

NITROMED

Annual Report 2003



MAKING TODAY'S BEST MEDICINES BETTER



Pictured on the front cover is Dr. Susan Bennett (A-HeFT clinical investigator) with an A-HeFT clinical trial patient. A-HeFT is considered a landmark study – as the first and only heart failure trial in an all African American patient population – testing the effects of the first nitric oxide enhancing drug candidate, BiDil®, when administered in addition to current heart failure therapy. If approved, BiDil would be the first heart failure medication aimed to address the endothelial dysfunction often underlying heart disease in these African American patients.

Dear Shareholders, Employees and Friends:

It is with pleasure that we update you on the Company's 2003 achievements and our plans for 2004. We recorded considerable progress in 2003, notably completing our initial public offering in November. The NitroMed Board of Directors and management team are grateful for your support. To honor the faith you have placed in us, we pledge to manage the Company with the highest professional and ethical standards; ensuring good business practices, transparency in financial reporting and the highest level of corporate governance.

In 2004, your Company will further build on its strengths by seeking to continue its leadership position in nitric oxide enhancing medicines and move towards its goal of becoming a fully integrated pharmaceutical company, with marketing and sales specialties in cardiovascular medicine and African American healthcare. Let's review 2003, a year of solid progress.

BiDil® is the first and most advanced of the Company's nitric oxide enhanced medicine candidates. It is being developed for African Americans with heart failure. A Phase III confirmatory clinical trial, A-HeFT (African American Heart Failure Trial) is ongoing and designed to evaluate BiDil's effectiveness – when added to current treatments – to reduce mortality and hospitalization and improve quality-of-life in African Americans with heart failure. African Americans suffer a disproportionate burden of this life threatening condition. In stark contrast to the clinical data in whites with the same disease, African Americans are more likely to develop heart failure and once acquired die at a greater rate and at a much younger age. This is a serious health disparity. We are committed to finding and providing new alternatives in the treatment of African Americans with heart failure. Our mission and commitment is clear. In this effort we continue to enjoy support from the Association of Black Cardiologists, the co-sponsor of A-HeFT; members of the Congressional Black Caucus; as well as leading cardiologists.

BiDil® is the first
and most advanced
of the Company's nitric
oxide enhanced
medicine candidates.

In March 2003 A-HeFT satisfied an important milestone when the safety results from the first 313 patients were deemed satisfactory for the trial to continue. Patient recruitment in A-HeFT continues apace and we project the final patient to be randomized at the end of the third quarter in 2004. We have begun preparing for the expected launch of BiDil in early 2006, assuming that we receive FDA approval. We expect this to be a transforming event for all of us at NitroMed, moving us beyond being purely a drug development company, to one with fully integrated marketing and sales capabilities.

Good progress was also recorded in our collaborations with Merck on an NO-based COX-2 inhibitor and with Boston Scientific on NO-enhanced drug coated stents. The NO-based COX-2 program is a worldwide R&D and licensing partnership with Merck and is intended to develop a second generation COX-2 inhibitor with improved gastrointestinal and renal properties. Work on this program began in January 2003. A lead drug candidate with the desired preclinical profile was identified in May and Phase I clinical studies were initiated in November. We believe that this excellent progress owes much to the efficiency of our nitric oxide technology, the professionalism of Merck and NitroMed scientists, and the importance that both parties place on this program. NitroMed, at Merck's expense, has dedicated research personnel to this program through 2005. Merck provided the Company with \$23 million in research, milestone and licensing payments in 2003. We are very pleased with the progress that has been made in the first year and with Merck as a partner.

We are also partnered with Boston Scientific to develop the next generation drug eluting stent, further improving on their already promising Taxol® drug-coated stent. This program is intended to simultaneously reduce both smooth muscle mediated (Taxol) and thrombogenic mediated (nitric oxide) restenotic processes. It is further intended that the antiplatelet properties of nitric oxide will reduce the need for prolonged, systemic anti-platelet therapy. Our R&D agreement with Boston Scientific was recently extended an additional two years, through the end of 2005. The Company received a further \$3 million at the end of 2003 associated with this research extension.

The launch of BiDil®
would transform NitroMed
beyond a purely drug
development company
to one with marketing
and sales capabilities



In 2003 our intellectual property base continued to expand and strengthen, providing NitroMed with what we expect will be a sustainable, competitive advantage. Our partnership with the Wellcome Trust and the Universities of Edinburgh and Saint Andrews in acute renal failure was predicated on NitroMed's intellectual property. NitroMed's issued, allowed or pending patent filings now stand at 270, which we believe is a considerable enduring worldwide asset.

The executive officers of your Company (each with the Company for a minimum of seven years) have extensive pharmaceutical backgrounds. In 2003, a year of intense transitional development, we further strengthened this team. Jerry Karabelas, Ph.D., retired Head of Health Care and CEO, Worldwide Pharmaceuticals, Novartis AG and current Partner, Care Capital LLC, was appointed Non-executive Chairman of the Board coincident with our initial public offering. Additionally, Davey S. Scoon, C.P.A. joined the Board serving as Chairman of the Audit Committee. Davey is Chief Administrative and Financial Officer of Tom's of Maine and current Non-executive Chairman of the Board of Tufts Health Plan. Also joining the Board was Joseph Loscalzo, M.D., scientific founder of NitroMed, Chairman of our Scientific Advisory Committee, and Chairman of Boston University's Department of Medicine and Physician-in-Chief of Boston Medical Center.

The Company has also strengthened its commitment to R&D. Additional personnel were hired to support our Merck and Boston Scientific partnerships; a research facility was opened at Boston University's BioSquare; and a lease was signed on a new facility located a few miles from our current headquarters with space sufficient to support additional research and development and to house our marketing and sales operations. We anticipate this 52,000 square foot renovated site with state-of-the-art laboratories will allow us to continue to build the Company.

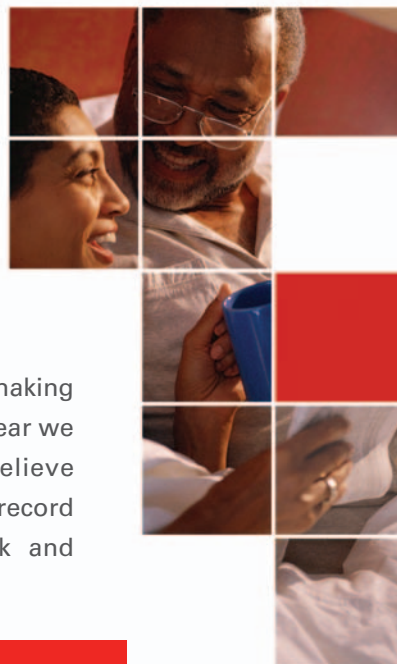
We believe that
we have a sustainable
strategic advantage
in our nitric oxide
know-how and in our
focus on making
the best medicines
and medical devices better.

NitroMed begins 2004 with \$97.1 million in cash. We believe we are sufficiently capitalized to carry the Company through the anticipated launch of BiDil in 2006, subject to FDA approval, and to generate data to support potential additional Nitric Oxide Enhancing cardiovascular drug development and partnerships.

We recorded substantial progress during 2003. Looking forward, we believe we have a sustainable strategic advantage in our nitric oxide know-how and in our focus on making the best medicines and medical devices better. In the coming year we intend to conclude recruitment in A-HeFT, which we believe will bring BiDil a step closer to market. We also expect to record continued strong progress in our partnerships with Merck and Boston Scientific.

The management and Directors of NitroMed are focused on providing value for you, our shareholders, employees and partners. NitroMed begins 2004 as a public company dedicated to building a high-value, integrated pharmaceutical business.

...dedicated to providing
a first in class therapy
for the treatment of
heart failure
in African Americans
and to building a
high-value, integrated
pharmaceutical business...



Thank you
for your confidence and support.

Sincerely,

Argeris "Jerry" Karabelas, Ph.D.
Chairman

Michael D. Loberg, Ph.D.
President and CEO



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO
SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2003

OR

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

For the transition period from _____ to _____
Commission file number 000-50439

NITROMED, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

22-3159793
(IRS Employer Identification No.)

12 Oak Park Drive, Bedford, Massachusetts
(Address of principal executive offices)

01730
(Zip Code)

Registrant's telephone number, including area code: **(781) 275-9700**

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

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, \$.01 par value per share
(Title of class)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). YES NO .

The aggregate market value of the registrant's common stock held by nonaffiliates of the registrant as of March 19, 2004 was approximately \$82,141,386, based on the price at which the registrant's common stock was last sold on March 19, 2004. Information regarding the aggregate market value of the registrant's common stock as of June 30, 2003 has not been provided due to the fact that trading of the registrant's common stock on the Nasdaq National Market did not commence until November 6, 2003.

As of March 19, 2004, there were 25,600,744 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Specified portions of the registrant's proxy statement for the annual meeting of stockholders to be held on May 18, 2004, which are to be filed pursuant to Regulation 14A within 120 days after the end of the registrant's fiscal year ended December 31, 2003 are incorporated by reference into Item 5 of Part II and Part III of this report.

NITROMED, INC.
ANNUAL REPORT
ON FORM 10-K

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PART I

This annual report on Form 10-K contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause the results of NitroMed to differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any projections of revenue, expenses, earnings or losses from operations, or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements concerning product research, development and commercialization timelines; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. The risks, uncertainties and assumptions referred to above include risks that are described in “Business—Factors That May Affect Future Results” and elsewhere in this annual report and that are otherwise described from time to time in our Securities and Exchange Commission reports filed after this report.

The forward-looking statements included in this annual report represent our estimates as of the date of this annual report. We specifically disclaim any obligation to update these forward-looking statements in the future. These forward-looking statements should not be relied upon as representing our estimates or views as of any date subsequent to the date of this annual report.

ITEM 1. BUSINESS

Overview

NitroMed is an emerging pharmaceutical company with substantial expertise and intellectual property in nitric oxide-based drug development. We are applying our nitric oxide technology to develop new pharmaceuticals, as well as safer and more effective versions of existing pharmaceuticals, to target significant diseases and major commercial markets. Our lead nitric oxide-enhancing medicine, BiDil[®], which is being developed to reduce mortality and hospitalization and to improve the quality of life of African Americans diagnosed with heart failure, is the subject of a phase III confirmatory clinical trial.

Our commercial strategy involves the development of proprietary nitric oxide drugs, the co-development and commercialization of nitric oxide-enhancing drugs with partners and the out-licensing of our nitric oxide-enhancing technology in exchange for potential milestone payments and royalties on sales. We plan to directly market BiDil, if approved, to those physicians who treat African Americans with heart failure. We have also entered into collaboration agreements with Merck to jointly develop nitric oxide-enhancing COX-2 inhibitors and with Boston Scientific to jointly develop nitric oxide stents.

Our Nitric Oxide-Enhancing Medicines

Nitric oxide is a naturally-occurring compound that is synthesized in cells to regulate a broad range of cellular reactions. Many disease states are associated with a deficiency in nitric oxide and might benefit from nitric oxide-enhancing medicines. For example, depleted levels of nitric oxide have been implicated in diseases such as heart failure, pulmonary hypertension and sexual dysfunction. Additionally, nitric oxide-enhancing medicines have been shown to reduce side effects associated with a variety of medications, including a broad range of anti-inflammatory medications.

We generally choose drugs for nitric oxide enhancement from among those marketed medicines whose safety and efficacy we believe can be improved by increased nitric oxide levels in the body. We estimate that candidate medicines for our nitric oxide technology have current annual worldwide sales in excess of \$30 billion. We seek to produce our nitric oxide-enhancing drug candidates by combining an existing, marketed medicine with a nitric oxide donor, which is a molecule capable of increasing nitric oxide levels in the body. The nitric oxide donor and the existing medicine can be combined

together through either a chemical linkage to potentially create a proprietary new chemical entity or through the direct mixing of the medicine and the nitric oxide donor to potentially create a patentable new use and dosage form.

We believe that the probability of clinical success for our drug candidates is increased because regulatory approvals have already been achieved for the existing medicines that we are seeking to improve. We also believe that the commercial risk associated with these drug candidates is mitigated because many of these existing medicines have already generated significant sales in their markets.

We have generated significant intellectual property rights for our nitric oxide technology and compounds to protect our interests and support our discovery and development of additional product candidates.

BiDil—Treatment for Heart Failure in African Americans

Our lead product, BiDil, is an orally-administered nitric oxide-enhancing medicine that is being investigated for its potential to reduce mortality and hospitalization and improve the quality of life of African Americans diagnosed with heart failure. BiDil is a combination of two drugs, isosorbide dinitrate and hydralazine. Isosorbide dinitrate is a nitric oxide donor. Hydralazine is an antioxidant and vasodilator agent, which means it dilates blood vessels and protects the nitric oxide formed by isosorbide dinitrate from deactivating. Through these properties, BiDil is intended to provide a number of beneficial effects for African American heart failure patients, including increasing levels of nitric oxide in the body. Because heart failure is a chronic disease, we expect that, if approved, BiDil, like other medicines taken for chronic heart disease, will be taken for the duration of the patient's life.

Heart failure—or end-stage cardiovascular disease—affects approximately five million Americans. There is no cure for this disease and more than 50% of patients die within five years of diagnosis. African Americans suffer a disproportionate incidence of cardiovascular disease. With respect to heart failure, they are affected at a rate almost twice the rate of the corresponding white population and are more likely to die from it. This dramatic ethnic difference in health outcomes has been attributed to a variety of factors, including access to medical care, management of heart failure and socioeconomic factors. Recent analyses of heart failure clinical trials, however, show that the mortality rate and the hospitalization rate for African Americans is significantly higher than for non-African Americans, even after adjustment for such factors. Based on data from the United States census bureau and the Centers for Disease Control, we estimate that 750,000 African Americans have been diagnosed with heart failure, and we expect this number to grow to approximately 900,000 persons by 2010.

African Americans may also be more vulnerable to heart failure because some medicines approved for use in heart failure appear in certain clinical studies to be less effective in African American patients. These ethnic differences are documented in FDA-required product package inserts, including:

- the package insert for enalapril, known commercially as Vasotec®, an angiotensin converting enzyme inhibitor, or ACE inhibitor, which states “it should be noted that in controlled clinical trials ACE inhibitors have an effect on blood pressure that is less in black patients than in non-blacks. In addition, it should be noted that black patients receiving ACE inhibitors have been reported to have a higher incidence of angioedema compared to non-blacks.”
- the package insert for losartan, known commercially as Cozaar®, an angiotensin receptor blocker, which states “. . . the LIFE study provides no evidence that the benefits of Cozaar on reducing the risk of cardiovascular events in hypertensive patients with left ventricular hypertrophy apply to Black patients” and also notes “this finding could not be explained on the basis of differences in the populations other than race.”

While BiDil may be of benefit to the general heart failure population, several factors lead us to believe BiDil has the potential to be particularly clinically and commercially successful in African-American heart failure patients. Specifically:

- African American heart failure patients are disproportionately overrepresented in the North American heart failure population;
- existing therapies for heart failure may not work as effectively in African Americans;
- BiDil's mechanism of action is intended to address the nitric oxide deficiency we believe to be associated with heart failure in African Americans; and
- a retrospective analysis of a completed heart failure study in the general population using the components of BiDil suggests that BiDil's components may have efficacy in African American patients.

We amended BiDil's previously submitted new drug application which had been filed by a prior sponsor of the drug who was investigating BiDil for use in the general heart failure population. In early 2001, we received a letter from the FDA stating that, in addition to the data already submitted to the agency, a clearly positive confirmatory trial in African Americans with heart failure would, together with the satisfaction of other conditions, including the FDA's approval of our manufacturing processes and marketing materials, provide a basis for approval of BiDil. In May 2001, we commenced our phase III confirmatory trial for BiDil, enrolling patients with moderate to severe heart failure who have identified themselves as being African American. As is generally true with most phase III trials, the protocol was developed and finalized with significant input from the FDA. It is a double-blind, placebo-controlled trial, meaning that neither the patients nor the investigators in the study are informed during the trial which patients are receiving BiDil and which are receiving a placebo, which is a pill that looks the same as the drug but has no active ingredients. This trial is being conducted at more than 160 clinical sites in the U.S. and, as of December 31, 2003, is over 75% enrolled. Based on the interim analysis, the independent third party calculated that the trial will need to enroll at least 900 patients to achieve statistical significance for the targeted primary clinical endpoints. The interim analysis also indicated that a 1,100 patient sample size would enhance the likelihood of generating statistically significant results. We believe that if we successfully complete enrollment in the trial by fall 2004, data from the study will be available by mid 2005. Pending successful FDA approval, we expect to launch BiDil in 2006.

Nitric Oxide-Enhancing COX-2 Inhibitors for the Treatment of Pain and Inflammation

COX-2 inhibitors, including Merck's Vioxx® and Pfizer's Celebrex®, are a class of medicines that are effective in treating inflammation. Inflammation is caused by the body's local response to injury and is part of the healing mechanism. However, the body sometimes overcompensates to cause acute and chronic problems of pain, swelling, and loss of function. COX-2 inhibitors are widely prescribed for conditions such as arthritis, mild to moderate pain, migraine and fever. We estimate that in 2002, COX-2 inhibitors generated approximately \$6.0 billion in worldwide sales.

We have created several series of proprietary nitric oxide-enhancing COX-2 inhibitors that we believe could improve the safety and efficacy of this drug class. COX-2 inhibitors have gained rapid commercial success due to their decreased gastrointestinal side effects, compared to aspirin and other commonly prescribed non-steroidal, anti-inflammatory drugs. In our laboratories, nitric oxide has been shown in animal studies to further decrease the gastrointestinal side effects of COX-2 inhibitors.

In December 2002, we entered into an exclusive, worldwide licensing research, collaboration and licensing agreement that granted Merck marketing and sales rights to our technology for nitric oxide-enhancing COX-2 inhibitors. The research portion of the agreement is for three years and can be extended by mutual agreement. In 2003, we have received \$10.0 million in license fees from Merck and

two payments, each of \$5.0 million, for achieving the first two milestones. In addition, we received \$3.0 million in research and development funding in 2003. We are currently working with Merck to screen proprietary nitric oxide-enhancing COX-2 inhibitors in advance of clinical testing as analgesic and anti-inflammatory agents and in other specified disease areas. In late 2003, Merck advanced the first lead compound under the collaboration into phase I clinical trials. These agents are intended to be second-generation COX-2 inhibitors. We are entitled to additional milestone payments upon our successful achievement of specified research objectives and royalties on product sales.

Nitric Oxide Stents for the Treatment of Restenosis

Balloon angioplasty is a procedure to widen blocked arteries that have resulted from certain conditions such as high cholesterol. It is increasingly common during angioplasty to place a stent, or mesh medical device, into the diseased artery to help maintain the artery width and prevent its re-closure, or restenosis. Several cardiovascular device companies are developing and commercializing stents coated with chemotherapeutic agents or other therapeutic agents designed to help reduce the risk of restenosis. We have demonstrated that a stent coated with a nitric oxide donor can significantly reduce restenosis in a variety of animal studies.

In November 2001, we entered into a development and license agreement with Boston Scientific pursuant to which we granted Boston Scientific an exclusive worldwide license to develop and commercialize products for restenosis which incorporate these nitric oxide-releasing compounds. In December 2003, we entered into an agreement to extend the research collaboration to develop nitric-oxide coated stents until December 31, 2005.

Boston Scientific made an up-front license payment to us of \$1.5 million in 2001 and made an additional payment of \$3.0 million in December 2003 in connection with the extension of the research and development collaboration. Boston Scientific also made equity investments in our redeemable convertible preferred stock in 2001 and 2003 totaling \$4.0 million. Boston Scientific will be obligated to make milestone payments to us if specified research, development and commercialization milestones are achieved and has also agreed to pay us royalties on the sale of any products resulting from the collaboration.

Nitric Oxide-Enhancing NSAIDs for Inflammation and Other Development Programs

We are utilizing our nitric oxide expertise and proprietary position to develop products for a variety of additional medical conditions. We are in various stages of discussions with potential partners in the areas of nitric oxide-enhancing non-steroidal anti-inflammatory drugs, or NSAIDs, for the treatment of pain and inflammation and the targeted delivery of nitric oxide-enhancing medicines to the kidney for acute renal failure.

NSAIDs are among the most widely-prescribed drugs for the treatment of inflammatory conditions, including arthritis, mild to moderate pain, migraine and fever. We estimate that the worldwide market for NSAIDs is approximately \$13.3 billion, 30% of which is for arthritis alone. Among the most serious side effects associated with NSAIDs are ulceration and bleeding in the gastrointestinal tract. Nitric oxide has been shown in preclinical studies to decrease the gastrointestinal side effects of NSAIDs. We have developed a proprietary approach to reducing the gastrointestinal side effects of traditional NSAIDs, including aspirin, by delivering a source of nitric oxide along with the NSAID.

Acute renal failure is characterized by a sudden deterioration in kidney function and affects approximately 5% of all hospitalized patients. It is a serious and life-threatening condition from which more than half of the affected patients die. Nitric oxide is known to be essential to kidney function, and we believe that acute renal failure can be moderated by the targeted delivery of nitric oxide to the kidneys.

The following table highlights those classes of nitric oxide-enhancing medicines where we have or are seeking to create intellectual property rights and where we believe we can offer a clinical benefit compared to existing FDA-approved medicines. Our efforts in these areas, except with respect to the COX-2 inhibitors for pain and inflammation, consist of discovery-stage research primarily directed to establishing our intellectual property position. With regard to COX-2 inhibitors for pain and inflammation, in late 2003, our collaborative partner, Merck, advanced the first lead compound under the collaboration into phase I clinical trials. In addition, pursuant to the collaboration additional specified preclinical compounds are being studied for advancement into clinical trials.

Product Candidate and Therapeutic Area	Anticipated Clinical Benefit
Nitric Oxide-Enhancing NSAIDs and COX-2 Inhibitors	
<ul style="list-style-type: none"> • Pain, inflammation, cancer and central nervous system diseases 	<ul style="list-style-type: none"> • Improved gastrointestinal tolerance; accelerated ulcer healing; reduced kidney damage and hypertension
Nitric Oxide-Enhancing PDE Inhibitors	
<ul style="list-style-type: none"> • Asthma • Male erectile dysfunction • Pulmonary hypertension • Chronic obstructive airway disease 	<ul style="list-style-type: none"> • Increased airway circulation; reduced lung inflammation and decreased sensitivity to airborne allergens • Increased response rate; rapid onset of action • Increased efficacy; longer duration of action • Increased airway circulation
Nitric Oxide-Enhancing Steroids	
<ul style="list-style-type: none"> • Allergy and asthma • Dermatology 	<ul style="list-style-type: none"> • Faster onset of action; increased airway circulation • Faster onset of action; increased efficacy
Nitric Oxide-Enhancing Gastrointestinal Protectants	
<ul style="list-style-type: none"> • Peptic ulcer 	<ul style="list-style-type: none"> • Improved efficacy; faster onset of action
Nitric Oxide-Enhancing Arginines	
<ul style="list-style-type: none"> • Kidney failure 	<ul style="list-style-type: none"> • Improved sodium and water balance

Our Strategy

Our goal is to become a leading, multi-product pharmaceutical company, focused on the discovery, development and commercialization of nitric oxide-based medicines. Key elements of our strategy include:

Successfully commercialize BiDil. We plan to develop an internal marketing and sales force to promote BiDil for the treatment of heart failure in African Americans. Based on the number of physicians serving the African American heart failure market, we believe we can successfully promote BiDil with approximately 150 to 200 sales representatives. Because BiDil, if approved, will be the only heart failure treatment specifically indicated to treat African Americans with heart failure, we believe that we will be able to capture significant market share in this population.

Develop and commercialize selected nitric oxide-enhancing versions of existing medicines with leading companies. We intend to continue entering into collaborations with leading pharmaceutical companies where our product candidates will benefit from the marketing reach, clinical expertise and technology of the partner. Our current strategic research and development collaborations with Merck for COX-2 inhibitors and with Boston Scientific for drug-coated stents are examples of our ability to enter into collaborations with leading companies.

Focus our internal development efforts on improved versions of existing medicines. We believe that many pharmaceutical companies have currently marketed drugs and products that can benefit from the therapeutic attributes and the potential patent protection of our nitric oxide-enhancement. We are currently conducting research and development on five drug classes and have consolidated an intellectual property position from which we believe we can generate significant value.

Expand our pipeline of nitric oxide-enhancing drug candidates through corporate development activities. Our nitric oxide expertise coupled with our corporate development capabilities affords us opportunities within the nitric oxide field that others may not recognize. For example, we were well suited to appreciate the value that BiDil, a nitric oxide-enhancing medicine, could bring to African American heart failure patients. We will continue to position ourselves to attract additional opportunities through in-licensing or other arrangements and anticipate using our planned BiDil sales force to market additional products in the future.

Continue to protect and enhance our nitric oxide intellectual property rights and capabilities. Because of its critical role in our on-going product development efforts, we intend to rigorously pursue the protection of our intellectual property. In order to protect and expand our current intellectual property position, we intend to invest significantly in nitric oxide-related research and development efforts, including attracting and retaining highly talented and experienced personnel.

BiDil Clinical Trials

In the 1980s, the U.S. Veterans Administration evaluated the components of BiDil, isosorbide dinitrate and hydralazine, in two landmark studies. The first of two six-year mortality studies on BiDil, also known as the vasodilators in heart failure trials, which began in 1980, compared the effects of a placebo, the BiDil components, and another vasodilator called prazosin in the general population. The primary endpoint of this trial was mortality over two years and the trial enrolled 642 patients who were followed for up to five years. The second six-year mortality study on BiDil began in 1986. This study compared the effects of enalapril, an ACE inhibitor, and the BiDil composition in the general population. The primary endpoint of this trial was mortality over two years and the trial enrolled 804 patients who were followed for up to five years. These data formed the basis of a new drug application filed by Medco Research, now King Pharmaceuticals, seeking approval of BiDil for treatment of heart failure in the general population. Medco received a non-approvable letter with respect to the application in 1997 from the FDA following a split vote at the FDA's CardioRenal Advisory Committee. The FDA review concluded that BiDil failed to satisfy typical statistical significance requirements after statistical adjustments were applied to account for multiple unplanned interim analyses that had been performed by the investigators.

