

Barry S. Miller
Director, Data Management

Elizabeth Morgan
Director, Clinical Development

Daryl D. Muenchau, Ph.D., J.D.
Director, Intellectual Property

Nanette Onizuka-Handa
Director, Regulatory Affairs

Richard Trauger, Ph.D.
Director, Tumor and
Vaccine Immunology

Steven White, Ph.D.
Director, Medicinal Chemistry

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New York, New York

OUTSIDE CORPORATE COUNSEL

Cooley Godward, LLP
San Diego, California

HOLLIS-EDEN HEADQUARTERS

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TRANSFER AGENT

American Stock Transfer
and Trust

ANNUAL STOCKHOLDERS MEETING

June 20, 2003, 2:00pm (PDT)
Hyatt Regency La Jolla
3777 La Jolla Village Drive
San Diego, California

www.holliseden.com

Nasdaq Symbol: HEPH

Statements made in the Letter to Shareholders and elsewhere in this annual report may constitute forward-looking statements and are subject to numerous risks and uncertainties, including the failure to successfully complete clinical trials, the Company's future capital needs, the Company's ability to obtain additional funding and required regulatory approvals, the ability of the Company to protect its intellectual property rights and to not infringe the intellectual property rights of others, the development of competitive products by other companies, and other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission. The actual results may differ materially from those contained in this annual report.

Design: **Alden**, San Diego, CA


HOLLISEDEN PHARMACEUTICALS

CREDO

FOR OUR EMPLOYEES

We pledge to create an environment
where business and personal
achievements are accomplished
to the highest standards of integrity,
excellence and professionalism.

Our vision is to build

FOR OUR PATIENTS

We pledge to provide safe,
affordable and effective treatments
that improve the quality of life.

a world-class pharmaceutical company

FOR OUR PRODUCTS

We pledge to remain steadfast
in our commitment to turn
our innovative science
into pharmaceutical products
for global health.

serving humanity by improving quality of life.

FOR OUR SHAREHOLDERS

We pledge to prosper
as a business and to reward
our owners with an attractive return.

HOLLISEDEN
PHARMACEUTICALS
Serving Humanity®