Our extensive work in the field of nitric oxide-enhancing medicines led us to believe that BiDil might be particularly well-suited to enhance *in-vivo* nitric oxide levels and to protect the nitric oxide after it is formed. As such, we postulated that BiDil might provide preferential survival advantages to African American heart failure patients suffering from a deficiency of nitric oxide. In 1999, we re-analyzed the results of the two prior BiDil mortality studies by ethnicity. Following this re-analysis and extensive discussions with the FDA, in 1999 we acquired the new drug application and a license to the BiDil intellectual property from Dr. Jay Cohn, Professor in the Department of Medicine at the University of Minnesota, who had acquired the new drug application and intellectual property from Medco Research. Our retrospective analysis of the first BiDil mortality study, which contained 180 African American patients, showed that BiDil reduced mortality versus placebo by 66% in African Americans with mild to moderate heart failure. These data have a $p < 0.004$, which indicates a four in one thousand probability that this result is due to chance. In addition, re-analysis of the second BiDil mortality study, which contained data from 215 African American patients, showed that African American patients treated with BiDil experienced an improvement in quality of life and mortality rates

that were not statistically different than mortality rates for African American patients treated with enalapril, an ACE inhibitor approved for the treatment of heart failure.

We amended the previously-submitted new drug application for BiDil in the third quarter of 2000 with the results from these ethnicity based re-analyses. In March 2001, the FDA advised us that results from an additional clearly positive clinical trial in African Americans with heart failure would, together with the satisfaction of other conditions, provide a basis for approval of BiDil. We are conducting the BiDil trial at approximately 160 sites in the U.S., with a goal of enrolling 1,100 patients. The trial is designed to demonstrate that BiDil, when administered together with standard heart failure therapies, can provide a combination of reduced mortality and hospitalization and improved quality of life for African Americans with heart failure. The Association of Black Cardiologists is jointly sponsoring the trial, principally by assisting with the identification, selection and training of clinical investigators, the identification of potential study participants, and by endorsing participation in our trial within the African American community. Representatives of the Association of Black Cardiologists also serve on the clinical trial steering committee, where their role includes providing input on trial design and modification.

We experienced decreased patient enrollment after the first 12 months of the BiDil trial primarily because we exhausted the available pool of potential patients at our existing sites and because many potential patients were disqualified from participation in the study because they did not meet the clinical protocol requirement of at least one prior hospitalization. We subsequently increased the number of clinical sites from approximately 100 to approximately 160, and in May 2003 we submitted to the FDA an amended clinical protocol, which permits the enrollment of patients with no prior hospitalizations so long as the other study criteria are met. As of December 31, 2003, we have achieved over 75% enrollment.

An independent third party designated by us performed an interim analysis of the BiDil trial clinical database in March 2003 in accordance with the protocol after 313 patients had completed the minimum of six months of patient follow-up. This interim analysis was incorporated into the study design, with the FDA's concurrence, to ascertain the appropriate number of patients to enroll and to perform an interim safety assessment. No significant treatment-related adverse drug reactions were observed. Based on the interim analysis, the independent third party calculated that the trial will need to enroll at least 900 patients to achieve statistical significance for the targeted primary clinical end points. The interim analysis also indicated that a 1,100 patient sample size would enhance the likelihood of generating statistically significant results. We believe that if we successfully complete enrollment in the trial by fall 2004, data from the study will be available by mid 2005. Pending successful FDA approval, we expect to launch BiDil in 2006.

Nitric Oxide's Role in Cellular Function and Disease

In the 1980s, nitric oxide was identified as a significant molecule that regulates a wide range of important cellular functions. Robert R. Furchgott, a member of our scientific advisory board, and two others were awarded the 1998 Nobel Prize in Physiology and Medicine for this discovery.

Recent research has also shown that nitric oxide also plays important biochemical and physiological roles in many diseases or medical conditions, including the following:

Cardiovascular Disease. The formation of nitric oxide in the cells that line the inner walls of blood vessels, referred to as the endothelium, has been found to play a crucial role in maintaining the dilation of the blood vessels, a process essential for the regulation of blood pressure. Nitric oxide produced by the endothelium also inhibits the clumping of platelets, which are cells in the blood that promote clotting, and the adhesion of platelets and white blood cells to the blood vessels' inner walls, thereby significantly reducing the obstruction of blood vessels that is associated with blood clots and stroke. Numerous other cardiovascular actions of nitric oxide have been reported, including maintaining

sufficient blood flow to the heart muscle and regulation of the contraction of the heart muscle. Cardiovascular diseases associated with nitric oxide imbalance include atherosclerosis, high cholesterol levels, high blood pressure, pulmonary hypertension and heart failure.

Gastrointestinal and Inflammatory Disease. Nitric oxide is capable of influencing many of the biochemical and physiological reactions that are key to preventing or repairing injury to the gastrointestinal tract, such as stimulating mucus secretion from the mucus membrane lining the stomach and intestines and regulating the blood flow feeding the wall of the gastrointestinal tract and the mucus membrane. Nitric oxide can control inflammatory cell activation and is active on other chemical mediators in the inflammatory process. Gastrointestinal diseases in which nitric oxide may have been shown to have beneficial actions include NSAID-induced gastric injury, inflammatory bowel disease, and peptic ulcer.

Central Nervous System Disorders. Nitric oxide is also synthesized in nerve cells, or neurons, of the central nervous system, where it performs many physiological functions, including the formation of memory and the modulation of pain. Nitric oxide-based therapies for diseases such as epilepsy, stroke, neuroinflammatory disorders and trauma may be able to provide protection to neurons.

Sexual Dysfunction. In the peripheral nervous system, nitric oxide is now known to play a role in regulating some forms of vasodilation and certain gastrointestinal, respiratory and genito-urinary functions. For example, male penile erection is dependent upon nitric oxide-relaxation of genital smooth muscles, and drugs like Viagra enhance the nitric oxide-signaling pathway.

Respiratory Disease. Nitric oxide inhalation reduces pulmonary hypertension and improves oxygenation, the absorption of oxygen by the lungs. In inflammatory pulmonary diseases, such as asthma and chronic obstructive pulmonary disease, nitric oxide has been shown to promote airway dilation and reduce inflammation, thus reducing airway sensitivity to airborne irritants and allergens.

Corporate Collaborations

As part of our strategy to accelerate our product development efforts, we have established collaborations with Merck Frosst Canada & Co., a Merck & Co., Inc. subsidiary, in the area of nitric oxide-enhancing COX-2 inhibitors for use in the treatment of various diseases, and Boston Scientific in the area of nitric oxide drug-coated stents to reduce restenosis. These collaborations are designed to provide us with capital and research, development and marketing capabilities. We intend to pursue other collaborations as appropriate. Since inception, all of our revenue has been derived from our collaborations with third parties. For the fiscal year ended December 31, 2003, our collaborations with Merck and Boston Scientific accounted for all of our \$12.8 million of revenue.

Merck Agreement

In December 2002, we entered into a research, collaboration and license agreement with Merck to jointly develop pharmaceutical products containing nitric oxide-enhancing COX-2 inhibitors. We are currently working with Merck to screen proprietary nitric oxide-enhancing COX-2 inhibitors in advance of clinical testing as analgesic and anti-inflammatory agents and in other specified disease areas. In late-2003, Merck advanced the first lead compound under the collaboration into phase I clinical trials. Under the terms of the agreement, we have granted Merck an exclusive worldwide, royalty-bearing license to develop, make and sell nitric oxide-enhancing COX-2 inhibitors for use in the treatment or prevention of various diseases, conditions or disorders.

Merck paid an up-front license fee of \$10.0 million under the agreement and has agreed to make research and development payments over the three-year term of the research program, of which \$3.0 million was paid in 2003. In the event that specified research, development and commercialization milestones are achieved, Merck is obligated to make additional payments to us. In 2003, Merck made two payments, each of \$5.0 million, for achieving the first two milestones. Merck has agreed to pay royalties to us on the sale by Merck, its affiliates or any sublicensees of any products resulting from the collaboration.

The research program may be extended beyond its initial three-year term by the parties for additional one-year periods by written agreement. Merck has the right to terminate the agreement after the initial three year research term upon 90 days' advance written notice. Each party has the right to terminate the agreement in the event of an uncured, material breach by the other party, provided that in the event of a termination by Merck for a material breach by us, Merck must continue to pay any royalty amounts due under the agreement.

Boston Scientific Agreement

In November 2001, we entered into a development and license agreement with Boston Scientific in the field of restenosis. We have granted Boston Scientific an exclusive worldwide license to develop and commercialize products for restenosis incorporating two nitric oxide-releasing compounds. We have also granted to Boston Scientific a right of first refusal to obtain an exclusive license under our nitric oxide technologies to commercialize products for restenosis, which right of first refusal is for a period of three years after the end of the research term. In December 2003, we entered into an extension to the agreement that continues the research and development collaboration through December 2005.

Boston Scientific made an up-front license payment of \$1.5 million to us in 2001 and made an additional payment of \$3.0 million in December 2003 in connection with the extension of the research and development collaboration. In the event that specified research, development and commercialization milestones are achieved, Boston Scientific is obligated to make milestone payments to us. Boston Scientific also is obligated to pay royalties to us on the sale of any products resulting from the collaboration. Boston Scientific made a \$3.5 million investment in our series F junior redeemable convertible preferred stock in 2001. In August 2003, in connection with a private placement, Boston Scientific made an additional \$500,000 investment in our series E redeemable convertible preferred stock.

Boston Scientific has the right to terminate our research program at any time upon 30 days' written notice. Boston Scientific may also terminate the agreement at any time upon 60 days' written notice in the event of an uncured material breach by us, in which event Boston Scientific may elect whether the licenses we have granted shall continue in effect. Unless earlier terminated, the agreement will remain in effect until the expiration of the obligation of Boston Scientific to pay royalties under the agreement. Boston Scientific also has a right of first refusal with respect to other nitric oxide-releasing compounds we may develop for delivery through the use of implantable medical devices or via specialty catheters.

Research and Development

As of December 31, 2003, our research and development group consists of 36 employees, consisting of 16 biologists, 10 medicinal chemists, six persons engaged in clinical development and four persons engaged in patent and other research and development-related functions. Our research and development group is focusing on continuous improvement of our core technology; new materials and platforms; complementary products; and new initiatives aimed at leveraging our core technology in new market areas.

During the years ended December 31, 2003, 2002 and 2001, we estimate that our total company-sponsored research and development expenses were \$15.1 million, \$14.7 million and \$9.9 million, respectively, and that our collaborator-sponsored research and development expenses were \$3.8 million, \$1.4 million and \$313,000, respectively.

Proprietary Rights and Licensing

Our policy is to prosecute and enforce our patents and proprietary technology. We intend to continue to file United States and foreign patent applications to protect technology, inventions and improvements that are considered important to the development of our business. We will be able to protect our proprietary technologies from unauthorized use by third parties only to the extent that our proprietary rights are covered by valid and enforceable patents or are effectively maintained as trade secrets.

As of December 31, 2003, we have 74 issued U.S. patents and 45 pending U.S. patent applications. We also have 23 issued patents and 133 pending patent applications in certain major industrial countries, including Canada, the major European market countries, Australia and Japan. Our issued U.S. and foreign patents expire on various dates between 2007 and 2024.

BiDil. We have two U.S. patents, expiring in 2007 and 2020, respectively, and one Canadian patent expiring in 2008, which relate to co-administration of the components of BiDil. The first U.S. patent and the Canadian patent cover methods for reducing mortality associated with chronic congestive heart failure. The second U.S. patent covers methods for reducing mortality associated with chronic congestive heart failure, for improving the quality of life, for improving oxygen consumption or improving exercise tolerance in black patients. In addition, we have filed three additional U.S. method-of-use patent applications and corresponding foreign patent applications that could provide additional patent protection for BiDil.

Nitric Oxide-Enhancing COX-2 Inhibitors and Nitric Oxide-Enhancing NSAIDs for Inflammation. We have one issued and six pending U.S. patent applications, which, if issued, will have expiration dates between 2020 and 2023 and which disclose and claim novel nitric oxide-enhancing COX-2 inhibitors. These applications also disclose kits and methods of use for the treatment of pain, inflammation and fever, gastrointestinal disorders, disorders resulting from elevated levels of COX-2 inhibitors, for reducing renal and respiratory toxicity, for facilitating wound healing and for improving the cardiovascular profile of COX-2 inhibitors. We have also filed additional foreign patent applications relating to this technology. We have three U.S. patents, expiring in 2015, two U.S. patents, expiring in 2018, and one patent application which, if issued, will expire in 2018, which cover different compositions of matter and methods of use for the treatment of pain, inflammation, fever and gastrointestinal disorders with novel nitric oxide-enhancing NSAIDs. One pending patent application, which, if issued, will expire in 2023, discloses specific composition of matter and methods of use for the treatment of pain, inflammation and gastrointestinal disorders of novel nitric oxide-enhancing NSAIDs.

We have filed additional patent applications worldwide and have been issued two Australian patents, both of which expire in 2016, and one allowed Canadian patent, which also expires in 2016.

Nitric Oxide Stents. We have five U.S. patents expiring on dates between 2013 and 2018 which cover the coating of medical devices with nitric oxide compounds, prevention of adverse effects associated with the use of a medical device, treatment of a damaged vessel or treatment of a damaged vascular surface in a patient by administration of a nitric oxide compounds. We have five pending U.S. patent applications which, if issued, will have expiration dates between 2021 and 2023 and which cover the composition of matter of specific nitric oxide donors or nitric oxide-linked compounds and their methods of use for the treatment of restenosis. We have filed additional patent applications worldwide, have been issued one Australian patent that expires in 2014 and have one allowed European patent which expires in 2014.

Other Development Programs. We also have a U.S. patent and a pending U.S. patent application, both of which expire in 2019, which disclose the methods of use of N-hydroxyguanidine compounds in the treatment of renal failure. We have also filed additional foreign patents applications covering this technology.

License and Royalty Agreements

Dr. Jay N. Cohn. In January 1999, as amended in January 2001, we entered into a collaboration and license agreement with Dr. Jay N. Cohn. Under the agreement, Dr. Cohn licensed to us exclusive worldwide royalty-bearing rights to technology and inventions owned or controlled by Dr. Cohn and that relate to BiDil for the treatment of cardiovascular disease. We have agreed to make milestone payments to Dr. Cohn upon FDA approval and upon first commercial sale of products, if any, arising out of the agreement. The agreement imposes upon us an obligation to use reasonable best efforts to develop and, upon receipt of regulatory approval, manufacture, market and commercialize products based upon the licensed rights. If we fail to meet this obligation, Dr. Cohn has the right to terminate the agreement and the license granted to us under the agreement. Dr. Cohn also has the right to terminate the agreement if we materially breach the agreement and fail to remedy the breach within 30 days. We have the right to terminate the agreement at any time upon 30 days' prior written notice. Unless earlier terminated, the agreement continues in perpetuity. Pursuant to the agreement, Dr. Cohn was appointed to our scientific advisory board, entered into a consulting agreement with us and was granted an option to purchase 10,000 shares of our common stock.

The Brigham and Women's Hospital. In August 1992 and as amended in November 1996, we entered into a research and license agreement with The Brigham and Women's Hospital, Inc., or BWH. Under the agreement, we sponsored a research program at BWH for a period of approximately two years relating to the diagnostic, therapeutic and prophylactic use of nitric oxide and related compounds. Under the agreement, in exchange for our sponsored research funding, BWH granted us exclusive worldwide royalty-bearing rights to technology and inventions owned at the effective time of, or developed in the course of, the sponsored research program. We are applying the patents, patent applications and other intellectual property rights licensed to us by the BWH in our nitric oxide stent program. The agreement imposes on us due diligence obligations with respect to the research, development and commercialization of products based upon the licensed rights. If we fail to meet these obligations, then upon written notice the license will become non-exclusive. BWH has the right to terminate the agreement if we materially breach the agreement and fail to remedy the breach within 60 days.

Boston University. In June 1993, as amended in January 1999, we entered into a research and license agreement with the Trustees of Boston University, or BU. Under the agreement, we have agreed to sponsor a multi-year research program at BU in the area of nitric oxide-enhancing medicines for erectile dysfunction and ureteral relaxation. Under the agreement, in exchange for our sponsored

research funding, BU has granted us exclusive worldwide royalty-bearing rights to technology and inventions owned by BU and/or for the principal investigator named in the research proposal at the effective time of, or developed in the course of, the sponsored research program. We have agreed to pay royalties to BU on all products sold or distributed by us or our affiliates which incorporate or utilize inventions, material or information specified in the agreement. The agreement imposes on us due diligence obligations with respect to the development and commercialization of products based upon the licensed rights. If we fail to meet these obligations, then upon notice by BU, the parties are required to enter into good faith negotiations, and if the parties cannot reach resolution, the license will become non-exclusive without the right to sublicense. BU has the right to terminate the agreement if we materially breach the agreement and fail to remedy the breach within 60 days. We may terminate funding of any sponsored research program on three months' prior written notice.

FoxKiser. In April 2001, we entered into an agreement with the law firm of FoxKiser LLC under which FoxKiser agreed to provide strategic counsel, including assistance in seeking FDA approval of BiDil. We and FoxKiser agreed that the fees owed by us to FoxKiser, including consulting services, would be deferred by us and would be paid in full within 45 days after the date on which we received written FDA approval, if any, for the first BiDil product. In further consideration for FoxKiser's services, we also agreed to pay FoxKiser a royalty on the sale of BiDil by us or a third party licensee. Our obligation to make royalty payments to FoxKiser on BiDil ends six months after the date of market introduction of an FDA-approved generic version of BiDil. The agreement continues in effect in perpetuity, unless either we or FoxKiser terminates the agreement in the event of a material breach by the other party that remains uncured for 60 days and unless renegotiation of the agreement is triggered by its terms in the event that we enter into a license or other business arrangement with a third party on terms that impose certain limitations on the royalties payable to us on sales of BiDil.

Dr. John D. Folts. In March 1995 and as amended in November 1996 and December 1998, we entered into an agreement with Dr. John D. Folts, a member of our scientific advisory board, pursuant to which Dr. Folts assigned to us his rights to any pending patent applications and issued patents relating to the use of nitric oxide adducts in exchange for a royalty on any products, methods or services sold or distributed by us or our licensees that are covered by the assigned patents. These patents cover technologies being used in our nitric oxide-coated stent development programs with Boston Scientific.

Trademarks, Trade Secrets and Other Proprietary Information

We also currently own the following U.S. trademarks:

- BiDil®;
- NitroMed®;
- NitRx®; and
- NitroMed "N" logo.

In addition, we depend upon trade secrets, know-how and continuing technological advances to develop and maintain our competitive position. To maintain the confidentiality of trade secrets and proprietary information, we require our employees, scientific advisors, consultants and collaborators, upon commencement of a relationship with us, to execute confidentiality agreements and, in the case of parties other than our research and development collaborators, to agree to assign their inventions to us. These agreements are designed to protect our proprietary information and to grant us ownership of technologies that are developed in connection with their relationship with us. These agreements may not, however, provide protection for our trade secrets in the event of unauthorized disclosure of such information.

Manufacturing

We have no manufacturing capabilities. We rely on third parties to manufacture bulk compounds and finished investigational medicines for research, development, preclinical and clinical trials. We currently engage Schwarz Pharma Manufacturing, Inc. for manufacture of small-scale batches of BiDil for clinical trials. Commercial quantities of BiDil and other drugs we seek to develop will have to be manufactured in facilities and by processes that comply with the FDA and other regulations. We plan to rely on third parties to manufacture commercial quantities of any products we successfully develop, including BiDil. We believe that there are several manufacturing sources available to us on commercially reasonable terms to meet our clinical and any commercial production requirements.

Marketing and Sales

We currently have no marketing, sales or distribution capabilities. Where the geographic market is limited or where the prescriptions are written principally by a relatively small number of physicians, such as oncologists or cardiologists, we may elect to establish our own marketing organization and sales force to market and sell those products for which we obtain regulatory approval. For example, we plan to directly market BiDil, if approved, to those physicians who treat African Americans with heart failure. To this end, in the near term we intend to initiate development of those marketing and sales capabilities necessary to launch and commercialize BiDil, including beginning to build out a marketing department and planning for the hiring of a U.S. sales force, medical science liaisons, and other professional services functions.

We plan to seek third party support for those products that would benefit from the worldwide promotional support of, branding by, and the reach of, a large sales and marketing force. These products are typically those prescribed by the primary care physician. In these cases we will promote our products in collaboration with marketing partners or rely on relationships with one or more companies with established sales forces and distribution systems spread around the world. Our partnerships with Merck in nitric oxide-enhancing COX-2 inhibitors and Boston Scientific in coated stents are examples of areas in which we have sought partners.

Competition

We and our corporate collaborators face intense competition from a wide range of pharmaceutical and life science companies, as well as academic and research institutions and government agencies. These competitors include organizations that are pursuing the same or similar technologies to those which constitute our technology platform and from organizations that are developing and commercializing pharmaceutical products that are competitive with our potential products.

We believe that competition for our BiDil product and other nitric oxide-enhancing cardiovascular medicines that we and our corporate collaborators may develop will initially come from companies currently marketing and selling therapeutics to treat heart failure in the general population. These competitors include GlaxoSmithKline, plc, Merck & Co., Inc., Pfizer Inc. and AstraZeneca plc. We

expect that COX-2 inhibitors currently marketed by Pfizer Inc. and Novartis Pharma, AG will compete with our and our corporate collaborators' nitric oxide-enhancing COX-2 inhibitor products under development. In the field of stents, we believe that competition will come from Cordis Corporation, a Johnson & Johnson Company, Guidant Corporation and Medtronic, Inc.

We also face competition from other companies that are active in or entering into the area of nitric oxide-based therapeutics. We are aware of four companies working in the area of nitric-oxide therapeutics:

- GB Therapeutics, of Ontario, Canada, which we believe is in early stage preclinical development of nitrate medicines for Alzheimer's disease, Parkinson's disease and dementia;
- NicOx S.A., a French company, which we believe is engaged in the research and development of nitric-oxide releasing derivatives of existing drug classes;
- OxoN Medica, of California, which we believe is in preclinical development of drug targets for diseases resulting from dysfunction of the endothelial cells that line the inside of blood vessel walls; and
- Vasopharm BIOTECH GmbH, of Germany, which we believe is focused on disease mechanisms involving nitric oxide signaling pathways within the vascular wall.

We intend to compete with these companies on the basis of our intellectual property portfolio, the expertise of our scientific personnel and our nitric oxide technologies. Principal competitive factors in our industry include:

- improved patient outcomes;
- cost-effectiveness;
- acceptance by physicians and other health care providers;
- the quality and breadth of an organization's technology;
- the skill of an organization's employees and its ability to recruit and retain skilled employees;
- an organization's intellectual property protection;
- development, sales and marketing capabilities; and
- the availability of substantial capital resources to fund development and commercialization activities.

Many of the companies competing against us have financial and other resources substantially greater than our own. In addition, many of our competitors have significantly greater experience in testing pharmaceutical and other therapeutic products, obtaining FDA and other regulatory approvals of products for use in health care, and marketing and selling those products. Accordingly, our competitors may succeed more rapidly than we will in obtaining FDA approval for products and achieving widespread market acceptance. If we obtain necessary regulatory approval and commence significant commercial sales of our products, we will also be competing with respect to manufacturing efficiency and marketing capabilities, areas in which we have limited or no experience.

Regulatory Matters

FDA Requirements for New Drug Compounds

The research, testing, manufacture and marketing of drug products are extensively regulated by numerous governmental authorities in the United States and other countries. In the United States, drugs are subject to rigorous regulation by the FDA. The Federal Food, Drug, and Cosmetic Act, and

other federal and state statutes and regulations, govern, among other things, the research, development, testing, manufacture, storage, recordkeeping, labeling, promotion and marketing and distribution of pharmaceutical products. Failure to comply with applicable regulatory requirements may subject a company to a variety of administrative or judicially-imposed sanctions and/or the inability to obtain or maintain required approvals or to market approved drug products.

The steps ordinarily required before a new pharmaceutical product may be marketed in the United States include preclinical laboratory tests, animal tests and formulation studies, the submission to the FDA of a notice of claimed investigational exemption or an investigational new drug application, which must become effective before clinical testing may commence, and adequate and well-controlled clinical trials to establish the safety and effectiveness of the drug for each indication for which FDA approval is sought. Satisfaction of FDA pre-market approval requirements typically takes several years and the actual time required may vary substantially based upon the type, complexity and novelty of the product or disease. Government regulation may delay or prevent marketing of potential products for a considerable period of time and impose costly procedures upon a manufacturer's activities. Success in early stage clinical trials does not assure success in later stage clinical trials. Data obtained from clinical activities is not always conclusive and may be susceptible to varying interpretations that could delay, limit or prevent regulatory approval. Even if a product receives regulatory approval, later discovery of previously unknown problems with a product may result in restrictions on the product or even complete withdrawal of the product from the market.

Preclinical tests include laboratory evaluation of product chemistry and formulation, as well as animal trials to assess the potential safety and efficacy of the product. The conduct of the preclinical tests and formulation of compounds for testing must comply with federal regulations and requirements. The results of preclinical testing are submitted to the FDA as part of an investigational new drug application.

A 30-day waiting period after the filing of each investigational new drug application is required prior to the commencement of clinical testing in humans. If the FDA has not commented on or questioned the investigational new drug application within this 30-day period, clinical trials may begin. If the FDA has comments or questions, the questions must be answered to the satisfaction of the FDA before initial clinical testing can begin. In addition, the FDA may, at any time, impose a clinical hold on ongoing clinical trials. If the FDA imposes a clinical hold, clinical trials cannot commence or recommence without FDA authorization and then only under terms authorized by the FDA. In some instances, the investigational new drug application process can result in substantial delay and expense.

Clinical trials involve the administration of the investigational new drug to healthy volunteers or patients under the supervision of a qualified investigator. Clinical trials must be conducted in compliance with federal regulations and requirements, under protocols detailing the objectives of the trial, the parameters to be used in monitoring safety and the effectiveness criteria to be evaluated. Each protocol involving testing on U.S. subjects must be submitted to the FDA as part of the investigational new drug application. The study protocol and informed consent information for patients in clinical trials must be submitted to institutional review boards for approval.

Clinical trials to support new drug applications for marketing approval are typically conducted in three sequential phases, but the phases may overlap. In phase I, the initial introduction of the drug into healthy human subjects or patients, the drug is tested to assess metabolism, pharmacokinetics and pharmacological actions and safety, including side effects associated with increasing doses. Phase II usually involves trials in a limited patient population, to determine dosage tolerance and optimum dosage, identify possible adverse effects and safety risks, and provide preliminary support for the efficacy of the drug in the indication being studied.

If a compound demonstrates evidence of effectiveness and an acceptable safety profile in phase II evaluations, phase III trials are undertaken to further evaluate clinical efficacy and to further test for

safety within an expanded patient population, typically at geographically dispersed clinical trial sites. Phase I, phase II or phase III testing of any product candidates may not be completed successfully within any specified time period, if at all.

After successful completion of the required clinical testing, generally a new drug application is prepared and submitted to the FDA. FDA approval of the new drug application is required before marketing of the product may begin in the United States. The new drug application must include the results of extensive clinical and other testing and a compilation of data relating to the product's pharmacology, chemistry, manufacture, and controls. The cost of preparing and submitting a new drug application is substantial. Under Federal law, the submission of new drug applications are additionally subject to substantial application user fees, currently exceeding \$500,000, and the manufacturer and/or sponsor under an approved new drug application are also subject to annual product and establishment user fees, currently exceeding \$30,000 per product and \$200,000 per establishment. These fees are typically increased annually.

The FDA has 60 days from its receipt of a new drug application to determine whether the application will be accepted for filing based on the agency's threshold determination that the new drug application is sufficiently complete to permit substantive review. Once the submission is accepted for filing, the FDA begins an in-depth review of the new drug application. Under federal law, the FDA has agreed to certain performance goals in the review of new drug applications. Most such applications for non-priority drug products are reviewed within ten months. The review process is often significantly extended by FDA requests for additional information or clarification regarding information already provided in the submission. The FDA may also refer applications for novel drug products or drug products which present difficult questions of safety or efficacy to an advisory committee, typically a panel that includes clinicians and other experts, for review, evaluation and a recommendation as to whether the application should be approved. The FDA is not bound by the recommendation of an advisory committee.

If FDA evaluations of the new drug application and the manufacturing facilities are favorable, the FDA may issue an approval letter, or, in some cases, an approvable letter followed by an approval letter. An approvable letter generally contains a statement of specific conditions that must be met in order to secure final approval of the new drug application. If and when those conditions have been met to the FDA's satisfaction, the FDA will typically issue an approval letter. An approval letter authorizes commercial marketing of the drug with specific prescribing information for specific indications. As a condition of new drug application approval, the FDA may require post approval testing and surveillance to monitor the drug's safety or efficacy and may impose other conditions, including labeling restrictions which can materially impact the potential market and profitability of the drug. Once granted, product approvals may be withdrawn if compliance with regulatory standards is not maintained or problems are identified following initial marketing.

Once the new drug application is approved, a product will be subject to certain post-approval requirements, including requirements for adverse event reporting and submission of periodic reports. Additionally, the FDA also strictly regulates the promotional claims that may be made about prescription drug products. In particular, the FDA requires substantiation of any claims of superiority of one product over another including, in many cases, requirements that such claims be proven by adequate and well controlled head-to-head clinical trials. To the extent that market acceptance of our products may depend on their superiority over existing therapies, any restriction on our ability to advertise or otherwise promote claims of superiority, or requirements to conduct additional expensive clinical trials to provide proof of such claims, could negatively effect the sales of our products and/or our costs.

If the FDA's evaluation of the new drug application submission or manufacturing facilities is not favorable, the FDA may refuse to approve the new drug application or issue a not approvable letter.

The not approvable letter outlines the deficiencies in the submission and often requires additional testing or information in order for the FDA to reconsider the application. Even with submission of this additional information, the FDA ultimately may decide that the application does not satisfy the regulatory criteria for approval. With limited exceptions, FDA may withhold approval of a new drug application regardless of prior advice it may have provided or commitments it may have made to the sponsor.

Once a new drug application is approved, the product covered thereby becomes a “listed drug” which can, in turn, be cited by potential competitors in support of approval of an abbreviated new drug application. An abbreviated new drug application provides for marketing of a drug product that has the same active ingredients in the same strengths and dosage form as the listed drug and has been shown through bioequivalence testing to be therapeutically equivalent to the listed drug. There is no requirement, other than the requirement for bioequivalence testing, for an abbreviated new drug application applicant to conduct or submit results of pre-clinical or clinical tests to prove the safety or effectiveness of its drug product. Drugs approved in this way are commonly referred to as “generic equivalents” to the listed drug, are listed as such by the FDA, and can often be substituted by pharmacists under prescriptions written for the original listed drug.

Federal law provides for a period of three years of exclusivity following approval of a listed drug that contains previously approved active ingredients but is approved in a new dosage, dosage form, route of administration or combination, or for a new use, the approval of which was required to be supported by new clinical trials conducted by or for the sponsor, during which such three year period FDA cannot grant effective approval of an abbreviated new drug application based on that listed drug. Federal law also provides a period of five years following approval of a drug containing no previously approved active ingredients, during which abbreviated new drug applications for generic versions of those drugs cannot be submitted unless the submission accompanies a challenge to a listed patent, in which case the submission may be made four years following the original product approval. Additionally, in the event that the sponsor of the listed drug has properly informed FDA of patents covering its listed drug, applicants submitting an abbreviated new drug application referencing that drug are required to certify whether they intend to market their generic products prior to expiration of those patents. If an abbreviated new drug application applicant certifies that it believes one or more listed patents are invalid or not infringed, it is required to provide notice of its filing to the new drug application sponsor and the patent holder. If the patent holder then initiates a suit for patent infringement against the abbreviated new drug application sponsor within 45 days of receipt of the notice, FDA cannot grant effective approval of the abbreviated new drug application until either 30 months has passed or there has been a court decision holding that the patents in question are invalid or not infringed. If the abbreviated new drug application applicant certifies that it does not intend to market its generic product before some or all listed patents on the listed drug expire, then FDA cannot grant effective approval of the abbreviated new drug application until those patents expire. The first abbreviated new drug applicant(s) submitting substantially complete applications certifying that listed patents for a particular product are invalid or not infringed may qualify for a period of 180 days after a court decision of invalidity or non-infringement or after it begins marketing its product, whichever occurs first, during which subsequently submitted abbreviated new drug applications cannot be granted effective approval.

From time to time, including presently, legislation is drafted and introduced in Congress that could significantly change the statutory provisions governing the approval, manufacturing and marketing of drug products. In addition, FDA regulations and guidance are often revised or reinterpreted by the agency in ways that may significantly affect our business and our products. It is impossible to predict whether legislative changes will be enacted, or FDA regulations, guidance or interpretations changed, or what the impact of such changes, if any, may be.

FDA Requirements for Medical Devices

Drugs that are incorporated into medical devices, such as drug-coated stents, are potentially subject to regulatory requirements applicable to medical devices as well as those applicable to drugs. For review purposes, applications for approval of drug-coated stents have been assigned by FDA primarily to the FDA Center for Devices and Radiological Health, which consults with the FDA Center for Drug Evaluation and Research on issues relating to the drug component of the product. The FDA has recently established an Office of Combination Products within the office of the FDA Commissioner and has published revised regulations implementing statutory requirements directed at ensuring prompt and consistent regulation of drug/device combination products. However, because of the limited experience with combination product review, the manner in which it may be modified and applied in the future to similar or different types of products is unpredictable. This uncertainty, and the complexity inherent in the testing and review of combination drug/device products, may lead to significant delays and additional costs in the process of developing and seeking approval to market such products.

Medical devices are regulated by the FDA according to their classification. The FDA classifies a medical device into one of three categories based on the device's risk and what is known about the device. The three categories are as follows:

Class I devices are generally lower risk products for which sufficient information exists establishing that general regulatory controls provide reasonable assurance of safety and effectiveness. Most class I devices are exempt from the requirement for premarket notification under section 510(k) of the Federal Food, Drug, and Cosmetic Act. FDA clearance of a premarket notification is necessary prior to marketing a non-exempt class I device in the United States.

Class II devices are devices for which general regulatory controls are insufficient to provide reasonable assurance of safety and effectiveness and for which there is sufficient information to establish special controls, such as guidance documents or performance standards, to provide a reasonable assurance of safety and effectiveness. Clearance of 510(k) notification is necessary prior to marketing a non-exempt class II device in the United States.

Class III devices are devices for which there is insufficient information demonstrating that general and special controls will provide a reasonable assurance of safety and effectiveness. Typical class III devices are life-sustaining, life-supporting or implantable devices, or devices posing substantial risk. Unless a device is a preamendments device that is not subject to a regulation requiring a premarket approval application, the FDA generally must approve a premarket approval application prior to the marketing of a class III device in the United States. Under current law and regulations, we expect that drug-coated stents will be treated as class III devices, to the extent that they are regulated as devices, and that approval of a device premarket approval application will be required to obtain authorization to market such products.

The premarket approval application process is expensive and uncertain and includes the imposition at the time of submission of significant device user fees. A premarket approval application must be supported by valid scientific evidence, which typically includes extensive data, including preclinical data and clinical data from well-controlled or partially controlled clinical trials, to demonstrate the safety and effectiveness of the device. Product and manufacturing and controls specifications and information must also be provided. The FDA may refuse to accept a premarket approval application for filing and often will require additional clinical trial data or other information before approval. Obtaining approval can take several years and approval may be conditioned on, among other things, the conduct of postmarket clinical studies or surveillance. Reduced device user fees also apply to most premarket approval supplements. Any subsequent change to an approved device that affects the safety or effectiveness of the device will require approval of a supplemental premarket approval application. We cannot be sure that approval of a premarket approval application or premarket approval application

supplement will be granted on a timely basis, if at all, or that the FDA's approval process will not involve costs and delays that will adversely affect our ability to commercialize our products. In the case of a combination drug/device product such as a drug-coated stent, the need for consultation with drug reviewers and the potential application of drug standards as well as device standards to different aspects of the product, its manufacturing process, and the associated FDA review processes may significantly increase the complexity, costs and potential delays involved in obtaining marketing approval.

Whether or not a product is required to be approved before marketing, we must comply with strict FDA requirements applicable to devices, including quality system requirements pertaining to all aspects of our product design and manufacturing process, such as requirements for packaging, labeling, record keeping, including complaint files, and corrective and preventive action related to product or process deficiencies. The FDA enforces its quality system requirements through periodic inspections of medical device manufacturing facilities. In addition, medical device reports must be submitted to the FDA to report device-related deaths or serious injuries, and malfunctions the recurrence of which would likely cause serious injury or death. Medical device reports can result in agency action such as inspection, recalls, and patient/physician notifications, and are often the basis for agency enforcement actions. Because the reports are publicly available, they can also become the basis for private tort suits, including class actions and unfavorable publicity.

As with drugs, the promotion of medical devices is regulated by the FDA and violations of FDA policies and regulations with respect to promotional activities may result in significant administrative and court sanctions.

Foreign Regulation of New Drug Compounds and Medical Devices

Approval of a product by comparable regulatory authorities may be necessary in foreign countries prior to the commencement of marketing of the product in those countries, whether or not FDA approval has been obtained. The approval procedure varies among countries and can involve requirements for additional testing. The time required may differ from that required for FDA approval. Although there are some procedures for unified filings for some European countries with the sponsorship of the country which first granted marketing approval, in general each country has its own procedures and requirements, many of which are time consuming and expensive. Thus, there can be substantial delays in obtaining required approvals from foreign regulatory authorities after the relevant applications are filed.

In Europe, marketing authorizations may be submitted at a centralized, a decentralized or a national level. The centralized procedure is mandatory for the approval of biotechnology products and provides for the grant of a single marketing authorization which is valid in all European Union member states. As of January 1995, a mutual recognition procedure is available at the request of the applicant for all medicinal products which are not subject to the centralized procedure. We will choose the appropriate route of European regulatory filing to accomplish the most rapid regulatory approvals. However, our chosen regulatory strategy may not secure regulatory approvals on a timely basis or at all.

Hazardous Materials

Our research and development processes involve the controlled use of hazardous materials, chemicals and radioactive materials and produce waste products. We are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of hazardous materials and waste products. We do not expect the cost of complying with these laws and regulations to be material.

Factors That May Affect Future Results

You should carefully consider the following risk factors, in addition to other information included in this annual report, in evaluating NitroMed and our business. If any of the following risks occur, our business, financial condition and operating results could be materially adversely affected.

Risks Relating to our Business

Because we have a history of losses and our future profitability is uncertain, our common stock is a highly speculative investment.

We have experienced significant operating losses since our inception in 1992. For the year ended December 31, 2003, we had a net loss of \$8.8 million. As of December 31, 2003, we had an accumulated deficit of approximately \$106.8 million. We expect that we will continue to incur substantial losses and that our cumulative losses will increase as our research, development and commercialization efforts expand. We expect that the losses that we incur will fluctuate from quarter to quarter and that these fluctuations may be substantial. To date, we have not recorded any revenue from the sale of products and we will not be able to do so unless and until one of our products completes clinical trials and receives regulatory approval. BiDil is our only product candidate that has advanced into clinical trials and we do not anticipate receiving revenues from BiDil until at least 2006, if ever. All of our other product candidates are in research or pre-clinical development, will require significant additional testing prior to submission of any regulatory applications and, as such, are not expected to be commercially available for many years, if at all.

A large portion of our expenses is fixed, including expenses related to facilities, equipment and personnel. In addition, we expect to spend significant amounts to fund research, development and commercialization of our product candidates and to enhance our core technologies. As a result, we expect that our operating expenses will continue to increase significantly in the near term and, consequently, we will need to generate significant revenue to achieve profitability. We do not expect to achieve profitability until at least 2008 and may not achieve profitability until after that date, if at all. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis. Our failure to become and remain profitable would depress the market price of our common stock and could impair our ability to raise capital, expand our business, diversify our product offerings or continue our operations.

We will require substantial additional funds and if additional capital is not available we may need to limit, scale back or cease our operations.

We have used and will continue to require substantial funds to conduct research and development, including preclinical testing and clinical trials of our potential products, and to manufacture and market any products that are approved for commercial sale. For example, we estimate that the total direct cost to complete our BiDil clinical trial will be at least \$39.0 million and that we will incur significant additional expenditures to conduct pre-clinical testing and any clinical trials of our nitric oxide-enhancing COX-2 inhibitors, nitric-oxide stents and other early-stage development programs. Because their successful development is uncertain, we are unable to estimate the actual funds we will require to complete research and development and commercialize our products under development. We believe that our existing cash and investment securities will be sufficient to support our current operating plan for at least 24 months from the date of this report.

However, our future capital requirements and the period in which we expect our current cash to support our operations may vary from what we expect due to a number of factors, including the following:

- the costs of launching BiDil, if and when it is approved by regulatory authorities;
- the timing, receipt, and amount of milestone and other payments, if any, from collaborators;
- the timing, receipt, and amount of sales and royalties, if any, from our potential products;
- the resources required to successfully complete our clinical trials;
- the time and costs involved in obtaining regulatory approvals;
- continued progress in our research and development programs, as well as the magnitude of these programs;
- the cost of manufacturing, marketing and sales activities;
- the costs involved in preparing, filing, prosecuting, maintaining, and enforcing patent claims;
- the cost of obtaining and maintaining licenses to use patented technologies; and
- our ability to establish and maintain additional collaborative arrangements.

We will be required to seek additional funding in the future and may do so through collaborative arrangements and public or private financings. Additional financing may not be available to us on acceptable terms or at all. In addition, the terms of the financing may adversely affect the holdings or the rights of our stockholders. For example, if we raise additional funds by issuing equity securities, further dilution to our then-existing stockholders will result. If we are unable to obtain funding on a timely basis, we may be required to significantly curtail one or more of our research or development programs. We also could be required to seek funds through arrangements with collaborators or others that may require us to relinquish rights to some of our technologies, product candidates, or products which we would otherwise pursue on our own.

We are heavily dependent on obtaining regulatory approval for and successfully commercializing BiDil, our most advanced drug candidate.

Our research, development and management resources are primarily dedicated to our most advanced drug candidate, BiDil, which is not expected to be commercially available until at least 2006, if at all. If we experience significant delays in completing our phase III confirmatory trial of BiDil, obtain unfavorable or only marginally favorable results from this trial, or fail to achieve regulatory approval or market acceptance of BiDil, our near term ability to generate product revenue, our reputation and our ability to raise additional capital will be materially impaired and the value of an investment in our stock will decline.

The application of our nitric oxide technology is unproven in humans and, as a result, we may not be able to successfully develop and commercialize any products based upon this technology.

A key component of our strategy is to seek to improve existing medicines with our proprietary nitric oxide technology. Our product candidates include nitric oxide enhancements of existing drugs. Thus, we are modifying compounds whose chemical and pharmacological profiles are well-documented and understood. However, each of our product candidates is a new molecule with a chemical and pharmacological profile that differs from that of the existing drug. None of our product candidates has been sufficiently studied or tested for its chemical and pharmacological properties to have been fully explored and documented. These compounds may not demonstrate in patients the chemical and pharmacological properties ascribed to them in laboratory studies, and they may interact with human biological systems in unforeseen, ineffective or harmful ways. In addition, it is possible that existing drugs or newly-discovered drugs may not benefit from the application of our nitric oxide technology. If

we are not able to successfully develop and commercialize drugs based upon our technological approaches we will not become profitable and the value of our stock will decline.

If our clinical trials for BiDil and any other product candidates we advance into clinical testing are not successful, we may not be able to successfully develop and commercialize our products.

In order to obtain regulatory approvals for the commercial sale of our product candidates, we and our collaborators will be required to complete extensive clinical trials in humans to demonstrate the safety and efficacy of our product candidates. We may not be able to obtain authority from the FDA or other regulatory agencies to commence or complete these clinical trials. If permitted, such clinical testing may not prove that our drug candidates are safe and effective to the extent necessary to permit us to obtain marketing approvals from regulatory authorities. Moreover, positive results demonstrated in preclinical studies and clinical trials that we complete may not be indicative of results obtained in future clinical trials. Furthermore, we, one of our collaborators, institutional review boards, or regulatory agencies may suspend clinical trials at any time if it is believed that the subjects or patients participating in such trials are being exposed to unacceptable health risks. Adverse or inconclusive clinical trial results concerning any of our drug candidates could require us to conduct additional clinical trials, result in increased costs and significantly delay the filing for marketing approval for such drug candidates with the FDA or result in a filing for a narrower indication.

The successful completion of our BiDil trial will depend on, among other things, the rate of patient enrollment. Patient enrollment is a function of many factors, including the size of the patient population, the nature of the clinical protocol, the availability of alternative treatments, the proximity of patients to clinical sites and the eligibility criteria for the study. We have experienced decreasing patient enrollment in our BiDil trial over time primarily due to the patient eligibility criteria and having exhausted the available pool of potential patients at our clinical sites. As a result, we have revised the patient eligibility criteria and increased the number of clinical sites in an attempt to maintain enrollment levels. Despite these changes, we may be unable to enroll the number of patients we need to complete the trial on a timely basis. Delays in planned patient enrollment for the trial may cause us to incur increased costs and delay commercialization.

Our BiDil trial is the first clinical trial of BiDil in the specific drug combination and formulation that we intend to commercialize. We did not conduct the prior clinical trials involving the two generic drugs that comprise the BiDil composition, which were conducted in the 1980s and were not specifically designed to study the safety or efficacy of the therapeutic for African Americans. These prior trials generated the data that served as the basis for the original new drug application for BiDil filed by Medco Research, now King Pharmaceuticals, a third-party pharmaceutical company with whom we have no relationship. Medco received a non-approvable letter from the FDA with respect to its new drug application in 1997. After re-analysis of this data and extensive discussions with the FDA, in 1999 we acquired the new drug application from Dr. Jay Cohn, Professor of the Department of Medicine at the University of Minnesota, who had acquired the new drug application from Medco Research. The data generated in these prior trials also served as the basis for our amendment to that new drug application and the FDA's resulting request for a confirmatory trial. In the trial, we are studying the use of BiDil as a supplement to current standard-of-care medicines, whereas in prior clinical trials the combination of drugs contained in BiDil was studied as a substitute for an approved therapeutic. As a result, we have limited clinical experience with BiDil in the drug combination and for the specific indication for which we intend to seek marketing approval.

The FDA deemed the original new drug application filed by Medco Research seeking approval for use of BiDil in the general heart failure population, non-approvable because the data did not show a statistically significant benefit in that population. In 2001, the FDA issued us a letter stating that, in addition to the data in African American heart failure patients already submitted to the agency, a clearly positive trial in African Americans with heart failure would, together with the satisfaction of

other conditions, including its approval of our manufacturing process and marketing materials, provide a basis for approval of BiDil. This letter from the FDA was not an “approvable” letter, which would generally be issued by the FDA if an application is deemed to substantially meet the FDA’s requirements and the FDA believes that the application can be approved if specific additional information is submitted or specific conditions are agreed to by the applicant. Because the letter we receive is not an “approvable” letter, the FDA retains broad discretion in determining whether to ultimately approve BiDil.

We rely on academic institutions or clinical research organizations to supervise or monitor some or all aspects of our BiDil trial and we expect to rely on academic institutions and clinical research organizations for other product candidates we advance into clinical testing. Accordingly, we have less control over the timing and other aspects of these clinical trials than if we conducted them entirely on our own.

As a result of these factors, we or third parties on whom we rely may not successfully begin or complete our clinical trials in the time periods we have forecasted, if at all. Moreover, if we incur costs and delays in our programs or if we do not successfully develop and commercialize our products, our stock price could decline.

If we and our partners do not obtain and maintain the regulatory approvals required to market and sell BiDil and our other products under development, then our business will be unsuccessful and the market price of our stock will substantially decline.

We and our partners will not be able to market any of our products in the United States, Europe or in any other country without marketing approval from the FDA or equivalent foreign regulatory agency. The regulatory process to obtain market approval for a new drug or medical device takes many years and requires expenditures of substantial resources. We have had only limited experience in preparing applications and obtaining regulatory approvals.

We are seeking regulatory approval of our lead drug candidate, BiDil, for the treatment of heart failure in African Americans, based upon a confirmatory clinical trial performed exclusively on subjects who are self-identified as African American. To our knowledge, the FDA has never approved a drug product for use particularly in an ethnic population. The FDA’s receptiveness to drugs that are approved and marketed on the basis of different ethnicity-based therapeutic outcomes is untested and we believe may be adversely affected by contrary scientific or public health evidence or political or legal factors. For example, scientific evidence could emerge that suggests that there is no physiological basis to support pharmaceutical development of drugs based upon ethnicity. Moreover, others may express the view that ethnicity is only a sociological concept and, accordingly, there is not a valid basis for the commercialization of medicines based on ethnicity. These factors may impede or prevent us from obtaining FDA approval of BiDil even if the data from our BiDil trial is positive.

If we do not receive required regulatory approval or clearance to market BiDil or any of our other products under development, we will not be able to develop and commercialize these products, which will affect our ability to achieve profitability, and will cause the value of our common stock to substantially decline.

Even if we receive regulatory approval to market our product candidates, the market may not be receptive to BiDil or our other product candidates upon their commercial introduction, which will prevent us from being profitable.

BiDil and the other product candidates that we are developing are based upon new technologies or therapeutic approaches. In addition, we plan to market BiDil only in the U.S. Key participants in the U.S. pharmaceutical marketplace, such as physicians, payors and consumers, may not accept a product intended to improve therapeutic results based on ethnicity. As a result, it may be more difficult for us to convince the medical community and third-party payors to accept and use our products.

Other factors that we believe will materially affect market acceptance of BiDil and our other product candidates under development include:

- the timing of our receipt of any marketing approvals, the terms of any approval, and the countries in which approvals are obtained;
- the safety, efficacy and ease of administration;
- the success of our physician education programs; and
- the availability of government and third-party payor reimbursement.

If we or our third party manufacturers or service providers fail to comply with regulatory laws and regulations, we or they could be subject to enforcement actions, which could affect our ability to market and sell our products and may harm our reputation.

If we or our third party manufacturers or service providers fail to comply with applicable federal, state or foreign laws or regulations, we could be subject to enforcement actions, which could affect our ability to develop, market and sell our products successfully and could harm our reputation and lead to less acceptance of our products by the market. These enforcement actions include:

- product seizures;
- voluntary or mandatory recalls;
- voluntary or mandatory patient or physician notification;
- withdrawal of product approvals;
- restrictions on, or prohibitions against, marketing our products;
- fines;
- restrictions on importation of our products;
- injunctions;
- civil and criminal penalties; and
- suspension of review, refusal to approve pending applications, or withdrawal of approval.

We depend on Merck and Boston Scientific, and expect to depend on additional collaborative partners in the future, for a significant portion of our revenues and to develop, conduct clinical trials with, obtain regulatory approvals for, and manufacture, market and sell some of our products under development, and these collaborations may not be successful.

We are relying on Merck to fund the development of and to commercialize products based upon our nitric oxide-enhancing COX-2 inhibitor technologies, and we are relying on Boston Scientific to fund the development of and to commercialize nitric oxide-enhancing stents using our technology to treat the re-closure of arteries, or restenosis, following balloon angioplasty, a treatment to widen blocked arteries. All of our \$12.8 million of revenues for 2003 were derived from licensing, research and development and milestone payments paid to us by Merck and Boston Scientific. Our agreements with Merck and Boston Scientific, which provide research and development funding for certain of our lead programs, generally are terminable upon short notice by the collaborator and additional payments due to us under the collaboration agreements are generally based on the achievement of specific development and commercialization milestones that may not be met. These collaborations also entitle us to royalty payments that are based on the sales of products developed and marketed through the collaboration. These future royalty payments may not materialize or be less than expected if the related products are not successfully developed or marketed, or if we or our collaborators are forced to license intellectual property from third parties. Accordingly, we cannot predict with certainty when, if ever,

either of these collaborations will continue to generate revenues for us. The loss of either of these large collaborations would likely significantly decrease our near term revenues and future prospects. We intend to enter into collaborative agreements with other parties in the future relating to other product candidates and we are likely to have similar risks with regard to any such future collaborations.

In addition, our existing collaborations and any future collaborative arrangements that we seek to enter into with third parties may not be scientifically or commercially successful. Factors that may affect the success of our collaborations include the following:

- our collaborators may be pursuing alternative technologies or developing alternative products, either on their own or in collaboration with others, that may be competitive with the product on which they are collaborating with us or which could affect our collaborative partners' commitment to the collaboration with us;
- reductions in marketing or sales efforts or a discontinuation of marketing or sales of our products by our collaborators would reduce our revenues, which will be based on a percentage of net sales by the collaborator;
- our collaborators may terminate their collaborations with us, which could make it difficult for us to attract new collaborators or adversely affect how we are perceived in the business and financial communities; and
- our collaborators may pursue higher-priority programs or change the focus of their development programs, which could affect the collaborators' commitment to us.

We have no sales and marketing experience and may depend significantly on third parties who may not successfully commercialize our products.

We have no sales, marketing and distribution experience. We intend to independently launch and market BiDil and certain other products not already subject to marketing agreements where we believe the target physician market can be effectively reached by the internal sales force we intend to establish. To develop an internal sales, distribution and marketing capability, we will have to invest significant amounts of money and management resources. We plan to minimize these expenditures prior to obtaining the results of our BiDil trial, but this may provide us insufficient time to build our sales and marketing capabilities in advance of BiDil's launch. If we develop these capabilities and approval of BiDil is delayed substantially, or BiDil is not approved, we will have incurred significant unrecoverable expenses.

For products where we decide to perform sales, marketing and distribution functions ourselves, we could face a number of additional risks, including:

- we may not be able to attract and build a significant marketing or sales force;
- the cost of establishing a marketing or sales force may not be justifiable in light of the revenues generated by any particular product; and
- our direct sales and marketing efforts may not be successful.

For product candidates with larger target physician markets, we plan to rely significantly on sales, marketing and distribution arrangements with third parties. For example, we plan to rely on our existing collaborative partners for the commercialization of nitric oxide-enhancing COX-2 inhibitors and stents coated with nitric oxide-releasing compounds. We may have to enter into additional marketing arrangements in the future and we may not be able to enter into these arrangements on terms which are favorable to us, if at all. In addition, we may have limited or no control over the sales, marketing and distribution activities of these third parties. Our future revenues may depend heavily on the success of the efforts of these third parties.

We have limited manufacturing experience and resources and we must incur significant costs to develop this expertise or rely on third parties to manufacture our products.

We have no manufacturing experience. In order to continue to develop products, apply for regulatory approvals, and commercialize our products, we will need to develop, contract for, or otherwise arrange for the necessary manufacturing capabilities. We currently rely on third parties for the production of certain of our products, including BiDil, for preclinical and clinical testing purposes and we expect to continue to do so in the future. Only a limited number of manufacturers can supply nitric oxide-based medicines, and we have not secured a long-term commercial supply arrangement for any of our product candidates, including BiDil. The manufacturing process for any of our products is an element of the FDA approval process and we will need to contract with manufacturers who can meet the FDA requirements on an ongoing basis. As part of obtaining regulatory approval for BiDil, we will need to engage a commercial manufacturer that will be required, among other things, to produce validation batches of the drug consistent with regulatory approval requirements. To the extent we enter into manufacturing arrangements with third parties, we will be dependent upon these third parties to perform their obligations in a timely manner and in accordance with applicable government regulations. In addition, if we receive the necessary regulatory approval for our products, we also expect to rely on third parties, including our collaborative partners, to produce materials required for commercial production. We may experience difficulty in obtaining adequate manufacturing capacity for our needs. If we are unable to obtain or maintain contract manufacturing of these products, or to do so on commercially reasonable terms, we may not be able to successfully develop and commercialize our products.

To the extent that we enter into manufacturing arrangements with third parties, we will be dependent upon these third parties to perform their obligations in a timely manner and consistent with regulatory requirements. If third-party manufacturers with whom we contract fail to perform their obligations, we may be adversely affected in a number of ways, including:

- we may not be able to initiate or continue clinical trials of products that are under development;
- we may be delayed in submitting applications for regulatory approvals for our products;
- we may be required to cease distribution and/or recall some or all batches of our products; and
- ultimately, we may not be able to meet commercial demands for our products.

Our patent protection for BiDil, which is a combination of two generic drugs, is limited and we may be subject to generic substitution or competition and resulting pricing pressure.

We have no composition of matter patent covering our lead product candidate, BiDil, which we intend to market for the treatment of heart failure in African Americans. BiDil is a combination of two generic drugs, isosorbide dinitrate and hydralazine, which are approved and separately marketed, in dosages similar to those we include in BiDil, for indications other than heart failure, at prices below the prices we expect to charge for BiDil. We have two issued method-of-use patents covering, respectively, the use of the combination of isosorbide dinitrate and hydralazine to reduce the incidence of mortality associated with chronic congestive heart failure, expiring in 2007, and to treat heart failure in African Americans, expiring in 2020. As a practical matter, we may not be able to enforce these method-of-use patents to prevent physicians from prescribing isosorbide dinitrate and hydralazine for the treatment of heart failure in African Americans, even though neither drug is approved for such use.

Other factors may also adversely affect our patent protection for BiDil. The combination therapy of isosorbide dinitrate and hydralazine for use in heart failure was developed through lengthy, publicly-sponsored clinical trials conducted during the 1980s, prior to the filing of the patent application that resulted in the 2007 patent. The U.S. patent office considered published reports on these clinical trials and concluded that they did not constitute prior art that would prevent the issuance of the 2007 patent. The U.S. patent office also considered the question of whether the 2007 patent constituted prior art with respect to the 2020 patent, but determined that the claims of the 2020 patent were non-obvious and patentable. A court considering the validity of the 2007 or 2020 patents with respect to questions of prior art might be presented with other alleged prior art or might reach conclusions different from those reached by the patent office. If the 2007 or 2020 patents were to be invalidated or if physicians were to prescribe isosorbide dinitrate and hydralazine rather than BiDil for heart failure in African Americans, our BiDil revenue could be significantly reduced, we could fail to recover the cost of developing BiDil and BiDil might not be a viable product.

If we are not able to obtain and enforce patent protection for our discoveries, our ability to develop and commercialize our product candidates will be harmed and we may not be able to operate our business profitably.

Our success depends, in part, on our ability to protect proprietary methods and technologies that we develop under the patent and other intellectual property laws of the United States and other countries, so that we can prevent others from using our inventions and proprietary information. Because certain United States patent applications are confidential until patents issue, such as applications filed prior to November 29, 2000, or applications filed after such date which will not be filed in foreign countries, third parties may have filed patent applications for technology covered by our pending patent applications without our being aware of those applications, and our patent applications may not have priority over any patent applications of others.

Our strategy depends on our ability to rapidly identify and seek patent protection for our discoveries. This process is expensive and time consuming, and we may not be able to file and prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. Despite our efforts to protect our proprietary rights, unauthorized parties may be able to obtain and use information that we regard as proprietary. The mere issuance of a patent does not guarantee that it is valid or enforceable, so even if we obtain patents, they may not be valid or enforceable against third parties.

The issued patents and patent applications for our drug development candidates and nitric oxide technology include claims with respect to both the composition of specific drugs or compounds and specific methods of using these drugs or compounds in therapeutic areas. In some cases, like BiDil, our only patent protection is with respect to the method of using a drug or compound and we do not have patent claims covering the underlying composition of the drug or compound. Method-of-use patents may provide less protection for our product candidates because it may be more difficult to prove direct infringement against a pharmaceutical manufacturer or distributor. In addition, if any other company markets a drug that we expect to market under the protection of a method-of-use patent, physicians will be able to prescribe that drug for use in the indication for which we have obtained approval, even though the drug is not approved for such indication. As a practical matter, we may not be able to enforce our method-of-use patents against physicians prescribing drugs for such off-label use. Off-label use and any resulting off-label sales could make it more difficult to obtain the price we would otherwise wish to achieve for, or to successfully commercialize, our product. In addition, where we have only method-of-use patent coverage for a product candidate, it may be more difficult to find a pharmaceutical company partner to license or support development of our product candidate.

Our pending patent applications may not result in issued patents. The patent position of pharmaceutical or biotechnology companies, including ours, is generally uncertain and involves complex

legal and factual considerations. The standards which the U.S. Patent and Trademark Office and its foreign counterparts use to grant patents are not always applied predictably or uniformly and can change. There is also no uniform, worldwide policy regarding the subject matter and scope of claims granted or allowable in pharmaceutical or biotechnology patents. Accordingly, we do not know the degree of future protection for our proprietary rights or the breadth of claims allowed in any patents issued to us or to others.

We also rely on trade secrets, know-how and technology, which are not protected by patents, to maintain our competitive position. If any trade secret, know-how or other technology not protected by a patent were to be disclosed to or independently developed by a competitor, our business and financial condition could be materially adversely affected.

If we become involved in patent litigation or other proceedings to enforce our patent rights, we could incur substantial costs and expenses, substantial liability for damages or be required to stop our product development and commercialization efforts.

A third party may sue us for infringing on its patent rights. Likewise, we may need to resort to litigation to enforce a patent issued to us or to determine the scope and validity of third party proprietary rights. For example, the cost to us of any litigation or other proceeding relating to intellectual property rights, even if resolved in our favor, could be substantial, and the litigation would divert our management's efforts. Some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources. In addition, our strategy of providing nitric oxide-enhancing versions of existing medicines could lead to more patent litigation as the markets for these existing medicines are very large and competitive. Uncertainties resulting from the initiation and continuation of any litigation could limit our ability to continue our operations.

For example, we have filed an opposition in the European Patent Office, or EPO, to revoke NicOx S.A.'s European Patent No. 904 110, which we refer to as EP '110. This patent is directed to the use of organic compounds containing a nitrate group or inorganic compounds containing a nitric oxide group to reduce the toxicity caused by certain drugs, including non-steroidal anti-inflammatory drugs, or NSAIDs. The basis for our opposition, in part, is that the claims in EP '110 are anticipated and therefore invalid if they are construed to cover a single compound chemically linked to a nitrate. While we believe that the claims in EP '110 will be invalidated, or be narrowed, we cannot predict with certainty the outcome of the opposition. If the EPO finds that there are valid claims in EP '110 that cover compounds chemically linked to nitrates, we may be adversely affected in our ability to market our product candidates for reducing gastrointestinal toxicity without first obtaining a license from NicOx, which may not be available on favorable terms, if at all. We do not know whether NicOx has filed claims of similar scope to the EP '110 patent in the U.S.

If any parties should successfully claim that our creation or use of proprietary technologies infringes upon their intellectual property rights, we might be forced to pay damages, potentially including treble damages, if we are found to have willfully infringed on such parties' patent rights. In addition to any damages we might have to pay, a court could require us to stop the infringing activity or obtain a license on unfavorable terms. Moreover, any legal action against us or our partners claiming damages and seeking to enjoin commercial activities relating to the affected products and processes could, in addition to subjecting us to potential liability for damages, require us or our partners to obtain a license in order to continue to manufacture or market the affected products and processes. Any license required under any patent may not be made available on commercially-acceptable terms, if at all. In addition, some licenses may be non-exclusive, and therefore, our competitors may have access to the same technology licensed to us. If we fail to obtain a required license or are unable to design around a patent, we may be unable to effectively market some of our technology and products, which could limit our ability to generate revenues or achieve profitability and

possibly prevent us from generating revenue sufficient to sustain our operations. In addition, a number of our collaborations provide that royalties payable to us for licenses to our intellectual property may be offset by amounts paid by our collaboration partners to third parties who have competing or superior intellectual property positions in the relevant fields, which could result in significant reductions in our revenues from products developed through collaborations.

We in-license a significant portion of our principal proprietary technologies and if we fail to comply with our obligations under any of the related agreements, we could lose license rights that are necessary to developing BiDil and our other product candidates.

We are a party to a number of licenses that give us rights to third party intellectual property that is necessary for our business. In particular, we have obtained the exclusive right to develop and commercialize BiDil pursuant to a license agreement with Dr. Jay N. Cohn, and some of our intellectual property rights relating to nitric oxide compounds have been obtained pursuant to license agreements with the Brigham and Women's Hospital and Boston University. We expect to enter into additional licenses in the future. These licenses impose various development, commercialization, funding, royalty, diligence, and other obligations on us. If we breach these obligations, the licensor may have the right to terminate the license or render the license non-exclusive, which would result in us being unable to develop, manufacture and sell products that are covered by the licensed technology.

We face significant competition, which may result in others discovering, developing or commercializing products before or more successfully than we do.

The pharmaceutical and medical device industries are highly competitive and characterized by rapid and significant technological change. Our principal competitors in the markets we have targeted, such as cardiovascular disease and inflammation, are large, multinational pharmaceutical and medical device companies that have substantially greater financial and other resources than we do and are conducting extensive research and development activities on technologies and products similar to or competitive with ours. Moreover, there are a number of companies currently marketing and selling products to treat heart failure in the general population that will compete with BiDil, if it is approved. These include GlaxoSmithKline, plc, which currently markets Coreg; Merck & Co., Inc., which currently markets Vasotec; Pfizer Inc., which currently markets Inspra; and Astra Zeneca, plc, which currently markets Tropol XL. We also face competition from other pharmaceutical companies seeking to develop drugs using nitric oxide technology. For example, we are aware of at least four companies working in the area of nitric-oxide based therapeutics. These companies are GB Therapeutics, of Ontario, Canada, which we believe is in early stage preclinical development of nitrate medicines for Alzheimer's disease, Parkinson's disease and dementia; NicOx S.A., a French company, which we believe is engaged in the research and development of nitric-oxide releasing derivatives of existing drug classes; OxoN Medica, of California, which we believe is in preclinical development of drug targets for diseases resulting from dysfunction of the endothelial cells that line the inside of blood vessel walls; and Vasopharm BIOTECH GmbH, of Germany, which we believe is focused on disease mechanisms involving nitric oxide signaling pathways within the vascular wall.

Many of our competitors are more experienced than we are in drug development and commercialization, obtaining regulatory approvals and product marketing and manufacturing. As a result, our competitors may develop and commercialize pharmaceutical products before we do. In addition, our competitors may develop and commercialize products which render our products obsolete or non-competitive.

We may be exposed to product liability claims and may not be able to obtain or maintain adequate product liability insurance.

Our business exposes us to the risk of product liability claims that is inherent in the manufacturing, testing, and marketing of human therapeutic products. Our clinical trial liability insurance is subject to deductibles and coverage limitations. We do not currently have any commercial product liability insurance. We may not be able to obtain or maintain insurance on acceptable terms or at all. Moreover, any insurance that we do obtain may not provide adequate protection against potential liabilities.

Risks Relating to Our Common Stock

Our stock price is subject to fluctuation, which may cause an investment in our stock to suffer a decline in value.

The market price of our common stock may fluctuate significantly in response to factors which are beyond our control. The stock market in general has recently experienced extreme price and volume fluctuations. The market prices of securities of pharmaceutical, biotechnology and other life sciences companies have been extremely volatile, and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. For example, our stock price could be adversely affected if drugs developed by others that utilize nitric oxide technology are not successful in clinical testing, fail to achieve regulatory approval or are not accepted in the marketplace, even though these failures may not be related to our product candidates or technology. These broad market fluctuations could result in extreme fluctuations in the price of our common stock, which could cause a decline in the value of our common stock.

We may incur significant costs from class action litigation due to our expected stock volatility.

Our stock price may fluctuate for many reasons, including as a result of public announcements regarding the progress of our development and marketing efforts, the addition or departure of key personnel, variations in our quarterly operating results and changes in market valuations of pharmaceutical, biotechnology or other life science companies. Recently, when the market price of a stock has been volatile as our stock price may be, holders of that stock have occasionally brought securities class action litigation against the company that issued the stock. If any of our stockholders were to bring a lawsuit of this type against us, even if the lawsuit is without merit, we could incur substantial costs defending the lawsuit. A stockholder lawsuit could also divert the time and attention of our management.

Insiders have substantial control over us and could delay or prevent a change in corporate control.

As of December 31, 2003, our directors, executive officers and principal stockholders, together with their affiliates, beneficially own, in the aggregate, approximately 64% of our outstanding common stock. As a result, these stockholders, if acting together, will have the ability to determine the outcome of matters submitted to our stockholders for approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these persons, if acting together, will have the ability to control the management and affairs of our company. Accordingly, this concentration of ownership may harm the market price of our common stock by:

- delaying, deferring or preventing a change in control of our company;
- impeding a merger, consolidation, takeover or other business combination involving our company; or
- discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company.

Provisions in our charter documents and under Delaware law may prevent or frustrate attempts by stockholders to change current management and hinder efforts to acquire a controlling interest in us.

Provisions of our restated certificate of incorporation and bylaws may discourage, delay or prevent a merger, acquisition or other change in control that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares. These provisions may prevent or frustrate attempts by stockholders to replace or remove our current management. These provisions include:

- a prohibition on stockholder action through written consent;
- a requirement that special meetings of stockholders be called only by a majority of the board of directors, the chairman of the board or the chief executive officer;
- advance notice requirements for stockholder proposals and nominations;
- limitations on the ability of stockholders to amend, alter or repeal our certificate of incorporation or bylaws; and
- the authority of the board of directors to issue preferred stock with such terms as the board of directors may determine.

In addition, Section 203 of the Delaware General Corporation Law prohibits a publicly-held Delaware corporation from engaging in a business combination with an interested stockholder, generally a person which together with its affiliates owns or within the last three years has owned 15% of our voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. Accordingly, Section 203 may discourage, delay or prevent a change in control of our company.

ITEM 2. PROPERTIES

We lease a facility that contains approximately 40,000 square feet of laboratory and office space in Bedford, Massachusetts. The lease has a term ending in September 2004. On January 30, 2004 we entered into a lease for approximately 52,000 square feet of laboratory and office space at 125 Spring Street, Lexington, Massachusetts. The lease is for a term of ten years with options that permit renewals for additional 5 year periods. We expect to move our principal offices and laboratories to the Lexington, Massachusetts facility in the third quarter of 2004.

ITEM 3. LEGAL PROCEEDINGS

We are currently not a party to any material legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The information set forth under Item 5 (Other Information) of Part II of our Quarterly Report on Form 10-Q for the period ended September 30, 2003 (file no. 000-50439) is incorporated herein by reference.

PART II

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

(a) Market Price of and Dividends on NitroMed's Common Stock and Related Stockholder Matters.

Our common stock began trading on the Nasdaq National Market under the symbol "NTMD" on November 6, 2003. The following table sets forth, for the period indicated, the high and low sales closing prices of our common stock on the Nasdaq National Market.

<u>Year ended December 31, 2003</u>	<u>High</u>	<u>Low</u>
Fourth Quarter (from November 6 to December 31)	\$11.55	\$6.90

On March 19, 2004, the closing price per share of our common stock was \$8.34, as reported on the Nasdaq National Market, and we had approximately 44 stockholders of record.

We have never paid or declared any cash dividends on our common stock. We currently intend to retain earnings, if any, to finance the growth and development of our business and we do not expect to pay any cash dividends on our common stock in the foreseeable future. Payment of future dividends, if any, will be at the discretion of our board of directors.

(b) Recent Sales of Unregistered Securities; Uses of Proceeds From Registered Securities

Recent Sales of Unregistered Securities

During the quarterly period ended December 31, 2003, we issued and sold an aggregate of 162,790 shares of our common stock to employees, consultants and directors pursuant to exercises of options under our 1993 Stock Incentive Plan at a weighted-average exercise price of \$0.57 per share. The securities issued in the foregoing transaction were offered and sold in reliance on exemptions from registration set forth in Sections 3(b) and 4(2) of the Securities Act or regulations promulgated thereunder, relating to sales by an issuer not involving any public offering, or an exemption from registration under Rule 701 promulgated under the Securities Act. No underwriters or placement agents were involved in the foregoing issuances and sales.

Use of Proceeds from Registered Securities

On November 10, 2003, we completed an initial public offering of 6,000,000 shares of our common stock at a price to the public of \$11.00 per share. The offer and sale of all of the shares in the initial public offering were registered under the Securities Act of 1933, as amended, pursuant to a registration statement on Form S-1 (File No. 333-108104), which was declared effective by the Securities and Exchange Commission on November 5, 2003. Deutsche Bank Securities Inc., J.P. Morgan Securities Inc. and Pacific Growth Equities were the managing underwriters of the initial public offering. The offering commenced on November 5, 2003 and did not terminate until after the sale of all of the securities registered in the Registration Statement. As part of the initial public offering, we granted these underwriters an over-allotment option to purchase up to an additional 900,000 shares of our common stock from us. The underwriters did not exercise the over-allotment option. There were no selling stockholders in the offering.

The aggregate price of the offering amount registered on our behalf was \$66.0 million. In connection with the offering, we paid approximately \$4.6 million in underwriting discounts and commissions to the underwriters and incurred an estimated \$1.3 million in other offering expenses. None of the underwriting discounts and commissions or offering expenses were incurred or paid to directors or officers of ours or their associates or to persons owning 10 percent or more of our common stock or to any affiliates of ours. After deducting the underwriting discounts and commissions and offering expenses, we received net proceeds from the offering of approximately \$60.1 million. As of December 31, 2003, we had approximately \$60.1 million of proceeds remaining from the offering, and pending use of the proceeds, we have invested these funds in short-term, interest-bearing, investment-grade securities.

ITEM 6. SELECTED FINANCIAL DATA

You should read carefully the financial statements included in this report, including the notes to the financial statements and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” The selected financial data in this section are not intended to replace the financial statements.

We derived the statement of operations data for the years ended December 31, 2003, 2002 and 2001 and the balance sheet data as of December 31, 2003 and 2002 from our audited financial statements, which are included elsewhere in this report. We derived the statement of operations data for the years ended December 31, 2000 and 1999 and the balance sheet data as of December 31, 2001, 2000 and 1999 from our audited financial statements which are not included herein. Historical results are not necessarily indicative of future results. See the notes to the financial statements for an explanation of the method used to determine the number of shares used in computing basic and diluted net loss per common share.

	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(in thousands, except per share data)				
Statement of Operations Data:					
Revenue	\$ 12,775	\$ 750	\$ 250	\$ 2,125	\$ 2,658
Operating expenses:					
Research and development	18,907	16,133	10,214	8,043	8,748
General and administrative	3,114	2,531	2,362	2,048	2,461
Total costs and expenses	22,021	18,664	12,576	10,091	11,209
Loss from operations	(9,246)	(17,914)	(12,326)	(7,966)	(8,551)
Other income, net	477	572	697	535	594
Net loss	(8,769)	(17,342)	(11,629)	(7,431)	(7,957)
Deemed dividends related to beneficial conversion features of redeemable convertible preferred stock	(19,357)	—	—	—	—
Accretion of dividends and redemption value . .	(2,794)	(2,697)	(1,662)	(157)	(101)
Net loss attributable to common stockholders . .	<u>\$ (30,920)</u>	<u>\$ (20,039)</u>	<u>\$ (13,291)</u>	<u>\$ (7,588)</u>	<u>\$ (8,058)</u>
Net loss per common share:					
Basic and diluted	\$ (6.95)	\$ (20.66)	\$ (17.91)	\$ (14.05)	\$ (15.86)
Weighted average basic and diluted common shares outstanding	4,447	970	742	540	508
	As of December 31,				
	2003	2002	2001	2000	1999
Balance Sheet Data:					
Cash, cash equivalents and marketable securities	\$ 97,088	\$ 11,843	\$ 28,331	\$ 4,559	\$ 11,878
Working capital	87,938	15,838	25,401	2,266	9,750
Total assets	99,170	22,492	29,809	5,507	13,232
Long-term debt	—	22	64	353	889
Redeemable convertible preferred stock	—	82,884	80,187	44,277	44,120
Accumulated deficit	(106,846)	(75,926)	(55,887)	(42,596)	(35,008)
Total stockholders’ equity (deficit)	<u>\$ 81,799</u>	<u>\$ (73,353)</u>	<u>\$ (54,275)</u>	<u>\$ (41,493)</u>	<u>\$ (34,030)</u>

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

Overview

We are an emerging pharmaceutical company that discovers, develops and seeks to commercialize proprietary pharmaceuticals. We have devoted substantially all of our efforts towards the research and development of our product candidates. Since our inception, we have had no revenue from product sales and have funded our operations through the sale of equity securities, debt financings, license fees, research and development funding and milestone payments from our collaborative partners. We have never been profitable and have incurred an accumulated deficit of \$106.8 million as of December 31, 2003.

We expect to incur significant operating losses for the next several years. Research, development and commercialization expenses relating to our product candidates and to enhancing our core technologies will continue to increase in the near term and may vary significantly from our current estimates. In particular, we expect to incur increased costs as we complete our phase III confirmatory trial of BiDil and seek regulatory approval for BiDil. General and administrative costs will increase as we prepare for the planned commercialization of BiDil and as we begin operating as a public company. We expect to incur operating expenses in a range of approximately \$28.0 million to \$33.0 million for the fiscal year ended December 31, 2004. We will need to generate significant revenues to achieve profitability. We do not expect to achieve profitability until at least 2008 and may not achieve profitability until after that date, if at all.

Financial Operations Overview

Revenue. We have not generated any revenue from product sales since our inception and do not expect to generate any revenue from the sale of products until at least 2006. All of our revenue to date has been derived from license fees, research and development payments and milestone payments we received from our corporate collaborators. We expect to generate revenue from our corporate collaborators in a range of approximately \$8.0 million to \$10.0 million for the fiscal year ended December 31, 2004. In future years, we will seek to generate revenue from a combination of product sales, up-front fees and milestone payments in connection with collaborative or strategic relationships, and royalties resulting from the license of our intellectual property. We expect that any revenue we generate will fluctuate from quarter to quarter as a result of the timing and amount of research and development, milestone and other payments received under our collaborative or strategic relationships and related continuing obligations, and the amount and timing of payments we receive upon the sale of our products, to the extent any are successfully commercialized.

Research and Development. Research and development expense consists of expenses incurred in identifying, developing and testing product candidates. These expenses consist primarily of salaries and related expenses for personnel, fees paid to professional service providers for independent monitoring and analysis of our clinical trials, costs of contract research and manufacturing, costs of facilities and the legal costs of pursuing patent protection of our intellectual property. We expense research and development costs, including patent-related costs, as incurred.

The following summarizes our primary research and development programs. We have not provided program costs since inception because prior to 2000 we did not track and accumulate cost information by research program.

- *BiDil.* We started enrolling patients in our phase III confirmatory clinical trial for BiDil in May 2001. The trial is being conducted at approximately 160 sites in the U.S. and is over 75% enrolled. We expect to complete this study in mid 2005. We expect to incur significant additional expenditures for BiDil as we complete our clinical trial, apply for regulatory approval, expand

our operations and bring BiDil to market. For example, as new clinical sites are initiated and additional patients are enrolled in the trial, we anticipate incurring increased costs from the use of professional service firms supporting the trial. We also anticipate incurring increased costs related to hiring of additional clinical personnel associated with preparations to launch BiDil. We estimate that the total direct cost for this trial will be at least \$39.0 million. However, the actual total cost of the clinical trial and our ability to complete this trial in the time period we expect, if at all, is dependent on a number of uncertainties, including our ability to enroll patients at the rate that we expect, potential unanticipated trial delays and other uncertainties relating to the regulatory approval process. We do not anticipate receiving revenue from BiDil until at least 2006, if ever. Our failure to commercialize BiDil on a timely basis would have a material adverse effect on our business, financial condition and results of operations.

- *Nitric Oxide-Enhancing COX-2 Inhibitors.* We are currently working with Merck Frosst Canada & Co., a wholly-owned subsidiary of Merck & Co., to screen proprietary nitric oxide-enhanced COX-2 inhibitors in advance of clinical testing as analgesic and anti-inflammatory agents and in other specified disease areas. In late 2003, Merck advanced the first of these compounds into phase I clinical trials. These agents are intended to be second-generation COX-2 inhibitors. We expect that additional expenditures will be required to conduct pre-clinical testing and, to apply for and conduct clinical trials. Because these agents are in pre-clinical or early clinical development, their successful development is highly uncertain. As such, we are unable to estimate the cost to complete the research and development phase nor are we able to estimate the timing of bringing potential products to market and, therefore, when material cash inflows from milestones and royalties could commence. Our failure to commercialize these products under development on a timely basis could have a material adverse effect on our business, financial condition and results of operations.
- *Nitric Oxide Stents.* We are currently working with Boston Scientific Corporation to develop stents coated with nitric oxide-releasing compounds. This program is in pre-clinical development. We expect that additional expenditures will be required to conduct pre-clinical testing and, if such pre-clinical testing is successful, to apply for and conduct clinical trials. Because this program is in pre-clinical development, the successful development of products based upon this program is highly uncertain and, as such we are unable to estimate the cost to complete the research and development phase nor are we able to estimate the timing of bringing potential products to market and, therefore, when material cash inflows from milestones and royalties could commence. Our failure to commercialize products based upon this program on a timely basis could have a material adverse effect on our business, financial condition and results of operations.

General and Administrative. General and administrative expense consists primarily of salaries and other related costs for personnel in executive, finance, accounting, business development and human resource functions. Other costs include facility costs not otherwise included in research and development expense and professional fees for legal and accounting services.

As a result of the completion of our initial public offering on November 10, 2003, we anticipate increases in general and administrative expense for investor relations and other activities associated with operating as a publicly-traded company. These increases will also likely include the hiring of additional personnel. We intend to continue to incur increased internal and external business development costs to support our various product development efforts, which can vary from period to period. We do not anticipate incurring significant costs to support the expected commercial introduction of BiDil until the second half of 2004.

Other Income, Net. Other income includes interest earned on our cash, cash equivalents and marketable securities, as well as rental income from a sublease of a portion of our facilities. Other income is net of interest expense.

Merck Collaboration. In December 2002, we entered into an exclusive, worldwide research, collaboration and licensing agreement that granted Merck marketing and sales rights for nitric oxide-enhancing COX-2 inhibitors. The research portion of the agreement is for three years and can be extended by mutual agreement. In 2003, we have received an upfront non-refundable license payment of \$10.0 million and two payments, each of \$5.0 million, for achieving the first two milestones. The license fee revenue and the revenue from the first \$5.0 million milestone payment are being recognized over the remaining life of the research and development program, which ends December 31, 2005. The revenue from the second \$5.0 million payment has been recognized in the fourth quarter of 2003, the period in which Merck achieved the milestone. We received \$3.0 million in research and development fees from Merck during 2003, all of which has been recognized as revenue for the year ended December 31, 2003. We expect to receive additional research and development funding through 2005 and milestone payments upon the successful achievement of specified research objectives and royalties on any product sales.

Boston Scientific Collaboration. In November 2001, we entered into a development and license agreement with Boston Scientific to develop stents coated with nitric oxide-releasing compounds. We have granted Boston Scientific an exclusive worldwide license to develop and commercialize products for restenosis incorporating two nitric oxide-releasing compounds. In consideration of this license, Boston Scientific made an upfront non-refundable license payment of \$1.5 million, which is being recognized over the estimated time period of our contractual obligation to provide research and development services. In the event that specified research, development and commercialization milestones are achieved, Boston Scientific is obligated to make milestone payments to us. Boston Scientific is also obligated to pay royalties to us on the sale of any products resulting from the collaboration. In December 2003, we entered into an extension to the agreement that continues the research and development collaboration through December 2005 and we received an additional \$3.0 million. Boston Scientific made a \$3.5 million investment in our series F junior redeemable convertible preferred stock in 2001 and made an additional \$500,000 investment in our series E redeemable convertible preferred stock in August 2003.

Results of Operations

Years Ended December 31, 2003, 2002 and 2001

Revenue. Revenue for the year ended December 31, 2003 was \$12.8 million, compared to \$750,000 in 2002 and \$250,000 in 2001. The \$12.0 million, or 1603% increase in revenue in 2003 compared to 2002 is attributable to our collaboration agreement with Merck, which we entered into in December 2002. During 2003 we received \$15.0 million of payments from Merck that have been deferred and are being recognized as revenue ratably over the contractual research and development term. In addition we recognized revenue for a \$5.0 million milestone when Merck advanced a lead nitric-oxide enhancing COX-2 inhibitor into human testing and \$3.0 million of research and development funding. The \$500,000, or 200% increase in revenue in 2002 compared to 2001 was attributable to our research agreement with Boston Scientific, which we entered into in November 2001.

Research and Development. Research and development expense for the year ended December 31, 2003 was \$18.9 million, compared to \$16.1 million in 2002 and \$10.2 million in 2001. The \$2.8 million, or 17% increase in research and development expenses in 2003 compared with 2002, is primarily the result of an additional \$1.2 million of expenses associated with the BiDil trial, reflecting the addition of new sites and additional patients and an additional \$1.1 million of compensation-related expenses due

to additional headcount and non-cash stock-based compensation related expenses. The \$5.9 million, or 58% increase in research and development expenses in 2002 compared with 2001, principally resulted from an increase of \$4.7 million of expenses associated with the BiDil trial, reflecting the addition of new sites and additional patients. Additionally, contract research and supplies associated with our other programs were \$290,000 higher in 2002, and 2001 expenses reflected a reversal of a \$533,000 accrual due to a change in our estimate of our liability associated with an unanticipated early termination of a research program.

The following table summarizes the primary components of our research and development expense for our principal research and development programs for the fiscal years ended December 31, 2003, 2002 and 2001.

<u>Research and Development Program</u>	<u>December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
BiDil	\$11,751,000	\$10,531,000	\$ 4,709,000
Nitric oxide-enhancing COX-2 inhibitors	2,358,000	2,372,000	2,248,000
Nitric oxide stents	1,447,000	1,401,000	1,042,000
Other	3,351,000	1,829,000	2,215,000
Total research and development expense	<u>\$18,907,000</u>	<u>\$16,133,000</u>	<u>\$10,214,000</u>

General and Administrative. General and administrative expense for the year ended December 31, 2003 was \$3.1 million, compared to \$2.5 million in 2002 and \$2.4 million in 2001. The \$583,000, or 23% increase in general and administrative expenses in 2003 compared to 2002 was primarily due to the fact that during the year ended December 31, 2003, we incurred additional costs in connection with evaluating and developing plans to commercialize BiDil of \$479,000 and public company reporting related costs of \$148,000. The \$169,000, or 7% increase in general and administrative expenses in 2002 compared to 2001 was due to higher stock compensation expense in 2002, primarily due to a \$392,000 charge associated with a loan to an officer for the purchase of our common stock, and increased personnel costs of \$160,000 offset by a decrease in market research costs of \$231,000.

Other Income, Net. Other income, net decreased to \$477,000 in 2003 compared to \$572,000 in 2002 and \$697,000 in 2001. The \$95,000, or 17% decrease in other income, net in 2003 compared to 2002 was primarily related to lower rental income due to our sublease agreement ending at our current facility. The decrease in interest income in 2002 compared to 2001 was primarily due to reduced yields on investments resulting from lower average interest rates and lower average fund balances available for investment. Interest expense declined in 2002 compared with 2001 due to the reduction of outstanding debt.

Liquidity and Capital Resources

We have financed our operations since inception through the sale of equity, debt and payments from collaborative partners for licenses, research and development and achievement of milestones. As of December 31, 2003, we have received net proceeds of \$159.2 million from the issuance of equity securities, primarily as the result of the sale of \$99.1 of our redeemable convertible preferred stock and net proceeds of \$60.1 million from our initial public offering in November 2003, which is described below. At December 31, 2003, we had \$97.1 million in cash, cash equivalents and marketable securities.

In November 2003, we closed our initial public offering of our common stock at a price to the public of \$11.00 per share. We sold 6,000,000 shares of our common stock resulting in gross proceeds of \$66.0 million. In connection with the offering, we paid approximately \$4.6 million in underwriting discounts and commissions to underwriters and incurred \$1.3 million in other offering expenses. After

deducting the underwriting discounts and commissions and offering expenses, we received net proceeds from the offering of approximately \$60.1 million.

In August 2003, we sold 2,776,347 shares of our series E redeemable convertible preferred stock for net proceeds of \$19.9 million to existing preferred stockholders. These shares contained a beneficial conversion feature based on the fair value of our common stock at the date of such sale compared to the series E redeemable convertible preferred stock share price. The total value of the beneficial conversion feature of approximately \$8.3 million was recognized as a dividend in the three month period ended September 30, 2003. In addition, the Company recognized a dividend of approximately \$11.0 million in the three month period ended December 31, 2003 as a result of an increase to the conversion ratio of the series E redeemable convertible preferred stock in connection with our initial public offering in November 2003.

During the year ended December 31, 2003, operating activities provided cash of \$5.8 million driven by the receipt of \$23.6 million from Merck for the license fee, research and develop funding and two milestone payments, the receipt of \$3.0 million from Boston Scientific for the extension of our development and license agreement and adjustments for non-cash charges for stock-based compensation and depreciation and amortization of \$1.2 million, offset by a net loss of \$8.8 million and an increase in prepaid and other assets of \$1.0 million.

During the year ended December 31, 2003, investing activities used cash of \$23.4 million due to the purchase of marketable securities of \$22.8 million and purchases of computer and lab equipment of \$655,000. We expect to invest approximately \$2.0 to \$4.0 million for capital expenditures in 2004, principally related to the purchase of laboratory equipment and build-out related cost for our new facility.

During the year ended December 31, 2003, financing activities provided cash of \$80.1 million primarily as a result of the sale of series E shares for net proceeds of \$19.9 million and the sale of common stock in our initial public offering for net proceeds of \$60.1 million.

The following table summarizes our contractual obligations at December 31, 2003 and the effects such obligations are expected to have on our liquidity and cash flows in future periods.

Payments Due by Period

<u>Contractual Obligations</u>	<u>Total</u>	<u>Less than one year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>More than five years</u>
Short and long-term debt	\$ 22,000	\$ 22,000	—	—	—
Operating lease obligations(1)	15,814,000	924,000	\$2,561,000	\$3,010,000	\$9,319,000
Total contractual cash obligations	<u>\$15,836,000</u>	<u>\$946,000</u>	<u>\$2,561,000</u>	<u>\$3,010,000</u>	<u>\$9,319,000</u>

(1) On January 30, 2004, we entered into a lease for approximately 52,000 square feet of laboratory and office space at 125 Spring Street, Lexington, Massachusetts. The rent obligation for the building is expected to commence thirty days from the earlier of (a) July 8, 2004 or (b) the date on which we commence occupancy of the building. The lease is for a term of ten years with options that permit renewals for additional 5 year periods. The expected minimum rental obligations are included in the table.

Based on our operating plans, we expect to have cash and marketable securities in a range of \$66.0 million to \$76.0 million at December 31, 2004. We believe that our existing cash, cash equivalents and marketable securities, and cash we expect to receive under our collaborations with Merck and Boston Scientific, will be sufficient to fund our planned operations, including increases in spending for our BiDil clinical program, for at least 24 months from the date of this report. However, we may

require significant additional funds earlier than we currently expect to conduct the clinical trial and to obtain regulatory approvals necessary to launch BiDil, and to develop our other product candidates.

We may seek additional funding through collaborative arrangements and public or private financings. Additional funding may not be available to us on acceptable terms or at all. In addition, the terms of any financing may adversely affect the holdings or the rights of our stockholders. For example, if we raise additional funds by issuing equity securities, further dilution to our existing stockholders may result. If we are unable to obtain funding on a timely basis, we may be required to significantly curtail one or more of our research or development programs. We also could be required to seek funds through arrangements with collaborators or others that may require us to relinquish rights to some of our technologies, product candidates, or products which we would otherwise pursue on our own.

Even if we are able to raise additional funds in a timely manner, our future capital requirements may vary from what we expect and will depend on many factors, including the following:

- the costs of launching BiDil, if and when it is approved by regulatory authorities;
- the timing, receipt, and amount of milestone and other payments, if any, from collaborators;
- the timing, receipt, and amount of sales and royalties, if any, from our potential products;
- the resources required to successfully complete our clinical trials;
- the time and costs involved in obtaining regulatory approvals;
- continued progress in our research and development programs, as well as the magnitude of these programs;
- the cost of manufacturing, marketing and sales activities;
- the costs involved in preparing, filing, prosecuting, maintaining, and enforcing patent claims;
- the cost of obtaining and maintaining licenses to use patented technologies; and
- our ability to establish and maintain additional collaborative arrangements.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. On an on-going basis, we evaluate our estimates and judgments, including those related to revenue, accrued expenses and the fair value assigned to our common stock. We base our estimates on historical experience, known trends and events and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue. We record revenue on an accrual basis as it is earned and when amounts are considered collectible. Revenues received in advance of performance obligations or in cases where we have a continuing obligation to perform services, are deferred and recognized over the contractual or estimated performance period. Revenues from milestone payments that represent the culmination of a

separate earnings process are recorded when the milestone is achieved. Contract revenues are recorded as the services are performed. When we are required to defer revenue, the period over which such revenue should be recognized is subject to estimates by management and may change over the course of the collaborative agreement.

Accrued Expenses. As part of the process of preparing financial statements, we are required to estimate accrued expenses. This process involves identifying services which have been performed on our behalf, and estimating the level of service performed and the associated cost incurred for such service as of each balance sheet date in our financial statements. Examples of estimated expenses for which we accrue include contract service fees such as amounts paid to clinical monitors, data management organizations and investigators in conjunction with clinical trials, and fees paid to contract manufacturers in conjunction with the production of clinical materials and professional service fees, such as lawyers and accountants. In connection with such service fees, our estimates are most affected by our understanding of the status and timing of services provided relative to the actual levels of services incurred by such service providers. The majority of our service providers invoice us monthly in arrears for services performed. In the event that we do not identify certain costs, which have begun to be incurred, or we under- or over-estimate the level of services performed or the costs of such services, our reported expenses for such period would be too low or too high. The date on which certain services commence, the level of services performed on or before a given date and the cost of such services are often determined based on subjective judgments. We make these judgments based upon the facts and circumstances known to us in accordance with generally accepted accounting principles.

Stock-Based Compensation. We have elected to follow Accounting Principle Board, or APB, Opinion No. 25, "Accounting for Stock Issued to Employees," or APB 25, and related interpretations, in accounting for our stock-based compensation plans, rather than the alternative fair value method provided for under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" or FAS 123. In 2003 and 2002, certain grants of stock options were made at exercise prices less than the fair value of our common stock and, as a result, we recorded deferred stock compensation expense. In the notes to our financial statements, we provide pro forma disclosures in accordance with FAS 123. We account for transactions in which services are received from non-employees in exchange for equity instruments based on the fair value of such services received or of the equity instruments issued, whichever is more reliably measured, in accordance with FAS 123 and the Emerging Issues Task Force, or EITF, Issue 96-18, "Accounting for Equity Instruments that Are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services."

Accounting for equity instruments granted or sold by us under APB 25, FAS 123 and EITF 96-18 requires fair value estimates of the equity instrument granted or sold. If our estimates of the fair value of these equity instruments are too high or too low, our expenses may be over or under stated. For equity instruments granted or sold in exchange for the receipt of goods or services we estimate the fair value of the equity instruments based upon consideration of factors which we deem to be relevant at that time. Because shares of our common stock have not been publicly traded prior to the commencement of our public offering on November 5, 2003, market factors historically considered in valuing stock and stock option grants include comparative values of public companies discounted for the risk and limited liquidity provided for in the shares we are issuing, pricing of private sales of our redeemable convertible preferred stock, prior valuations of stock grants and the effect of events that have occurred between the time of such grants, economic trends, and the comparative rights and preferences of the security being granted compared to the rights and preferences of our other outstanding equity.

Prior to our initial public offering the fair value of our common stock was determined by our board of directors contemporaneously with the grant. In the absence of a public trading market for our common stock, our board of directors considered numerous objective and subjective factors in determining the fair value of our common stock. At the time of option grants and other stock

issuances, our board of directors considered the liquidation preferences, dividend rights, voting control and anti-dilution protection attributable to our then-outstanding redeemable convertible preferred stock, the status of private and public financial markets, valuations of comparable private and public companies, the likelihood of achieving a liquidity event such as an initial public offering, our existing financial resources, our anticipated continuing operating losses and increased spending levels required to complete our clinical trials, dilution to common stockholders from anticipated future financings and a general assessment of future business risks.

Recently Issued Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, “*Consolidation of Variable Interest Entities*” (FIN 46), which was amended by FIN 46R issued in December 2003. This interpretation of Accounting Research Bulletin No. 51, “*Consolidated Financial Statements*,” addresses consolidation by business enterprises of variable interest entities (VIEs) that either: (1) do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) for which the equity investors lack an essential characteristic of a controlling financial interest. This Interpretation applies immediately to VIEs created after January 31, 2003. It also applies in the first fiscal year or interim period ending after March 15, 2004, to VIEs created before February 1, 2003 in which an enterprise holds a variable interest. FIN 46 requires disclosure of VIEs in financial statements issued after January 31, 2003, if it is reasonably possible that as of the transition date: (1) we will be the primary beneficiary of an existing VIE that will require consolidation or, (2) we will hold a significant variable interest in, or have significant involvement with, an existing VIE. We are currently in the process of completing our review of the requirements of FIN 46. However, we have not yet identified any entities that require disclosure or entities that would require consolidation under FIN 46 that had not previously been consolidated as a result of FIN 46.

In November 2003, during discussion on EITF Issue No. 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, the EITF reached a consensus which requires certain quantitative and qualitative disclosures for debt and marketable equity securities classified as available-for-sale or held-to-maturity under SFAS 115 and SFAS 124 that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The consensus on quantitative and qualitative disclosures is effective for fiscal years ending after December 15, 2003 and comparative information for earlier periods presented is not required. We currently do not have any impaired investments and thus the adoption of this consensus did not have a material impact on our financial statements.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104, *Revenue Recognition*, (“SAB 104”) which supercedes SAB 101, *Revenue Recognition in Financial Statements*. SAB 104’s primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements and to rescind the SEC’s *Revenue Recognition in Financial Statements Frequently Asked Questions and Answers* (“FAQ”) issued with SAB 101. Selected portions of the FAQ have been incorporated into SAB 104. The adoption of SAB 104 did not have a material impact on our revenue recognition policies.

Inflation

We believe the effects of inflation generally do not have a material adverse impact on our operations or financial condition.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk related to changes in interest rates. Our current investment policy is to maintain an investment portfolio consisting mainly of U.S. money market and high-grade corporate securities, directly or through managed funds, with maturities of two years or less. Our cash is deposited in and invested through highly rated financial institutions in North America. Our marketable securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels at December 31, 2003, we estimate that the fair value of our investment portfolio would decline by an immaterial amount. We have the ability to hold our fixed income investments until maturity, and therefore we do not expect our operating results or cash flows to be affected to any significant degree by the effect of a change in market interest rates on our investments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Ernst & Young LLP, Independent Auditors

The Board of Directors and Stockholders
NitroMed, Inc.

We have audited the accompanying balance sheets of NitroMed, Inc. as of December 31, 2003 and 2002, and the related statements of operations, redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2003. 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 NitroMed, Inc. at December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

Boston, Massachusetts
February 19, 2004

NITROMED, INC.
BALANCE SHEETS
(in thousands, except par value amounts)

	December 31,	
	2003	2002
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 67,614	\$ 5,160
Marketable securities	29,474	6,683
Accounts receivable	—	10,000
Prepaid expenses and other current assets	1,296	267
Total current assets	98,384	22,110
Property and equipment, net	686	282
Other assets	100	100
Total assets	\$ 99,170	\$ 22,492
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Notes payable	\$ 22	\$ 42
Accounts payable	832	695
Accrued expenses	2,067	1,577
Deferred revenue	7,525	3,958
Total current liabilities	10,446	6,272
Deferred revenue, long term	6,925	6,667
Notes payable, less current portion	—	22
Total liabilities	17,371	12,961
Commitments and contingencies		
Redeemable convertible preferred stock, \$.01 par value; no shares authorized, issued or outstanding at December 31, 2003; 31,912 shares authorized at December 31, 2002; 30,770 shares issued and outstanding at December 31, 2002	—	82,884
Stockholders' equity (deficit):		
Preferred stock, \$.01 par value; 5,000,000 shares authorized; no shares authorized, issued or outstanding at December 31, 2003	—	—
Common stock, \$.01 par value; authorized 65,000 and 18,077 shares at December 31, 2003 and 2002, respectively; issued and outstanding 25,601 shares and 985 shares as of December 31, 2003 and 2002, respectively	256	10
Additional paid-in capital	191,604	3,090
Deferred stock compensation	(3,240)	(527)
Accumulated deficit	(106,846)	(75,926)
Accumulated other comprehensive income	25	—
Total stockholders' equity (deficit)	81,799	(73,353)
Total liabilities and stockholders' equity (deficit)	\$ 99,170	\$ 22,492

The accompanying notes are an integral part of the consolidated financial statements.

NITROMED, INC.
STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	<u>Year Ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Research and development revenues	\$ 12,775	\$ 750	\$ 250
Expenses:			
Research and development	18,907	16,133	10,214
General and administrative	3,114	2,531	2,362
Total expenses	<u>22,021</u>	<u>18,664</u>	<u>12,576</u>
Loss from operations	(9,246)	(17,914)	(12,326)
Interest expense	(4)	(10)	(48)
Interest income	399	387	557
Rental income	82	195	188
	<u>477</u>	<u>572</u>	<u>697</u>
Net loss	(8,769)	(17,342)	(11,629)
Deemed dividends related to beneficial conversion features of redeemable convertible preferred stock	(19,357)	—	—
Dividends and accretion to redemption value of redeemable convertible preferred stock	(2,794)	(2,697)	(1,662)
Net loss attributable to common stockholders	<u>\$(30,920)</u>	<u>\$(20,039)</u>	<u>\$(13,291)</u>
Basic and diluted net loss attributable to common stockholders per common share	<u>\$ (6.95)</u>	<u>\$ (20.66)</u>	<u>\$ (17.91)</u>
Shares used in computing basic and diluted net loss attributable to common stockholders per common share	<u>4,447</u>	<u>970</u>	<u>742</u>

The accompanying notes are an integral part of the consolidated financial statements.

NITROMED, INC.

STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)

(in thousands, except per share amounts)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Note Receivable from Stock Purchase Agreement	Deferred Stock Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Par Value						
Balance at December 31, 2000	26,228	\$ 44,277	589	\$ 6	\$ 1,349	\$ (252)		\$ (42,596)	—	\$(41,493)
Exercise of stock options			9	—	6					6
Exercise of warrants			365	4	26					30
Compensation expense associated with note receivable from stock purchase agreement					253					253
Compensation expense associated with options issued to non-employees and performance options issued to employees					220					220
Issuance of Series E preferred stock in June 2001 at \$7.20 per share for cash (net of issuance costs of \$143)	4,292	30,773								
Issuance of Series F preferred stock in November 2001 at \$14.00 per share for cash (net of issuance costs of \$25)	250	3,475								
Accretion of Series E dividends		1,471						(1,471)		(1,471)
Accretion of preferred stock to redemption value		191						(191)		(191)
Net loss								(11,629)		(11,629)
Balance at December 31, 2001	30,770	\$ 80,187	963	\$ 10	\$ 1,854	\$ (252)		\$ (55,887)	—	\$(54,275)

The accompanying notes are an integral part of the consolidated financial statements.

NITROMED, INC.

STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)

(in thousands, except per share amounts)

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	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Note Receivable from Stock Purchase Agreement	Deferred Stock Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Par Value						
Balance at December 31, 2001	30,770	\$ 80,187	963	\$ 10	\$ 1,854	\$ (252)		\$ (55,887)	—	\$(54,275)
Exercise of stock options			22	—	23					23
Compensation expense associated with and forgiveness of note receivable from stock purchase agreement					392	252				644
Deferred stock compensation expense associated with stock options					566		\$ (566)			—
Amortization of deferred stock compensation							39			39
Compensation expense associated with options issued to non-employees and performance options issued to employees					255					255
Accretion of Series E dividends		2,473						(2,473)		(2,473)
Accretion of preferred stock to redemption value		224						(224)		(224)
Net loss								(17,342)		(17,342)
Balance at December 31, 2002	30,770	\$ 82,884	985	\$ 10	\$ 3,090	\$ —	\$ (527)	\$ (75,926)	—	\$(73,353)

The accompanying notes are an integral part of the consolidated financial statements.

NITROMED, INC.
STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)
(in thousands, except per share amounts)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Note Receivable from Stock Purchase Agreement	Deferred Stock Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Par Value						
Balance at December 31, 2002	30,770	\$ 82,884	985	\$ 10	\$ 3,090	—	\$ (527)	\$ (75,926)	—	\$(73,353)
Exercise of stock options			217	2	131					133
Deferred stock compensation expense associated with stock options					3,317		(3,317)			—
Amortization of deferred stock compensation							604			604
Compensation expense associated with options issued to non-employees and performance options issued to employees					303					303
Accretion of Series E dividends		2,469						(2,469)		(2,469)
Accretion of preferred stock to redemption value		325						(325)		(325)
Beneficial conversion features of Series E					19,320			(19,320)		—
Beneficial conversion features of Series F					37			(37)		—
Issuance of Series E preferred stock in August 2003 at \$7.20 per share for cash (net of issuance costs of \$100)	2,776	19,900								
Issuance of common stock from initial public offering ("IPO") (net of issuance costs of \$5,928)			6,000	60	60,012					60,072
Conversion of preferred stock to common stock at IPO	(33,546)	(105,578)	18,399	184	105,394					105,578
Unrealized gains on cash equivalents and marketable securities									25	25
Net loss								(8,769)		(8,769)
Comprehensive loss										(8,744)
Balance at December 31, 2003	—	\$ —	25,601	\$ 256	\$191,604	\$ —	\$ (3,240)	\$(106,846)	\$ 25	\$ 81,799

The accompanying notes are an integral part of the consolidated financial statements.

NITROMED, INC.
STATEMENTS OF CASH FLOWS

	<u>Year Ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:			
Net loss	\$ (8,769)	\$(17,342)	\$(11,629)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	251	219	319
Employee loan receivable forgiven	—	—	30
Forgiveness of note receivable from stock purchase agreement	—	252	—
Stock-based compensation expense	907	686	474
Changes in operating assets and liabilities:			
Accounts receivable	10,000	—	—
Prepaid expenses and other current assets	(1,029)	636	(825)
Accounts payable and accrued expenses	627	103	335
Deferred revenue	3,825	(750)	1,375
Net cash provided by (used in) operating activities	<u>5,812</u>	<u>(16,196)</u>	<u>(9,921)</u>
Cash flows from investing activities:			
Purchases of marketable securities	(37,562)	(11,041)	(7,669)
Sales of marketable securities	14,796	12,017	10
Capital expenditures	(655)	(26)	(54)
Net cash provided by (used in) investing activities	<u>(23,421)</u>	<u>950</u>	<u>(7,713)</u>
Cash flows from financing activities:			
Principal payments on notes payable	(42)	(289)	(537)
Proceeds from exercise of stock options	133	23	6
Proceeds from exercise of stock purchase warrants	—	—	30
Net proceeds from sale of redeemable convertible preferred stock	19,900	—	34,248
Net proceeds from sale of common stock in initial public offering	60,072	—	—
Net cash provided by (used in) financing activities	<u>80,063</u>	<u>(266)</u>	<u>33,747</u>
Net increase (decrease) in cash and cash equivalents	62,454	(15,512)	16,113
Cash and cash equivalents, beginning balance	5,160	20,672	4,559
Cash and cash equivalents, ending balance	<u>\$ 67,614</u>	<u>\$ 5,160</u>	<u>\$ 20,672</u>
Supplemental disclosure:			
Cash paid during the year for interest	<u>\$ 4</u>	<u>\$ 10</u>	<u>\$ 48</u>

The accompanying notes are an integral part of the consolidated financial statements.

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS
(all tabular amounts in thousands except per share amounts)

1. The Company

NitroMed, Inc. (the Company) is an emerging pharmaceutical company that discovers, develops and seeks to commercialize pharmaceuticals based on the therapeutic benefits of the naturally-occurring molecule nitric oxide. The Company utilizes its nitric oxide expertise and proprietary technology in an effort to both develop novel pharmaceuticals and improve the safety and efficacy of widely-prescribed drugs. The Company's research and development efforts focus on major diseases that are characterized by a deficiency in nitric oxide, such as cardiovascular and inflammatory diseases.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Concentrations of Credit Risk

The financial instruments that potentially subject the Company to a concentration of credit risk primarily consist of cash, cash equivalents and marketable securities. The majority of the Company's cash and cash equivalents and marketable securities are maintained with well-known, established financial institutions.

Cash Equivalents and Marketable Securities

Cash equivalents are short-term, highly liquid investments with maturities of three months or less at the time of acquisition. Investments with maturities in excess of three months at the time of acquisition are classified as marketable securities and designated as available-for-sale. Cash equivalents consist of institutional money market funds, and marketable securities consist of corporate bonds with contractual maturities of less than two years. Available-for-sale securities are carried at fair market value, which approximates amortized cost, as reported by the custodian, and unrealized gains and losses, if any, are reported as a separate component of other comprehensive income within stockholders' equity (deficit). Realized gains and losses and unrealized gains and losses were not material for the years ended December 31, 2003, 2002 and 2001.

Fair Value of Financial Instruments

Financial instruments mainly consist of cash and cash equivalents, marketable securities, accounts receivable and long-term obligations. The carrying amounts of these instruments approximate their fair values.

Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives, which range between three to five years. Leasehold improvements are amortized based upon the lesser of the term of the lease or the useful life of the asset. The Company

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

2. Summary of Significant Accounting Policies (Continued)

reviews its property and equipment whenever events or changes in circumstances indicate that the carrying value of certain assets may not be recoverable and recognizes an impairment loss when it is probable that the estimated cash flows are less than the carrying value of the asset.

Research and Development Expenses

Research and development costs primarily consist of salaries and related expenses for personnel, fees paid to consultants and outside service providers and materials used in clinical trials and research and development. The Company charges research and development expenses, including costs associated with acquiring patents, to operations as incurred.

The Company enters into contracts with professional service providers to conduct clinical trials and related services. These professional service providers render services over an extended period of time, generally one to three years. Typically, the Company enters into two types of vendor contracts, patient-based or time-based. Under a patient-based contract, the Company first determines an appropriate per patient cost using critical factors contained within the contract, which include the estimated number of patients, the cost assigned to each patient based on a patient's number of visits and the total dollar value of the contract. The Company then records expense based upon the total number of patients enrolled during the period and the status of each patient. Under a time based contract, using critical factors contained within the contract such as the stated duration of the contract and the timing of services provided, the Company records the contractual expense for each service provided ratably over the period during which the Company estimates the service will be performed. On a monthly basis, the Company reviews both the timetable of services to be rendered and the timing of services actually received based on regular communications with its vendors in order to gauge the reasonableness of its estimates. Based upon this review, revisions may be made to the forecasted timetable or the extent of services performed, or both, in order to reflect the Company's most current estimate of the contract.

Revenue Recognition

Revenue is deemed earned when all of the following have occurred: all obligations of the Company relating to the revenue have been met and the earnings process is complete; the monies received or receivable are not refundable irrespective of research results; and there are neither future obligations or milestones to be met by the Company with respect to such revenue. The Company recognizes revenue from nonrefundable, up-front licenses and related payments, not specifically tied to a separate earnings process, ratably over the period that the Company is obligated to participate on a continuing and substantial basis in the research and development activities outlined in each contract. When payments are specifically tied to a separate earnings process, revenue is recognized when the specific performance obligation associated with the payment has been satisfied. Performance obligations typically consist of contracted services or development milestones. Revenue from services performed under collaborative research agreements is recognized as reimbursable costs are incurred. Revenue from significant milestones in the development lifecycle of the related technology, including initiation of clinical trials or filing for and obtaining approvals with regulatory agencies are considered earned when the payor acknowledges the milestone achievement, which is generally by payment of amounts due.

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

2. Summary of Significant Accounting Policies (Continued)

Stock-Based Compensation

The Company has elected to account for its stock-based compensation plans under the intrinsic value method pursuant to Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and related Interpretations, rather than the alternative fair value accounting provided under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (FAS 123). In accordance with EITF 96-18, *Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Connection with Selling Goods or Services* (EITF 96-18), the Company records compensation expense equal to the fair value of the option granted to non-employees over the vesting period, which is generally the period of service.

FAS 123 requires pro forma information regarding net loss and net loss per share as if the Company had accounted for its stock-based awards to employees under the fair value method of FAS 123. The fair value of the Company's stock options used to compute pro forma net loss is the estimated fair value at the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	December 31,		
	2003	2002	2001
Risk-free interest rate	2.8%	3.5%	4.5%
Expected volatility	80%	80%	80%
Expected lives	4 years	4 years	4 years
Expected dividend	—	—	—

The per-share, weighted-average grant date fair value of options granted during the years ended December 31, 2003, 2002 and 2001 were \$6.49, \$3.28 and \$1.29, respectively.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized over the option vesting period. Had compensation expense for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

2. Summary of Significant Accounting Policies (Continued)

consistent with the method of FAS 123, the Company's net loss and net loss per share would have been as follows:

	<u>Years Ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net loss attributable to common stockholders as reported	\$(30,920)	\$(20,039)	\$(13,291)
Add: Stock-based employee compensation expense included in reported net loss	722	522	310
Deduct: Stock-based employee compensation expense determined under fair value based method	<u>(850)</u>	<u>(319)</u>	<u>(213)</u>
FAS 123 Pro forma net loss	<u>\$(31,048)</u>	<u>\$(19,836)</u>	<u>\$(13,194)</u>
Basic and diluted net loss per share			
As reported	\$ (6.95)	\$ (20.66)	\$ (17.91)
FAS 123 Pro forma	\$ (6.98)	\$ (20.45)	\$ (17.78)

Accumulated Other Comprehensive Income

The Company presents comprehensive loss in accordance with SFAS 130, *Reporting Comprehensive Income*. Accumulated other comprehensive income is comprised entirely of unrealized gains and losses on available-for-sale marketable securities.

Income Taxes

Deferred tax assets and liabilities are determined based on differences between the financial reporting and income tax bases of assets and liabilities, as well as net operating loss carryforwards and tax credits, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization.

Net Loss Per Share

Basic net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of shares of common stock and the dilutive potential common stock equivalents then outstanding. Potential common stock equivalents consist of stock options, warrants and redeemable convertible preferred stock. Since the Company has a net loss for all periods presented, the effect of all potentially dilutive securities is antidilutive. Accordingly, basic and diluted net loss per share is the same.

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

2. Summary of Significant Accounting Policies (Continued)

Segment Information

During the three years ended December 31, 2003, the Company operated in one reportable business segment, developing nitric oxide enhancing medicines, under the management approach of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

New Accounting Standards

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, “*Consolidation of Variable Interest Entities*” (FIN 46), which was amended by FIN 46R issued in December 2003. This interpretation of Accounting Research Bulletin No. 51, “*Consolidated Financial Statements*,” addresses consolidation by business enterprises of variable interest entities (VIEs) that either: (1) do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) for which the equity investors lack an essential characteristic of a controlling financial interest. This Interpretation applies immediately to VIEs created after January 31, 2003. It also applies in the first fiscal year or interim period ending after March 15, 2004, to VIEs created before February 1, 2003 in which an enterprise holds a variable interest. FIN 46 requires disclosure of VIEs in financial statements issued after January 31, 2003, if it is reasonably possible that as of the transition date: (1) the Company will be the primary beneficiary of an existing VIE that will require consolidation or, (2) the Company will hold a significant variable interest in, or have significant involvement with, an existing VIE. The Company is currently in the process of completing its review of the requirements of FIN 46. However, the Company has not yet identified any entities that require disclosure or entities that would require consolidation under FIN 46 that had not previously been consolidated as a result of FIN 46.

In November 2003, during discussion on EITF Issue No. 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, the EITF reached a consensus which requires certain quantitative and qualitative disclosures for debt and marketable equity securities classified as available-for-sale or held-to-maturity under SFAS 115 and SFAS 124 that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The consensus on quantitative and qualitative disclosures is effective for fiscal years ending after December 15, 2003 and comparative information for earlier periods presented is not required. The Company currently does not have any impaired investments and thus the adoption of this consensus did not have a material impact on its financial statements.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104, *Revenue Recognition*, (“SAB 104”) which supercedes SAB 101, *Revenue Recognition in Financial Statements*. SAB 104’s primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements and to rescind the SEC’s *Revenue Recognition in Financial Statements Frequently Asked Questions and Answers* (“FAQ”) issued with SAB 101. Selected portions of the FAQ have been incorporated into SAB 104. The adoption of SAB 104 did not have a material impact on the Company’s revenue recognition policies.

NITROMED, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

(all tabular amounts in thousands except per share amounts)

3. Cash Equivalents and Marketable Securities

The following is a summary of the fair market value of available-for-sale money market funds and marketable securities the Company held at December 31, 2003 and 2002:

<u>December 31, 2003</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
Cash and money market funds	\$ 7,893	—	—	\$ 7,893
Commercial paper	58,712	9	—	58,721
U.S. Government agencies				
Due in one year or less	7,150	3	—	7,153
Asset-backed securities				
Due in one year or less	2,262	—	—	2,262
Due in one to three years	5,596	12	—	5,608
Corporate notes				
Due in one year or less	12,866	2	(6)	12,862
Due in one to three years	2,584	5	—	2,589
Total	<u>97,063</u>	<u>31</u>	<u>(6)</u>	<u>97,088</u>
Less amounts classified as cash and cash equivalents	<u>67,605</u>	<u>9</u>	<u>—</u>	<u>67,614</u>
Total marketable securities	<u>\$29,458</u>	<u>22</u>	<u>(6)</u>	<u>\$29,474</u>
<u>December 31, 2002</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
Cash and money market funds	\$5,160	—	—	\$5,160
U.S. Government agencies				
Due in one year or less	574	—	—	574
Corporate notes				
Due in one year or less	6,109	—	—	6,109
Total	<u>11,843</u>	<u>—</u>	<u>—</u>	<u>11,843</u>
Less amounts classified as cash and cash equivalents	<u>5,160</u>	<u>—</u>	<u>—</u>	<u>5,160</u>
Total marketable securities	<u>\$6,683</u>	<u>—</u>	<u>—</u>	<u>\$6,683</u>

4. Note Receivable from Stock Purchase Agreement

On December 31, 1997, the Company executed a \$252,000 loan to an officer that was used to purchase 350,000 shares of restricted common stock of the Company at a purchase price of \$0.72 per share. These shares were granted under the Company's 1993 Equity Incentive Plan. The loan was due and payable in full in September 2002, bore interest at a rate of 6.02% per annum (which interest was forgiven) and was secured, pursuant to the terms of a Pledge Agreement, by the restricted shares. Twenty percent of the shares vested at the date of issuance and an additional 20% of the shares vested annually each September. Based on the terms of the arrangement, the award was required to be accounted for as variable compensation. Accordingly, the Company recorded noncash stock

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

4. Note Receivable from Stock Purchase Agreement (Continued)

compensation charges for the years ended December 31, 2002 and 2001 of \$392,000 and \$253,000, respectively. In addition, during September 2002, the Company forgave the loan and recorded an additional noncash compensation charge of \$252,000 for the year ended December 31, 2002.

5. Property and Equipment

Property and equipment consist of the following:

	December 31,	
	2003	2002
Laboratory furniture, fixtures and equipment	\$1,021	\$ 634
Office furniture, fixtures and equipment	438	233
Leasehold improvements	940	877
.....	2,399	1,744
Less accumulated depreciation and amortization	(1,713)	(1,462)
	\$ 686	\$ 282

6. Accrued Expenses

Accrued expenses consist of the following:

	December 31,	
	2003	2002
Clinical trial costs	\$ 865	\$1,017
Compensation and related benefits	759	450
Other	443	110
	\$2,067	\$1,577

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

7. Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)

Redeemable Convertible Preferred Stock

The Company had issued Series A, Series B, Series C, Series D and Series E redeemable convertible preferred stock, and Series F junior redeemable convertible preferred stock (collectively, Series Preferred Stock) as follows:

	<u>December 31, 2003</u>	<u>December 31, 2002</u>
Series A: 5,000 shares authorized, issued and outstanding	\$ —	\$ 4,996
Series B: 17,005 shares authorized; 16,510 shares issued and outstanding	—	16,507
Series C: 3,158 shares authorized issued and outstanding	—	11,985
Series D: 2,138 shares authorized; 1,560 shares issued and outstanding	—	11,104
Series E: 4,361 shares authorized at December 31, 2002; 4,292 shares issued and outstanding	—	34,804
Series F: 250 shares authorized, issued and outstanding	—	3,488
Total	<u>\$ —</u>	<u>\$82,884</u>

Initial Public Offering

On November 10, 2003, the Company completed its initial public offering and sold 6,000,000 shares of common stock for \$11.00 per share for net proceeds of approximately \$60.1 million. In connection with the initial public offering all of the outstanding shares of the Company's redeemable convertible preferred stock, including accrued but unpaid Series E dividends of \$6.4 million, converted into 18,398,496 shares of the Company's common stock based upon the conversion ratios then applicable.

Conversion

The Series Preferred Stock were convertible, at the option of the holder, subject to adjustments for stock splits, stock dividends, recapitalizations and the like, as well as dilutive issuances of common stock, if any, as follows as of December 31, 2002:

<u>Series of Preferred Stock</u>	<u>Number of Shares of Preferred Stock</u>	<u>Conversion Ratio</u>	<u>Equivalent Shares of Common Stock</u>
Series A	5,000	0.125	625
Series B	16,510	0.250	4,127
Series C	3,158	1.000	3,158
Series D	1,560	1.000	1,560
Series E	4,292	1.000	4,292
Series F	250	1.000	250
Total	<u>30,770</u>		<u>14,012</u>

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

7. Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit) (Continued)

Series E and F

On August 1, 2003, the Company completed the sale of 2,776,347 shares of Series E redeemable convertible preferred stock for net proceeds of \$19.9 million. These shares automatically converted to common stock upon the closing of the Company's initial public offering of common stock on November 10, 2003. These shares contained a beneficial conversion feature based on the fair value of the common stock into which the shares were convertible. In accordance with EITF 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, the value of such beneficial conversion feature of approximately \$8.3 million has been recognized as a deemed dividend in the three month period ended September 30, 2003.

The Series F conversion ratio provided for additional shares of common stock when the Company issued equity securities, as defined, for consideration of less than \$14 per share, the purchase price of Series F. As a result of the above sale of these Series E shares, the Series F conversion ratio was increased from 1:1 to 1:1.073364. The adjustment to the Series F conversion ratio is a beneficial conversion feature. In accordance with EITF 00-27, *Application of Issue 98-5 to Certain Convertible Instruments*, the value of such beneficial conversion feature of approximately \$37,000 has been recognized as a deemed dividend in the three month period ended September 30, 2003.

Subsequent to the August 2003 sale of the Series E shares, the Series E stockholders and the Company agreed to increase the Series E conversion ratio from 1:1 to 1:1.1526 in consideration of the Series E stockholders waiving their rights to certain anti-dilution provisions. The adjustment to the conversion ratio, which was contingent on the initial public offering, is a beneficial conversion feature. In accordance with EITF 00-27, the value of the Series E beneficial conversion feature of approximately \$11.0 million has been recognized as a deemed dividend in the period of issuance, which occurred in the fourth quarter of 2003 as a result of the initial public offering. In addition, the conversion of the Series E shares in the initial public offering caused the accrued but unpaid Series E dividends of approximately \$6.4 million to become payable through the issuance of 513,033 shares of common stock at the time of the initial public offering.

Undesignated Preferred and Common Stock

On August 18 2003, the Board of Directors approved an Amendment to Certificate of Incorporation, which became effective on November 5, 2003 and increased the Company's authorized shares of common stock to 35,000,000. On August 18, 2003, the Board of Directors also approved a Restated Certificate of Incorporation, which became effective upon the consummation of the initial public offering on November 10, 2003 and increased the Company's authorized shares of common stock to 65,000,000 and authorized 5,000,000 shares of undesignated preferred stock, issuable in one or more series designated from time to time by the Board of Directors.

Stock Purchase Warrants

At December 31, 2003 and 2002, there were stock purchase warrants outstanding to purchase 127,187 and 24,160 shares of the Company's common stock at exercise prices of \$.08 to \$.01 per share, respectively, which expire beginning in 2004 through 2007. In addition, stock purchase warrants to

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

7. Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit) (Continued)

purchase 123,749 shares of common stock at an exercise price of \$4.00 per share, which expire in 2006, were outstanding at December 31, 2003.

Stock Option Plans

The Company's Restated 1993 Equity Incentive Plan (the "1993 plan") provides for the grant of incentive stock options, nonstatutory stock options and restricted stock awards to purchase up to 2,288,200 shares of common stock. Officers, employees, directors, consultants and advisors of the Company are eligible to be granted options under the 1993 plan at a price not less than 100% (110% in the case of incentive stock options granted to 10% or greater stockholders) of the fair market value of such stock, as determined by the Board of Directors, at the time the option is granted. In May 2003, the Company's stockholders approved the 2003 Stock Incentive Plan (the "2003 plan"), under which 800,000 shares of common stock were authorized for issuance. In October 2003, the stockholders approved an amended and restated plan which provided, among other things, for an increase of shares authorized for issuance under the 2003 plan to 2,500,000.

While the Company may grant options to employees, which become exercisable at different times or within different periods, the Company generally has granted options to employees that are exercisable in annual installments of 25% each on the first four anniversary dates of the grant.

Information with respect to activity under the Plans is as follows:

<u>Stock Option Activity</u>	<u>Number of Options</u>	<u>Weighted-Average Exercise Price Per Share</u>
Balance at December 31, 2000	1,718	\$0.94
Options granted	441	2.00
Options canceled	(2)	1.82
Options exercised	(9)	0.74
Balance at December 31, 2001	2,148	1.16
Options granted	241	2.00
Options canceled	(226)	1.74
Options exercised	(22)	1.04
Balance at December 31, 2002	2,141	1.19
Options granted	978	5.30
Options canceled	(3)	1.95
Options exercised	(217)	0.61
Balance at December 31, 2003	<u>2,899</u>	\$2.62

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

7. Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit) (Continued)

The following table summarizes information about options outstanding at December 31, 2003:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number of Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Life (In years)</u>	<u>Number of Shares</u>	<u>Weighted-Average Exercise Price</u>
\$0.08-\$0.72	859	\$0.72	4.0	858	\$0.72
\$1.20-\$2.00	1,503	1.77	6.8	668	1.57
\$7.98-\$8.90	537	8.04	9.9	—	—
	<u>2,899</u>	<u>\$2.62</u>	<u>6.5</u>	<u>1,526</u>	<u>\$1.09</u>

There were 1,531,468 and 1,276,796 options exercisable at December 31, 2002 and 2001, respectively. At December 31, 2003, the Company has 1,545,494 options available for future grant.

During 1999 and 2000, the Company granted 75,100 and 100,000 performance-based options, respectively, with an exercise price of \$1.30 to certain employees, which allow for acceleration of the vesting period upon the occurrence of certain defined events. Of the 100,000 granted, 5,000 options were forfeited in 2002. Based on the terms of the arrangements, the awards are required to be accounted for as variable, and compensation expense is measured as the difference between the fair market value of the Company's common stock at the reporting period date and the exercise price of the award. Compensation expense is recognized over the vesting period and totaled \$118,000, \$91,000 and \$57,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

During 2003, 2001, 2000 and 1999, the Company granted a total of 161,000 stock options to nonemployees at a weighted-average exercise price of \$1.53 per share, all of which remain outstanding at December 31, 2003. The Company has applied the recognition provisions of FAS 123 and EITF 96-18 related to these stock options and utilized the Black-Scholes option pricing model to determine the fair value of these stock options at each reporting date. In connection with these awards, the Company recognized compensation expense of \$185,000, \$164,000 and \$163,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

During 2003 and 2002, the Company granted 413,250 and 241,000 options, respectively, to employees at exercise prices below the fair value of the Company's common stock. The weighted average exercise price of these options is \$2.00 per share. The Company recorded deferred stock compensation expense related to these grants of \$3,317,000 and \$566,000 for the years ended December 31, 2003 and 2002, respectively. These amounts are being recognized as stock-based compensation expense ratably over the vesting period of four years. Included in the results of operations for the years ended December 31, 2003 and 2002 is compensation expense of \$604,000 and \$39,000, respectively.

Employee Stock Purchase Plan

On August 18, 2003, the Board of Directors adopted the 2003 Employee Stock Purchase Plan (the "Stock Purchase Plan"), which provides for the sale of up to 75,000 shares of common stock to participating employees. Under the Stock Purchase Plan, eligible employees may purchase common

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

7. Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit) (Continued)

stock at a price per share equal to 85% of the lower of the fair market value of the common stock at the beginning or end of each offering period. Participation in the offering is limited to 10% of the employee's compensation or \$25,000 in any calendar year. The first offering period began on January 1, 2004.

8. Net Loss per Share

The following table sets forth the computation of basic and diluted net loss per share for the respective periods.

	Year Ended December 31,		
	2003	2002	2001
<i>Basic and Diluted:</i>			
Net loss	\$ (8,769)	\$(17,342)	\$(11,629)
Deemed dividends related to beneficial conversion features of redeemable convertible preferred stock	(19,357)	—	—
Dividends and accretion to redemption value of redeemable convertible preferred stock prior to conversion	<u>(2,794)</u>	<u>(2,697)</u>	<u>(1,662)</u>
Net loss attributable to common stockholders	<u>\$(30,920)</u>	<u>\$(20,039)</u>	<u>\$(13,291)</u>
Weighted average common shares used to compute net loss per share	<u>4,447</u>	<u>970</u>	<u>742</u>
Basic and diluted net loss per share	<u>\$ (6.95)</u>	<u>\$ (20.66)</u>	<u>\$ (17.91)</u>

Options to purchase 2,898,584, 2,141,401 and 2,148,235 shares of common stock for the years ended December 31, 2003, 2002 and 2001, respectively, and warrants to purchase 275,096 shares of common stock have been excluded from the computation of net loss per share as their effects would have been antidilutive.

9. Notes Payable

Notes payable consisted of the following:

	December 31,	
	2003	2002
Note payable in monthly payments of \$4 through June 30, 2004, including interest at 8% per annum	\$22	\$64
Less current portion	<u>(22)</u>	<u>(42)</u>
Long-term portion	<u>\$—</u>	<u>\$22</u>

10. Operating Lease

The Company leases its research facilities under an operating lease that expires September 30, 2004 with an option to extend for two additional successive periods of five years each. The lease requires payment of real estate taxes and other common area maintenance expenses. Under the lease, a security deposit of \$100,000 is required to be held in escrow for the life of the lease. Annual rent expense was \$580,000 for 2003, 2002 and 2001. Future annual minimum rental payments for non

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
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10. Operating Lease (Continued)

cancelable operating leases as of December 31, 2003 are \$532,000. The Company sub-leased a portion of its premises and recognized rental income of \$82,000, \$195,000 and \$188,000 in 2003, 2002 and 2001, respectively. The sublease agreement ended in 2003.

On January 30, 2004 the Company executed a lease for approximately 52,000 square feet of laboratory and office space in Lexington, Massachusetts. The rent obligation for the building is expected to commence thirty days from the earlier of (a) July 8, 2004 or (b) the date on which the Company commences occupancy of the building. The lease is for a term of ten years with options that permit renewals for additional 5 year periods. The Company has the option to terminate the lease at the end of the fifth year for a fee of \$4.2 million. The expected minimum rental commitments under the lease agreement are \$392,000, \$1,126,000, \$1,435,000, \$1,505,000, and \$1,505,000 for each year in the five year period ending December 31, 2008, respectively, and \$9.3 million in total for the remainder of the lease term. In addition to minimum lease commitment, the lease agreement requires the Company to pay its pro rata share of property taxes and building operating expenses.

11. Research, License and Consulting Agreements

The Company has entered into various research, license and consulting agreements to support its research and development activities.

Johnson & Johnson Agreements

Prior to 2001, the Company had two principal research and development collaboration agreements, both dated April 1997, in which the Company had licensed its technology to Johnson & Johnson and affiliates in return for initial license fees, reimbursement of qualified research expenditures and the purchase of \$3.0 million of Series B. The agreements contained provisions for future payments to the Company upon the achievement of certain research and development milestones and future royalties to the Company on sales of products developed under the agreements. One of the agreements with affiliates of Johnson & Johnson was terminated in April 2000 and the other agreement was terminated in September 2001.

With respect to one of the Johnson & Johnson agreements noted above, during 2001, the Company reacquired the previously licensed technology in consideration of future payments totaling \$4.5 million. The Company is required to make payments to Johnson & Johnson contingent upon the occurrence of the following events: a portion of up-front and milestone payments received in consideration for granting the rights to the technology; a percent of net sales revenue generated by the Company from product manufactured using the technology; and a percentage of royalty payments received based upon the sale of products derived from the technology. Payments are only required upon the occurrence of such events. Through December 31, 2003, the Company had paid \$375,000 to Johnson & Johnson as a result of receiving payments for licensing the reacquired technology.

Boston Scientific Corporation Agreement

In November 2001, the Company entered into a development and license agreement with Boston Scientific Corporation (“BSC”) that granted a nonexclusive, nonroyalty bearing right and license in certain technology, which had been reacquired from Johnson & Johnson as noted above. In

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
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11. Research, License and Consulting Agreements (Continued)

consideration of the license, the Company received a nonrefundable up-front license payment of \$1.5 million. At the same time the Company sold to BSC 250,000 shares of Series F for \$3.5 million. Under the agreement, the Company planned to deliver two drug compounds, as defined in the agreement, to BSC during the two year research term. Accordingly, the Company was recognizing the \$1.5 million license fee as revenue ratably over the term of its contractual performance obligation. In January 2003, the Company informally agreed to an extension of the research term to May 2004. As a result, the Company extended the period of revenue recognition for the unrecognized portion of the license payment at December 31, 2002 to May 31, 2004. In December 2003 the Company executed an amendment to extend the research term to December 31, 2005 and received an additional \$3.0 million. The Company will recognize the \$3.0 million extension fee and the remaining deferred revenue related to the nonrefundable license payment of \$1.5 million over the extension period. For the years ended December 31, 2003, 2002 and 2001, the Company recognized revenue of \$442,000, \$750,000 and \$125,000, respectively.

In connection with the agreement, the Company may receive up to \$8.3 million in milestone payments if certain development events are achieved by BSC. The Company may receive additional milestone payments for commercial success of any products derived from the licensed technology by BSC. For any individual product that exceeds certain sales levels in any consecutive 12-month period, the Company will receive milestone payments. In addition, the Company may receive royalty payments on net sales of products derived from the licensed technology. The royalty term, which is on a country by country basis, related to each product derived by the licensed technology will generally be 12 years.

BiDil License Agreement

In connection with its development program for BiDil, the Company's lead product candidate, the Company entered into an agreement to license certain technology from an individual who is on the Company's Scientific Advisory Board. The Company also receives services from this individual in consideration of nominal payments and the grant of stock options. Upon achieving certain development events, the Company is required to make milestone payments of up to \$1 million in the aggregate. In addition, upon commercial sale of products developed from the technology, the Company is required to make royalty payments on net sales, which will vary depending on sales volume. The royalty term expires upon the later of the expiration of the patent rights or ten years from the first commercial sale. The agreement may be terminated by the Company at any time.

Merck Agreement

In December of 2002, the Company executed a research collaboration and license agreement with Merck Frosst Canada & Co., a wholly-owned subsidiary of Merck & Co., in which the Company granted an exclusive, worldwide, royalty-bearing license to certain existing technology and any technology, pertaining to the licensed technology, developed by the Company during a three-year period commencing January 1, 2003. In consideration of this license, the Company received \$10 million in January of 2003. During the three-year period, the Company is obligated to perform certain research and development activities in consideration of quarterly fees totaling \$7.2 million. The Company is recognizing the license fee as revenue ratably over the term of its contractual performance obligation of three years.

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

11. Research, License and Consulting Agreements (Continued)

In connection with this agreement, the Company may receive milestone payments associated with certain development and approval events and sales and marketing events. In addition, the Company may receive royalty payments based on net sales of licensed products derived from the licensed technology. The royalty term, which is on a country by country basis, related to each product derived by the licensed technology is the later of a) the expiration of the patent as defined in the agreement or b) ten years after the first commercial sale of the product as defined by the agreement. For the year ended December 31, 2003, the Company recognized revenue of \$12.3 million related to \$15.0 million of license and milestone payments that have been deferred and are being recognized as revenue ratably over the contractual research and development term, a \$5.0 million milestone payment for advancing a lead nitric oxide enhancing COX-2 inhibitor into Phase I human testing and \$3.0 million of research and development funding.

12. Income Taxes

A reconciliation of federal statutory income tax provision to the Company's actual provision is as follows:

	<u>Year Ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Benefit at federal statutory tax rate	\$(2,982)	\$(5,896)	\$(3,954)
Unbenefited operating losses	3,175	6,922	4,576
State taxes, net of federal benefit	(550)	(1,087)	(729)
Non-deductible expenses	357	215	5
Other	—	(154)	102
Income tax provision	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

The significant components of the Company's deferred tax assets are as follows:

	<u>December 31,</u>	
	<u>2003</u>	<u>2002</u>
Deferred tax assets:		
Net operating loss carryforwards	\$11,292	\$14,223
Capitalized research costs, net of amortization	14,534	12,969
Tax credit carryforwards	4,791	3,504
Deferred revenue	4,369	252
Depreciation	288	286
Accrued expenses	202	181
Other	27	26
	<u>35,503</u>	<u>31,441</u>
Valuation allowance	<u>(35,503)</u>	<u>(31,441)</u>
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

12. Income Taxes (Continued)

The Company has increased its valuation allowance by \$4,062,000 in 2003 to provide a full valuation allowance for deferred tax assets since the realization of these benefits is not considered more likely than not. At December 31, 2003, the Company has unused net operating loss carryforwards of approximately \$28,649,000 available to reduce federal taxable income expiring in 2010 through 2023 and \$24,741,000 available to reduce state taxable income expiring in 2003 through 2008. The Company also has federal and state research tax credits of approximately \$5,694,000 available to offset federal and state income taxes, both of which expire beginning in 2010. The net operating losses and tax credit carryforwards may be subject to the annual limitation provisions of Internal Revenue Code (IRC) Sections 382 and 383. No income tax payments were made in 2003, 2002 or 2001.

13. Commitments and Contingencies

In connection with its pursuit of obtaining FDA approval of BiDil, the Company contracted with a consulting firm for services related to the development approval process of BiDil. The agreement provides for payment of legal consulting fees if and when the Company receives written FDA approval of BiDil. At December 31, 2003, the Company estimates the potential payment to be approximately \$1,097,000 for services incurred to date, which will be accrued when FDA approval becomes probable. In addition, the agreement requires the Company to pay royalties on sales of BiDil product. The royalty term ends six months from the date of market introduction of an FDA approved generic version of the BiDil product.

An academic institution has asserted that patents and patent applications which relate to the nitric oxide stent program may require a license from such institution. It is the opinion of the Company's management and legal counsel that the disputed intellectual property has been validly licensed to, or is validly owned by, the Company. Accordingly, the accompanying financial statements do not include any provision related to this claim.

14. Retirement Plan

The Company sponsors a 401(k) plan covering substantially all employees. The plan provides for salary deferral contributions by participants of up to 15% of eligible wages not to exceed Federal requirements. Those employees over 50 years old are permitted to contribute an additional \$1,000 per year. The Company does not match employee contributions.

NITROMED, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
(all tabular amounts in thousands except per share amounts)

15. Quarterly Results of Operations (Unaudited)

The following table presents unaudited quarterly financial data of the Company.

	<u>Year Ended December 31, 2003</u>			
	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
Net revenues	\$ 1,694	\$1,694	\$ 2,194	\$ 7,193
Net income (loss)	(3,187)	(3,150)	(3,411)	979
Net loss available to common stockholders	(3,861)	(3,825)	(12,748)	(10,486)
Basic and diluted net loss available to common stockholders per share	\$ (3.92)	\$ (3.88)	\$ (12.65)	\$ (0.71)
Weighted average common shares used to compute net loss per share	985	985	1,008	14,697
	<u>Year Ended December 31, 2002</u>			
	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
Net revenues	\$ 187	\$ 188	\$ 187	\$ 188
Net loss	(3,668)	(3,554)	(5,627)	(4,493)
Net loss available to common stockholders	(4,342)	(4,229)	(6,301)	(5,167)
Basic and diluted net loss available to common stockholders per share	\$ (4.51)	\$ (4.39)	\$ (6.49)	\$ (5.25)
Weighted average common shares used to compute net loss per share	963	963	971	985

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2003. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2003, our disclosure controls and procedures were (1) designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to our chief executive officer and chief financial officer by others within those entities, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 31, 2003 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors and Executive Officers

Information regarding our directors and executive officers may be found under the captions "Election of Directors" and "Executive Officers" in the Proxy Statement for our 2004 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

Audit Committee

We have a separately-designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. Additional information regarding the Audit Committee may be found under the captions "Board of Directors Meetings and Committee Meetings" and "Report of the Audit Committee" in the Proxy Statement for our 2004 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

Audit Committee Financial Expert

The Board of Directors has designated Davey S. Scoon as the "Audit Committee Financial Expert" as defined by Item 401(h) of Regulation S-K of the Exchange Act and determined that he is independent within the meaning of Item 7(d)(3)(iv) of Schedule 14A of the Exchange Act.

Section 16(a) Beneficial Ownership Reporting Compliance

Information regarding Section 16(a) Beneficial Ownership Reporting Compliance may be found under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement for our 2004 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

Code of Ethics

We have adopted a code of business conduct and ethics that applies to our directors, officers (including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions) as well as our employees. A copy of our Code of Business Conduct and Ethics is attached as an exhibit to this Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

Information with respect to this item may be found under the captions “Directors’ Compensation,” “Compensation Committee Interlocks and Insider Participation,” “Executive Compensation,” and “Employment Agreements,” in the Proxy Statement for our 2004 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

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

Information with respect to this item may be found under the caption “Security Ownership of Certain Beneficial Owners and Management” in the Proxy Statement for our 2004 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information with respect to this item may be found under the caption “Certain Relationships and Related Transactions” in the Proxy Statement for our 2004 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information with respect to this item may be found under the caption “Audit Fees” in the Proxy Statement for our 2004 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1) Financial Statements.

For a list of the financial information included herein, see “Index to Financial Statements” on page 43.

(a)(1) Financial Statement Schedules.

All schedules are omitted because they are not applicable or the required information is shown in the Financial Statements or Notes thereto.

(a)(3) List of Exhibits. The list of Exhibits filed as a part of this Annual Report on Form 10-K are set forth on the Exhibit Index immediately preceding such Exhibits, and is incorporated herein by this reference.

(b) Reports on Form 8-K.

(b)(1) A current report on Form 8-K was furnished to the Securities and Exchange Commission on December 30, 2003 to report, pursuant to Item 2 (Results of Operations and Financial Condition) that we announced on December 18, 2003 our financial results for the three and nine month periods ended September 30, 2003.

SIGNATURES

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

Date: March 30, 2004

NITROMED, INC.

/s/ MICHAEL D. LOBERG, PH.D.

Michael D. Loberg, Ph.D.

By: President and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this report has been signed by the following persons in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ MICHAEL D. LOBERG, PH.D.</u> Michael D. Loberg, Ph.D.	President and Chief Executive Officer and Director (Principal Executive Officer)	March 30, 2004
<u>/s/ JOSEPH GRIMM</u> Joseph Grimm	Chief Financial Officer (Principal Financial and Accounting Officer)	March 30, 2004
<u>/s/ ROBERT S. COHEN</u> Robert S. Cohen	Director	March 30, 2004
<u>/s/ ZOLA HOROVITZ, PH.D.</u> Zola Horovitz, Ph.D.	Director	March 30, 2004
<u>/s/ ARGERIS KARABELAS, PH.D.</u> Argeris Karabelas, Ph.D.	Director	March 30, 2004
<u>/s/ MARK LESCHLY</u> Mark Leschly	Director	March 30, 2004
<u>/s/ JOHN W. LITTLECHILD</u> John W. Littlechild	Director	March 30, 2004
<u>/s/ JOSEPH LOSCALZO, M.D., PH.D.</u> Joseph Loscalzo, M.D., Ph.D.	Director	March 30, 2004
<u>/s/ DAVEY S. SCOON</u> Davey S. Scoon	Director	March 30, 2004

EXHIBIT INDEX

Exhibit No.	Description
3.1(1)	Restated Certificate of Incorporation of the Company
3.2(1)	Amended and Restated Bylaws of the Company
*10.1(1)	Restated 1993 Equity Incentive Plan
*10.2(1)	Amended and Restated 2003 Stock Incentive Plan
*10.3(1)	2003 Employee Stock Purchase Plan
10.4†(1)	Development and License Agreement dated November 20, 2001 by and between Boston Scientific Corporation and the Company
10.5†(1)	Research Collaboration and License Agreement dated December 12, 2002 by and between Merck Frosst Canada & Co. and the Company
10.6†(1)	Research and License Agreement between the Company and Brigham and Women's Hospital, Inc. dated August 1, 1992, as amended November 22, 1996
10.7†(1)	Collaboration and License Agreement between the Company and Professor Jay N. Cohn dated January 22, 1999, as amended January 29, 2001 and March 15, 2002
10.8†(1)	Research and License Agreement between the Company and Trustees of Boston University dated June 1, 1993, as amended January 1, 1999
10.9†(1)	Agreement, between the Company and FoxKiser dated April 26, 2001
10.10†(1)	Agreement, dated March 13, 1995, by and between the Company and John D. Folts, as amended, November 22, 1996 and December 2, 1998
10.11†(1)	Professional Service Agreement between the Company MIMC, Inc., dated May 1, 2001, as amended
*10.12(1)	Letter Agreement between the Company and Michael D. Loberg dated July 14, 1997
*10.13(1)	Letter Agreement between the Company and Manual Worcel dated July 29, 1993
*10.14(1)	Letter Agreement between the Company and L. Gordon Letts dated November 4, 1993
*10.15(1)	Letter Agreement between the Company and Joseph M. Grimm dated April 22, 1999
10.16(1)	Fourth Amended and Restated Stockholders' Agreement among the Company and the stockholders named therein dated May 22, 2001, as amended November 20, 2001, May 12, 2003 and July 31, 2003
10.17(1)	Form of Warrant to purchase shares of the Company's Common Stock, together with a schedule of warrant holders
10.18(1)	Lease between the Company and William J. Callahan dated May 29, 1997
10.19	First Amendment to Lease Agreement between the Company and William J. Callahan dated March 22, 2004
10.20	Lease between the Company and PM Atlantic Lexington, LLC dated January 30, 2004
10.21	Letter Agreement between the Company, Boston University School of Medicine and Martin Feelisch, Ph.D. dated May 5, 2003

<u>Exhibit No.</u>	<u>Description</u>
10.22	Consulting Agreement between the Company and Joseph Loscalzo, M.D., Ph.D. dated October 27, 2003
14.1	Code of Business Conduct and Ethics
21.1	Subsidiaries of the Company
23.1	Consent of Ernst & Young LLP, Independent Auditors
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Management contract or compensation plan or arrangement required to be filed as an exhibit pursuant to Item 15(c) of Form 10-K

† Confidential treatment requested as to certain portions, which portions have been filed separately with the Securities and Exchange Commission

(1) Incorporated by reference to the exhibits to the Company's Registration Statement on Form S-1 (333-108104)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

**FORM 10-K/A
AMENDMENT NO. 1**

**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO
SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended December 31, 2003

OR

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

For the transition period from _____ to _____

Commission file number 000-50439

NITROMED, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

22-3159793
(IRS Employer Identification No.)

12 Oak Park Drive, Bedford, Massachusetts
(Address of principal executive offices)

01730
(Zip Code)

Registrant's telephone number, including area code: **(781) 275-9700**

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

None

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

Common Stock, \$.01 par value per share
(Title of class)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). YES NO

The aggregate market value of the registrant's common stock held by nonaffiliates of the registrant as of March 19, 2004 was approximately \$82,141,386, based on the price at which the registrant's common stock was last sold on March 19, 2004. Information regarding the aggregate market value of the registrant's common stock as of June 30, 2003 has not been provided due to the fact that trading of the registrant's common stock on the Nasdaq National Market did not commence until November 6, 2003.

As of March 19, 2004, there were 25,600,744 shares of the registrant's common stock outstanding.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the year ended December 31, 2003 that was originally filed with the Securities and Exchange Commission on March 30, 2004 is being filed to provide additional information required by Items 10, 11, 12, 13 and 14 of Part III. This Amendment No. 1 on Form 10-K/A does not change our previously reported financial statements and other financial disclosure.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors

Currently, our board of directors is comprised of eight directors. Our directors are elected annually by the stockholders and hold office until the next annual meeting and until successors are elected and qualified or until death, resignation or removal. Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled until the next annual meeting of stockholders by a majority of directors then in office.

Set forth below are the names of each member of our board of directors, their ages, the year in which each first became one of our directors, their principal occupations and employment during the past five years and the names of other public companies of which they serve as a director.

Argeris Karabelas, Ph.D., age 51, became a director in 2002.

Argeris Karabelas, Ph.D. has served as a member of our board of directors since January 2002 and as our Chairman since August 2003. Since November 2001, he has been a partner in Care Capital LLC, a life sciences investment firm. From June 2000 to November 2001, Dr. Karabelas served as Chairman of Novartis BioVentures Ltd., a private equity firm affiliated with Novartis A.G., a pharmaceutical company. Dr. Karabelas has also served as Chief Executive Officer of Worldwide Pharmaceuticals for Novartis AG from January 1998 to July 2000. He is a member of the Scientific Advisory Council of Massachusetts General Hospital and the Visiting Committee for Health Sciences and Technology at Massachusetts Institute of Technology. In addition, Dr. Karabelas serves as a director of Halsey Drug Co., Inc., Human Genome Sciences, Inc. and SkyePharma plc. Dr. Karabelas holds a Ph.D. in pharmacokinetics from the Massachusetts College of Pharmacy.

Michael D. Loberg, Ph.D., age 56, became a director in 1997.

Michael D. Loberg, Ph.D. has served as a member of our board of directors and as our Chief Executive Officer since September 1997. He has served as President since September 2003. From 1996 to January 1997, Dr. Loberg served as President of Bristol-Myers Squibb Company's Oncology and Immunology division, a pharmaceuticals company. From 1994 to 1996, Dr. Loberg served as President of Bristol-Myers Squibb Company's U.S. Primary Care division. Dr. Loberg also serves as a director of Advanced Magnetics, Inc. Dr. Loberg holds a B.S. in chemistry from Trinity College and a Ph.D. in chemistry from Washington University.

Robert S. Cohen, age 61, became a director in 1997.

Robert S. Cohen has served as a member of our board of directors since July 1997. Mr. Cohen has served as a consultant to pharmaceutical and biotechnology companies for the past two years. From October 1999 to May 2001, Mr. Cohen served as Chief Executive Officer of Memory Pharmaceuticals Corp., a pharmaceutical company. From March 1997 to June 1999, Mr. Cohen served as President and Chief Executive Officer of Shire Laboratories Inc., a drug delivery company. Mr. Cohen also served first as Chief Operating Officer and then Chief Executive Officer of Pharmavene Inc. which subsequently merged with Shire Pharmaceutical Group, plc. Mr. Cohen holds a B.S. and an M.S.

degree from Brooklyn College of Pharmacy of Long Island University and attended the Harvard Business School Advanced Management Program.

Zola Horovitz, Ph.D., age 69, became a director in 1997.

Zola P. Horovitz, Ph.D. has served as a member of our board of directors since September 1997. Dr. Horovitz has served as a consultant to the pharmaceutical and biotechnology industries since 1994. Prior to his retirement in 1994, Dr. Horovitz served as Vice President, Business Development and Planning for Bristol-Myers Squibb Company. He also serves as a Director of Avigen, Inc., BioCryst Pharmaceuticals, Inc., DOV Pharmaceutical, Inc., Genaera Corporation, GenVec, Inc., Paligent Inc. and Palatin Technologies, Inc. Dr. Horovitz holds a Ph.D. in pharmacology from the University of Pittsburgh.

Mark Leschly, age 35, became a director in 1996.

Mark Leschly has served as a member of our board of directors since September 1996. Since July 1999, Mr. Leschly has been a Managing Partner with Rho Capital Partners, an investment and venture capital management company. Starting in July 1994 to July 1999, Mr. Leschly was an associate and then a General Partner of HealthCare Ventures, L.L.C., a venture capital management company. From September 1991 to June 1993, Mr. Leschly served as a consultant for McKinsey & Co., a management consulting company. In addition to being a director of Diversa Corporation, a biotechnology company, Mr. Leschly is a director of a number of private companies. Mr. Leschly holds a B.A. degree from Harvard University and an M.B.A. from the Stanford Graduate School of Business.

John W. Littlechild, age 52, became a director in 1999.

John W. Littlechild has served as a member of our board of directors since June 1999. Mr. Littlechild previously served as our President from inception to May 1993 and as a director from May 1992 to December 1997. Since January 1991, he has served as General Partner of HealthCare Ventures, L.L.C., a venture capital management company. He currently serves on the Executive Committee of the Board of Fellows for Harvard Medical School as well as on the Science and Technology Committee and as Chairman of the Microbiology Department Advisory Board. Mr. Littlechild also serves as a director of Dyax Corp. and Orthofix International NV. Mr. Littlechild holds a B.Sc. from the University of Manchester in England and an M.B.A. from the Manchester Business School.

Joseph Loscalzo, M.D., Ph.D., age 52, became a director in 2004.

Joseph Loscalzo, M.D., Ph.D. has served as a member of our board of directors since January 2004. Since 1994 he has been a member of the faculty of Boston University, first as Chief of Cardiology and, since 1997, Chairman of the Department of Medicine. Dr. Loscalzo is also currently the Director of the Whitaker Cardiovascular Institute at Boston University School of Medicine and Physician-in-Chief at the Boston Medical Center. From 1984 to 1994, Dr. Loscalzo was a member of the faculty of Harvard University, where he rose to the rank of Associate Professor of Medicine, and of the staff at Brigham and Women's Hospital, where he became the Director of the Center for Research in Thrombolysis. Dr. Loscalzo holds an A.B., M.D., and a Ph.D. in biochemistry from the University of Pennsylvania.

Davey S. Scoon, age 57, became a director in 2003.

Davey S. Scoon has served as a member of our board of directors since November 2003. Since October 2003, he has been Chief Administrative and Financial Officer of Tom's of Maine. He also serves as Non-Executive Chairman of the Board of Directors of Tufts Health Plan, where he has been a director since 1981. Prior to joining Tom's of Maine, Mr. Scoon served as Chief Administrative and Financial Officer for SunLife Financial from 1999 to 2003. From 1985 to 1999, Mr. Scoon was employed by Liberty Funds Group of Boston (formerly Colonial Management) as Executive Vice

President and Chief Operating Officer. Mr. Scoon holds a B.A. from the University of Wisconsin and an M.B.A. from the Harvard Business School.

Executive Officers

Our executive officers, their respective ages and their positions are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Michael D. Loberg, Ph.D.	56	President and Chief Executive Officer and Director
L. Gordon Letts, Ph.D.	56	Senior Vice President, Research and Development and Chief Scientific Officer
Joseph Grimm	53	Senior Vice President, Business Development and Chief Financial Officer, Treasurer and Secretary
Manuel Worcel, M.D.	65	Chief Medical Officer

Michael D. Loberg, Ph.D., age 56, has served as a member of our board of directors and as our Chief Executive Officer since September 1997. He has served as President since September 2003. From 1996 to January 1997, Dr. Loberg served as President of Bristol-Myers Squibb Company’s Oncology and Immunology division, a pharmaceuticals company. From 1994 to 1996, Dr. Loberg served as President of Bristol-Myers Squibb Company’s U.S. Primary Care division. Dr. Loberg also serves as a director of Advanced Magnetics, Inc. Dr. Loberg holds a B.S. in chemistry from Trinity College and a Ph.D. in chemistry from Washington University.

L. Gordon Letts, Ph.D., age 56, has served as our Senior Vice President, Research and Development and as our Chief Scientific Officer since May 1997. From December 1993 to May 1997, Dr. Letts served as our Vice President, Research. From 1987 to 1993, he served as Director of Pharmacology for Boehringer Ingelheim Pharmaceuticals, a United States subsidiary of a German pharmaceuticals company. Dr. Letts currently serves as a Vice President of the International Association of Inflammation Societies and serves on the scientific advisory board of IPS Pharma, Inc., a privately-held biopharmaceutical company. Dr. Letts holds a Ph.D. in pharmacology from Sydney University.

Joseph Grimm, age 53, has served as our Senior Vice President, Business Development, and as our Chief Financial Officer since April 1999. Mr. Grimm has tendered his resignation as our Senior Vice President, Business Development and Chief Financial Officer, Treasurer and Secretary, effective as of the earlier of September 1, 2004 or the date when a new Chief Financial Officer begins employment with us. From October 1997 to January 1999, he served as Chief Financial Officer of Alpha-Beta Technology, Inc., a biopharmaceutical company, and from May 1986 to April 1997, he served as Vice President Finance and Treasurer of Genetics Institute, Inc., a biopharmaceutical company. Mr. Grimm holds a B.A. from the University of Wisconsin and a M.B.A. from the University of Minnesota.

Manuel Worcel, M.D., age 65, has served as our Chief Medical Officer since 1997. He also served as our President from September 1993 to September 2003. From 1993 to 1997, Dr. Worcel also served as our Chief Executive Officer and as a director. From 1989 to 1993, Dr. Worcel served as Head of Cardiovascular Research and Development of Ciba Geigy Corp., a pharmaceutical company. Dr. Worcel has served as a professor at the Institut de la Sante et de la Recherche Medicale in France and is currently a Fellow of the Hypertension Council of the American Heart Association. Dr. Worcel holds a M.D. from the University of Buenos Aires.

Audit Committee

We have a separately-designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. The members of our Audit Committee are Davey S. Scoon, Robert S. Cohen and Zola Horovitz, Ph.D.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our directors, executive officers and the holders of more than 10% of our common stock to file with the SEC initial reports of ownership of our common stock and other equity securities on a Form 3 and reports of changes in such ownership on a Form 4 or Form 5. Officers, directors and 10% stockholders are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. Based solely on a review of our records and written representations by the persons required to file these reports, we believe that all filing requirements of Section 16(a) were satisfied with respect to our most recent fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

Executive Compensation

The table below sets forth the total compensation paid or accrued for the fiscal years ended December 31, 2003, 2002 and 2001 to our chief executive officer and each of our three most highly compensated other executive officers who were serving as executive officers on December 31, 2003 and whose total annual compensation exceeded \$100,000 for the year ended December 31, 2003. We refer to these officers as our named executive officers.

Summary Compensation Table

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation Awards	All Other Compensation (2)
		Salary	Bonus	Other Annual Compensation (\$)	Number of Securities Underlying Options	
Michael D. Loberg, Ph.D. President and Chief Executive Officer	2003	\$319,693	\$136,889	—	230,000	\$1,032
	2002	304,560	90,577	293,208(1)	—	1,032
	2001	284,502	74,682	27,405(3)	60,000	552
Manuel Worcel, M.D. Chief Medical Officer	2003	259,121	87,588	—	130,000	3,048
	2002	246,774	52,439	—	—	1,558
	2001	238,451	44,705	—	30,000	1,492
L. Gordon Letts, Ph.D. Senior Vice President, Research and Development and Chief Scientific Officer	2003	239,080	77,596	—	130,000	976
	2002	227,689	46,750	35,843(3)	65,000	490
	2001	219,989	36,298	51,540(3)	30,000	469
Joseph Grimm (4) Senior Vice President, Business Development, Chief Financial Officer, Treasurer and Secretary	2003	216,243	72,574	—	95,000	459
	2002	205,947	38,512	—	—	430
	2001	198,989	32,825	—	25,000	411

- (1) Amount represents loan forgiveness of principal and accrued interest, including a gross up on taxable amounts resulting from the forgiveness of interest.
- (2) Amount represents the payment of premiums on group term life insurance.
- (3) Amount represents loan forgiveness of principal and accrued interest, including a gross up on taxable amounts resulting from the forgiveness of both principal and interest.
- (4) Mr. Grimm has tendered his resignation as our Senior Vice President, Business Development, Chief Financial Officer, Treasurer and Secretary, effective as of the earlier of September 1, 2004 or the date when a new Chief Financial Officer begins employment with us.

Option Grants in Last Fiscal Year

The following table sets forth certain information concerning grants of stock options to purchase shares of our common stock made to executive officers named in the Summary Compensation Table during the fiscal year ended December 31, 2003.

Option Grants in Last Fiscal Year

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (1)	
	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price	Expiration Date	5%	10%
Michael D. Loberg, Ph.D. .	100,000	10%	\$2.00	06/17/2013	\$125,779	\$ 318,748
	130,000	13%	\$7.98	12/01/2013	652,415	1,653,348
Manuel Worcel, M.D.	55,000	6%	\$2.00	06/17/2013	69,178	175,312
	75,000	8%	\$7.98	12/01/2013	376,393	953,855
L. Gordon Letts, Ph.D.	55,000	6%	\$2.00	06/17/2013	69,178	175,312
	75,000	8%	\$7.98	12/01/2013	376,393	953,855
Joseph Grimm	35,000	4%	\$2.00	06/17/2013	44,023	111,562
	60,000	6%	\$7.98	12/01/2013	301,115	763,084

(1) Amounts reported in these columns represent amounts that may be realized upon exercise of the stock options immediately prior to the expiration of their term assuming the specified compounded rates of appreciation (5% and 10%) on our common stock over the term of the stock options, net of exercise price. These numbers are calculated based on the requirements of the Securities and Exchange Commission and do not reflect our estimate of future stock price growth. Actual gains, if any, on stock option exercises will depend on the future performance of our common stock and the date on which the options are exercised.

Aggregated Option Exercises and Fiscal Year-End Option Value Table

The following table sets forth certain information regarding the exercise of stock options during the fiscal year ended December 31, 2003 and the number and value of unexercised options held as of December 31, 2003 by the executive officers named in the Summary Compensation Table.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

Name	Shares Acquired on Exercise (#)	Value Realized (\$)(1)	Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)	Value of Unexercised In-The-Money Options at Fiscal Year-End \$(2)
			Exercisable/Unexercisable	Exercisable/Unexercisable
Michael D. Loberg, Ph.D. . .	—	—	212,940/272,060	\$1,325,822/\$745,023
Manuel Worcel, M.D.	30,469	58,500	317,345/151,930	\$1,985,240/\$403,733
L. Gordon Letts, Ph.D.	100,525	138,672	182,695/210,430	\$1,112,708/\$707,056
Joseph Grimm	—	—	115,965/110,335	\$ 731,704/\$262,971

- (1) Value represents the difference between the exercise price per share and the fair market value per share of our common stock on the date of exercise, multiplied by the number of shares acquired on exercise.
- (2) Value is based on the difference between the closing sale price per share of our common stock on December 31, 2003, the last trading day of the fiscal year ended December 31, 2003 (\$7.185), and the applicable option exercise price, multiplied by the number of shares subject to the option.

Employment Letters

We have entered into employment letters with the following executive officers: Dr. Loberg, Dr. Worcel and Dr. Letts. Each of these agreements provide for severance payments in the event of a termination by us without cause up to an amount equal to six months of such executive officer's base salary. In addition, Dr. Worcel's agreement provides that in the event of a sale of our company prior to July 1 of any calendar year, Dr. Worcel will receive 50% of his scheduled bonus for such year, and if such sale occurs anytime after July 1 of any calendar year, he will be entitled to 100% of his scheduled bonus for such year.

We are in the process of negotiating a Severance and Settlement Agreement and Release with Mr. Grimm to set forth the terms that will govern his separation from the company. We anticipate that Mr. Grimm will remain as Senior Vice President, Business Development and Chief Financial Officer, Treasurer and Secretary until the earlier of September 1, 2004 or the date when a new Chief Financial Officer is hired. Upon his separation, we currently anticipate that Mr. Grimm will receive six months of his base salary as severance pay and a bonus payment equal to \$3,739.21 per each bi-monthly pay period between January 1, 2004 and his separation date. In addition, for the six-month period after Mr. Grimm's separation, we anticipate that we will contribute toward the health and dental insurance premiums for Mr. Grimm's coverage. We anticipate that we will accelerate the vesting of Mr. Grimm's options to purchase 31,418 shares of the company's common stock and will provide Mr. Grimm with twelve months after his separation date in which to exercise such options. Finally, we anticipate that Mr. Grimm will be available to provide consulting services to us through December 31, 2004 at the rate of \$2,500 per day.

Each executive officer has signed our standard form of invention and non-disclosure agreement, providing for protection of our confidential information and ownership of intellectual property developed by such executive officer and our standard form of non-competition and non-solicitation agreement, providing for a one-year non-compete and one year non-solicitation agreement.

Compensation of Directors

Effective August 2003, we compensate our directors for service on the board of directors in the amount of \$4,000 per quarter. In addition, members of the audit committee will receive \$2,000 per committee meeting and members of the compensation committee and nominating and corporate governance committee will receive \$1,000 per committee meeting. The chair of the audit committee will receive an additional \$2,000 per year, and the chair of the compensation committee and the chair of the nominating and corporate governance committee will each receive an additional \$1,000 per year. Directors are reimbursed for reasonable travel and other expenses incurred in connection with attending meetings of the board of directors and its committees.

Directors are also eligible to participate in our amended and restated 2003 stock incentive plan. In August 2003, the board of directors adopted a program under which each non-employee director is eligible to receive an option to purchase 20,000 shares of our common stock upon his appointment to the board and also is eligible to receive an annual grant of an option to purchase 10,000 shares of our common stock at each year's annual meeting at which he serves as a director. All options granted under our director option program vest in four equal annual installments beginning on the first anniversary of the grant date. Each option terminates on the earlier of ten years from the date of grant or 90 days after the optionee ceases to serve as a director, except in the case of death or disability, in which event the option terminates three months from the date of the director's death or disability. Mr. Loberg's options terminate one year from his death or disability. The exercise price of these options equals the fair market value of our common stock on the date of grant.

In accordance with our director stock option program in effect in 2003, in November 2003 we granted Mr. Scoon an option to purchase 20,000 shares of our common stock at an exercise price of \$8.90 per share, which was the closing sale price of our common stock, as reported on the NASDAQ National Market, on the date of grant, upon his appointment to the board of directors.

For information regarding consulting fees paid to members of our board of directors, see “Item 13. Certain Relationships and Related Transactions—Consulting Arrangements.”

Compensation Committee Interlocks and Insider Participation

The members of the Compensation Committee during the fiscal year ended December 31, 2003 were Dr. Karabelas and Messrs. Cohen and Leschly. No member of the Compensation Committee was at any time during the fiscal year ended December 31, 2003, or formerly, an officer or employee of NitroMed or any subsidiary of NitroMed, nor has any member of the Compensation Committee had any relationship with NitroMed during the fiscal year ended December 31, 2003 requiring disclosure under Item 404 of Regulation S-K under the Securities Exchange Act of 1934.

None of our executive officers has served as a director or member of the compensation committee (or other committee serving an equivalent function) of any other entity, one of whose executive officers served as a director of or member of the Compensation Committee of NitroMed.

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

Security Ownership

The following table sets forth information regarding beneficial ownership of our common stock as of April 16, 2004 by:

- each person or entity that beneficially owns more than 5% of the outstanding shares of our common stock,
- each of our directors,
- our chief executive officer and our three other most highly compensated executive officers on December 31, 2003, and
- all of our directors and executive officers as a group.

The number of shares of common stock beneficially owned by each person or entity is determined in accordance with the applicable rules of the Securities and Exchange Commission and includes voting or investment power with respect to shares of our common stock. The information is not necessarily indicative of beneficial ownership for any other purpose. Unless otherwise indicated, to our knowledge, all persons named in the table have sole voting and investment power with respect to their shares of common stock, except to the extent authority is shared by spouses under community property laws. The

inclusion of any shares deemed beneficially owned in this table does not constitute an admission of beneficial ownership of those shares.

<u>Name and Address of Beneficial Owner (1)</u>	<u>Number of Shares Owned</u>	<u>Common Stock Underlying Options Acquirable Within 60 Days</u>	<u>Total Beneficial Ownership</u>	<u>Percentage of Common Stock Beneficially Owned (2)</u>
5% Stockholders				
Funds Managed by HealthCare Ventures, L.L.C. (3) 44 Nassau Street, Second Floor Princeton, NJ 08837	6,354,103	—	6,354,103	24.8
Rho Ventures (4) 152 West 57th Street, 23rd Floor New York, NY 10019	5,469,333	—	5,469,333	21.3
Funds Managed by Care Capital LLC (5) 47 Hullfish Street, Suite 310 Princeton, NJ 08542	2,051,533	—	2,051,533	8.0
Delaware Management Holdings (6) 2005 Market Street Philadelphia, PA 19103	2,044,300	—	2,044,300	8.0
Johnson & Johnson Development Corporation . . . One Johnson & Johnson Plaza New Brunswick, NJ 08933	1,342,207	—	1,342,207	5.2
Directors and Named Executive Officers				
Michael D. Loberg, Ph.D. (7)	359,384	233,970	593,354	2.3
Manuel Worcel	53,758	328,310	382,068	1.5
L. Gordon Letts, Ph.D.	100,125	200,160	300,285	1.2
Joseph Grimm	34,383	123,632	158,015	*
Robert S. Cohen	—	25,000	25,000	*
Argeris Karabelas, Ph.D. (8)	2,051,533	7,500	2,059,033	8.0
Zola Horovitz, Ph.D.	—	25,000	25,000	*
Mark Leschly (9)	5,489,333	—	5,489,333	21.4
John W. Littlechild (10)	6,361,603	5,625	6,367,228	24.8
Joseph Loscalzo	3,449	72,551	76,000	*
Davey S. Scoon	—	—	—	*
All directors and executive officers as a group (11 persons)	14,453,568	1,021,748	15,475,316	60.3

* Less than 1% of our outstanding common stock.

- (1) Unless otherwise indicated, the address of each stockholder is NitroMed, Inc., 12 Oak Park Drive, Bedford, MA 01730.
- (2) Percentage of beneficial ownership is based on 25,644,862 shares of our common stock outstanding as of April 16, 2004. Shares of common stock subject to options currently exercisable, or exercisable within 60 days of April 16, 2004, are deemed outstanding for computing the percentage of the person holding such options but are not deemed outstanding for computing the percentage for any other person.
- (3) Consists of 2,407,472 shares of common stock held by HealthCare Ventures III, L.P.; 707,033 shares of common stock held by HealthCare Ventures IV, L.P.; 1,240,788 shares of common stock held by HealthCare Ventures V, L.P.; and 1,998,810 shares of common stock held by HealthCare Ventures VI, L.P. Mr. Littlechild, a director of NitroMed, is a general partner of HealthCare Partners III, L.P., the general partner of HealthCare Ventures, III, L.P., HealthCare Partners IV, L.P., the general partner of HealthCare Ventures IV, L.P., HealthCare Partners V, L.P., the general partner of HealthCare Ventures V, L.P. and HealthCare Partners

VI, L.P., the general partner of HealthCare Ventures VI, L.P. Mr. Littlechild disclaims beneficial ownership of the shares held by each of the funds managed by HealthCare Ventures, L.L.C., except to the extent of his pecuniary interest therein.

- (4) Consists of 3,268,877 shares of common stock held by Rho Management Trust II; 378,884 shares of common stock held by Rho Ventures IV L.P., 891,990 shares of common stock held by Rho Ventures IV (QP) L.P. and 929,582 shares of common stock held by Rho Ventures IV GmbH & Co., Beteiligungs KG. Mark Leschly, a director of NitroMed, is a Managing Member of the general partner of Rho Ventures IV, L.P. and Rho Ventures IV (QP), L.P., a Managing Director of the general partner of Rho Ventures IV GmbH & Co. Beteiligungs KG and a Managing Partner of the investment advisor to Rho Management Trust II. Mr. Leschly disclaims beneficial ownership of the shares held by each of the funds managed by Rho Capital Partners, Inc. except to the extent of his pecuniary interest therein.
- (5) Consists of 617,486 shares of common stock held by CC/Q Partners, L.P.; 718,677 shares of common stock held by CC/M NitroMed Holdings, L.P.; 281,954 shares of common stock held by CC NitroMed Holdings, L.P.; and 433,416 shares of common stock held by Care Capital Investments II, L.P. Argeris Karabelas, a director of NitroMed, is a partner of Care Capital LLC, the general partner of each of the funds managed by Care Capital LLC.
- (6) Based on a Schedule 13G filed with the Securities and Exchange Commission on February 9, 2004.
- (7) Includes 72,776 shares of common stock held in trust for the benefit of Dr. Loberg's children of which Dr. Loberg disclaims beneficial ownership except to the extent of his pecuniary interest therein.
- (8) Includes 2,051,533 shares of common stock held by funds managed by Care Capital LLC. (See Note 4 above).
- (9) Includes 5,469,333 shares of common stock held by funds managed by Rho Ventures. Mark Leschly, a director of NitroMed, is a Managing Member of the general partner of Rho Ventures IV, L.P. and Rho Ventures IV (QP), L.P., a Managing Director of the general partner of Rho Ventures IV GmbH & Co. Beteiligungs KG and a Managing Partner of the investment advisor to Rho Management Trust II. Mr. Leschly disclaims beneficial ownership of the shares held by each of the funds managed by Rho Capital Partners, Inc. except to the extent of his pecuniary interest therein.
- (10) Includes 6,354,103 shares of common stock held by funds managed by HealthCare Ventures, L.L.C. Mr. Littlechild, a director of NitroMed, is a general partner of HealthCare Partners III, L.P., the general partner of HealthCare Ventures III, L.P., HealthCare Partners IV, L.P., the general partner of HealthCare Ventures IV, L.P., HealthCare Partners V, L.P., the general partner of HealthCare Ventures V, L.P. and HealthCare Partners VI, L.P., the general partner of HealthCare Ventures VI, L.P. Mr. Littlechild disclaims beneficial ownership of the shares held by each of the funds managed by HealthCare Ventures, L.L.C., except to the extent of his pecuniary interest therein.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of December 31, 2003 about the securities authorized for issuance under our equity compensation plans, consisting of our 1993 Equity Incentive Plan, our Amended and Restated 2003 Stock Incentive Plan, and our 2003 Employee Stock Purchase Plan. All of our equity compensation plans were adopted with the approval of our stockholders.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (1) (c)
Equity compensation plans approved by stockholders	2,898,584	\$2.62	1,545,494
Equity compensation plans not approved by stockholders	—	—	—
Total:	2,898,584	\$2.62	1,545,494

(1) Includes 1,472 shares of our common stock issuable under our 1993 Equity Incentive Plan, 1,544,022 shares of our common stock issuable under our Amended and Restated 2003 Stock Incentive Plan and no shares of our common stock issuable under our 2003 Employee Stock Purchase Plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Issuance of Series E Convertible Preferred Stock

In August 2003, we sold an aggregate of 2,776,347 shares of our series E convertible preferred stock at a price per share of \$7.2037 for an aggregate purchase price of approximately \$19.9 million. Of these 2,776,347 shares, an aggregate of 2,639,365 shares of series E convertible preferred stock were sold to the directors, officers and five percent stockholders and their affiliates named below. These shares automatically converted into shares of our common stock upon the closing of our initial public offering on November 11, 2003 at a conversion ratio of 1.1526 shares of common stock for each share of series E convertible preferred stock then held.

<u>Name</u>	<u>Series E Convertible Preferred Stock</u>	<u>Purchase Price</u>
Rho Ventures (1)	1,665,808	\$11,999,981
Funds managed by HealthCare Ventures, L.L.C. (2)	416,452	2,999,995
Funds managed by Care Capital LLC (3)	557,105	4,013,217
Total:	2,639,365	\$19,013,194

- (1) Consists of 1,060,132 shares of series E preferred stock purchased by Rho Management Trust II; 104,288 shares of series E preferred stock purchased by Rho Ventures IV, L.P.; 245,520 shares of series E preferred stock purchased by Rho Ventures IV (QP), L.P.; and 255,868 shares of series E preferred stock purchased by Rho Ventures IV GmbH & Co. Beteiligungs KG. Mark Leschly, a director of NitroMed, is a Managing Member of the general partner of Rho Ventures IV, L.P. and Rho Ventures IV (QP), L.P., a Managing Director of the general partner of Rho Ventures IV GmbH & Co. Beteiligungs KG and a Managing Partner of the investment advisor to Rho Management Trust II.
- (2) Consists of 208,226 shares of series E preferred stock purchased by HealthCare Ventures V, L.P. and 208,226 shares of series E preferred stock purchased by HealthCare Ventures VI, LP. John W. Littlechild, a director of NitroMed, is a general partner of HealthCare Ventures, L.L.C., the general partner of each of the funds managed by HealthCare Partners V, L.P., the general partner of HealthCare Ventures V, L.P., and HealthCare Partners VI, L.P., the general partner of HealthCare Ventures VI, L.P.
- (3) Consists of 91,231 shares of series E preferred stock purchased by CC/M NitroMed Holdings, L.P.; 15,167 shares of series E preferred stock purchased by CC NitroMed Holdings, L.P.; 78,386 shares of series E preferred stock purchased by CC/Q Partners, L.P.; and 372,321 shares of series E preferred stock purchased by Care Capital Investments II, L.P. Argeris Karabelas, a director of NitroMed, is a partner of Care Capital LLC, the general partner of each of the funds managed by Care Capital LLC.

Registration Rights

Certain holders of our common stock, including shares of our common stock underlying warrants, are entitled to require us to register their shares of common stock or participate in a registration of shares of common stock by us under the Securities Act of 1933. These rights are provided under the

terms of stockholders' agreements between us and these holders. These holders include the following directors, officers and holders of more than five percent of our voting securities and their affiliates:

<u>Name of Holder</u>	<u>Number of Registrable Shares of Common Stock</u>
Funds managed by HealthCare Ventures, L.L.C. (1)	6,354,103
Rho Ventures (2).	5,169,375
Funds managed by Care Capital LLC (3)	2,051,533
Johnson & Johnson Development Corporation	1,342,207
Michael D. Loberg	286,608
Joseph Grimm	34,383
Manuel Worcel	23,289
Total:	<u>15,261,498</u>

- (1) John W. Littlechild, a director of NitroMed, is a general partner of HealthCare Partners III, L.P., the general partner of HealthCare Ventures III, L.P., HealthCare Partners IV, L.P., the general partner of HealthCare Ventures IV, L.P., HealthCare Partners V, L.P., the general partner of HealthCare Ventures V, L.P., and HealthCare Partners VI, L.P., the general partner of HealthCare Ventures VI, L.P.
- (2) Mark Leschly, a director of NitroMed, is a Managing Member of the general partner of Rho Ventures IV, L.P. and Rho Ventures IV (QP), L.P., a Managing Director of the general partner of Rho Ventures IV GmbH & Co. Beteiligungs KG and a Managing Partner of the investment advisor to Rho Management Trust II.
- (3) Argeris Karabelas, a director of NitroMed, is a partner of Care Capital LLC, the general partner of each of the funds managed by Care Capital LLC.

Boston University

Dr. Loscalzo, a member of our board of directors, is the Chairman of the Department of Medicine at Boston University Medical School, Physician-in-Chief, Boston Medical Center and Director of the Whitaker Cardiovascular Institute at the Boston Medical Center.

Dr. Loscalzo has served as a consultant since 1992 and as the chair of our scientific advisory board since 1999. In October 2003, we entered into a consulting agreement with Dr. Loscalzo, as amended in April 2004, pursuant to which we have agreed to pay Dr. Loscalzo an annual retainer of \$55,000 for his services. The agreement is for a period of ten years, subject to the Company's right to terminate the agreement at any time on 30 days' notice. In 2003, we paid Dr. Loscalzo an aggregate of \$70,000.

In June 1993, as amended in January 1999 and May 2003, we entered into a research and license agreement with the Trustees of Boston University, or BU. Under the agreement, we have agreed to fund a multi-year research program under Dr. Loscalzo's direction at BU in the area of nitric oxide-enhancing medicines. Our funding is principally for laboratory equipment and supplies as well as a portion of the salary of Martin Feelish, Ph.D., a professor of medicine at BU and a member of our scientific advisory board. We have also agreed to provide Dr. Feelish with access to our research facilities at the BU School of Medicine. Under the agreement, in exchange for our sponsored research funding, BU has granted us exclusive worldwide royalty-bearing rights to technology and inventions owned by BU at the effective time of, or developed in the course of, the sponsored research program. We have agreed to pay royalties to BU on all products sold or distributed by us or our affiliates which incorporate or utilize inventions, material or information specified in the agreement. In 2003, we made payments to BU in the amount of \$295,750 pursuant to this agreement, excluding the lease payments described below.

In May 2003, we entered into an oral agreement with BU pursuant to which we lease approximately 1,500 square feet of laboratory space from BU at its Evans Biomedical Research Center in Boston, Massachusetts. The lease has a term of three years and we make annual rental payments of \$60,000 pursuant to the lease. As provided above, we have agreed to make this space available to Dr. Feelish of BU. In 2003, we made payments to BU under this agreement in the amount of \$30,000.

For executive officer compensation and option exercise information, see “Item 11. Executive Compensation.”

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Independent Auditor’s Fees

The following table summarizes the fees of Ernst & Young LLP, our independent auditor, billed to us for each of the last two fiscal years for audit services and billed to us in each of the last two years for other services:

<u>Fee Category</u>	<u>2003</u>	<u>2002</u>
Audit Fees (1)	\$442,700	\$48,000
Audit-Related Fees	—	—
Tax Fees (2)	11,300	11,300
All Other Fees	—	—
Total Fees	<u>\$454,000</u>	<u>\$59,300</u>

- (1) Audit fees consist of fees for the audit of our financial statements, the review of the interim financial statements included in our quarterly reports on Form 10-Q, and other professional services provided in connection with regulatory filings or engagements. In 2003, audit fees included services in connection with our initial public offering totaling \$327,000.
- (2) Tax fees consist of fees for tax compliance. Tax compliance services accounted for all of the total tax fees paid for 2003 and 2002.

Pre-Approval Policy and Procedures

The Audit Committee has adopted policies and procedures relating to the approval of all audit and non-audit services that are to be performed by our independent auditor. This policy generally provides that we will not engage our independent auditor to render audit or non-audit services unless the service is specifically approved in advance by the Audit Committee or the engagement is entered into pursuant to one of the pre-approval procedures described below.

From time to time, the Audit Committee may pre-approve specified types of services that are expected to be provided to us by our independent auditor during the next 12 months. Any such pre-approval is detailed as to the particular service or type of services to be provided and is also generally subject to a maximum dollar amount.

The Audit Committee has also delegated to the chairman of the Audit Committee the authority to approve any audit or non-audit services to be provided to us by our independent auditor. Any approval of services by a member of the Audit Committee pursuant to this delegated authority is reported on at the next meeting of the Audit Committee.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this Amendment No. 1 on Form 10-K/A.

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

NITROMED, INC.

Date: April 29, 2004

By: /s/ MICHAEL D. LOBERG, PH.D.

Michael D. Loberg, Ph.D.
President and Chief Executive Officer

CERTIFICATIONS

I, Michael D. Loberg, Ph.D., certify that:

1. I have reviewed this Amendment No. 1 to the Annual Report on Form 10-K/A of NitroMed, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

Dated: April 29, 2004

/s/ MICHAEL D. LOBERG, PH.D.

Michael D. Loberg, Ph.D.

President and Chief Executive Officer

CERTIFICATIONS

I, Joseph Grimm, certify that:

1. I have reviewed this Amendment No. 1 to the Annual Report on Form 10-K/A of NitroMed, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

Dated: April 29, 2004

/s/ JOSEPH GRIMM

Joseph Grimm
Senior Vice President, Business Development and
Chief Financial Officer, Treasurer and Secretary

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Michael A. Marletta, Ph.D.

Kevin McIntyre, M.D., J.D.

Inigo Saenz de Tejada, M.D.

CORPORATE INFORMATION

CORPORATE HEADQUARTERS

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INDEPENDENT AUDITORS

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LEGAL COUNSEL

Hale and Dorr LLP
60 State Street
Boston, MA 02109

TRANSFER AGENT

American Stock Transfer & Trust Company
40 Wall Street, 46th Floor
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(800) 937-5449

STOCK LISTING

NitroMed's common stock is traded on the
Nasdaq National Market under the symbol
NTMD.

WEB SITE

www.nitromed.com

SAFE HARBOR STATEMENT

This annual report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding NitroMed's future financial position, business strategy, and plans and objectives of management for future operations. We may, in some cases, use such words as "believes", "expects", "anticipates", "plans", "estimates" and similar expressions to identify these forward-looking statements.

There are a number of important factors that could cause NitroMed's actual results to differ materially from those indicated by such forward-looking statements, including those risk factors identified in the filings that NitroMed makes from time to time with the SEC. NitroMed disclaims any intention or obligation to update any forward-looking statements as a result of developments occurring after the date such statement was first made.

NITROMED

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