MEXICO FUND INC
Form N-CSR
December 30, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT

INVESTMENT COMPANIES

Investment Company Act file number

811-02409

THE MEXICO FUND, INC.

(Exact name of registrant as specified in charter)

1775 I STREET, N.W.,

WASHINGTON, DC 20006-2401

(Address of principal executive offices) (Zip code)

José Luis Gómez Pimienta

77 ARISTOTELES STREET, 3RD FLOOR

POLANCO D.F. 11560 MEXICO

(Name and address of agent for service)

Copies to:

Sander M. Bieber

Dechert LLP

1775 I STREET, N.W.,

WASHINGTON, DC 20006-2401

Registrant s telephone number, including area code: 202-261-7941

Date of fiscal year end: October 31, 2008

Date of reporting period: October 31, 2008

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Item 1. Reports to Stockholders.

A copy of the Registrant s annual report to stockholders for the period ending October 31, 2008 transmitted to stockholders pursuant to Rule 30e-1 under the Investment Company Act of 1940 is provided below.

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ANNUAL REPORT

www.themexicofund.com

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Managed Distribution Plan (MDP)

On September 4, 2008, the Fund announced that it had received authorization from the Securities and Exchange Commission (SEC) to distribute long-term capital gains to stockholders more frequently than once per year. Accordingly, the Board of Directors formally approved the implementation of a Managed Distribution Plan (MDP) to make quarterly cash distributions to stockholders.

On December 8, 2008, the Fund announced that in light of current market circumstances, the Fund s Board of Directors decided to reduce from 12% to 10% of net asset value (NAV) the amount of annual distributions that the Fund will pay to stockholders under the MDP during 2009. The Fund intends to pay quarterly cash dividends during April, July and October 2009 and January 2010, each for 2.5% of the NAV per share as of December 31, 2008. You should not draw any conclusions about the Fund s investment performance from the amount of these distributions or from the terms of the MDP. The MDP will be subject to regular periodic review by the Fund s Board of Directors.

With each distribution, the Fund will issue a notice to stockholders and an accompanying press release which will provide detailed information regarding the amount and composition of the distribution and other information required by the Fund s exemptive order. The Fund s Board of Directors may amend or terminate the MDP at any time without prior notice to stockholders; however, at this time, there are no reasonably foreseeable circumstances that might cause the termination of the MDP.

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The Mexico Fund, Inc.

The Fund s Management

Directors:

Emilio Carrillo Gamboa *Chairman*

Eugenio Clariond Reyes-Retana

José Luis Gómez Pimienta

Claudio X. González

Robert L. Knauss

Jaime Serra Puche

Marc J. Shapiro

Officers:

José Luis Gómez Pimienta *President and Chief Executive Officer*

Alberto Osorio *Senior Vice President, Treasurer and Chief Financial Officer*

Samuel García-Cuéllar *Secretary*

Carlos H. Woodworth *Corporate Governance Vice President, Chief Compliance Officer*

Eduardo Solano *Investor Relations Vice President*

Sander M. Bieber *Assistant Secretary*

Investment Adviser

Impulsora del Fondo México, S.C.

Custodian

BBVA Bancomer, S.A.

Comerica Bank

Transfer Agent and Registrar

American Stock Transfer & Trust Company

Counsel

Dechert LLP

Creel, García-Cuéllar, Aiza y Enríquez, S.C.

Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP

This report, including the financial statements herein, is transmitted to stockholders of The Mexico Fund, Inc. for their information. It is not a prospectus, circular or representation intended for use in the purchase of shares of the Fund or any securities mentioned in the report.

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The Mexico Fund, Inc.

Annual Report

October 31, 2008

Highlights

The Fund s fiscal 2008 ended on October 31, 2008. This has been a particularly difficult period for world financial markets, affected by a credit crisis caused by the collapse of the sub-prime mortgage market in the United States and some European countries, and by the high prices of energy and food. The S&P500 Index and the Dow Jones Industrials Average lost 37.5% and 33.1%, respectively.

Losses extended to emerging markets, which suffered significantly during October 2008, and the Mexican equity market and the Fund were affected by this declining trend as well. During fiscal 2008, the Fund s market price and net asset value (NAV) per share registered total returns[1] of -54.4% and -55.1%, respectively, compared with -48.3% and -45.3% registered by the Morgan Stanley Capital International Mexico Index and Bolsa IPC Index, respectively.

At the end of October 2008, the Fund s market price and NAV per share were $16.56 and $19.41, respectively, reflecting a discount of 14.68%, compared with 11.77% at the end of fiscal 2007.

The Fund adopted a defensive strategy at the end of fiscal 2008, investing approximately 81.69% of its net assets in equity securities and 18.62% of its net assets in cash equivalent securities.

The Fund has had a non-fundamental investment policy of investing at least 80% of its total assets in equity securities listed on the Mexican Stock Exchange. In December 2008, the Fund s Board of Directors approved a change to this investment policy. Effective March 1, 2009, the Fund may invest at least 80% of its total assets in equity securities listed on the Mexican Stock Exchange, but may reduce its holdings in equity securities listed on the Mexican Stock Exchange below 80% of its total assets for temporary defensive purposes when unusual market or economic conditions occur.

On September 4, 2008, the Fund announced the implementation of an MDP to make quarterly cash distributions to stockholders. The first two distributions under the MDP were made during September and November 2008, for $1.13 each. The Board has announced that the third dividend distribution of fiscal 2008, of $1.2388 per share, will be paid on January 5, 2009 to stockholders of record on December 18, 2008. Together, these three dividends represent 21.1% of the Fund s market price at the end of fiscal 2008.

Mexico s gross domestic product (GDP) increased 1.6% during the third quarter of 2008, compared with 3.7% during the third quarter of 2007.

The Mexican country risk ended this period at 349 basis points, the second lowest after Chile within Latin America.

The Mexico Fund, Inc. is a non-diversified closed-end management investment company with the investment objective of long-term capital appreciation through investments in securities, primarily equity, listed on the Mexican Stock Exchange. The Fund provides a vehicle to investors who wish to invest in Mexican companies through a managed non-diversified portfolio as part of their overall investment program.

Notice is hereby given in accordance with Section 23(c) of the Investment Company Act of 1940 that the Fund may purchase, from time to time, shares of its common stock in the open market.

[1] Performance figures consider reinvestment of dividend distributions.

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The Mexico Fund, Inc.

To Our Stockholders:

We present to you the Fund s 2008 Annual Report. In this Report, we summarize the period s prevailing economic, political and market conditions in Mexico and outline the Fund s investment strategy and resulting performance. We hope you find this Report useful and informative.

Economic Environment

The Mexican economic environment has been affected by several international factors such as a recessionary period in the United States, which is Mexico s most important economic partner, and, during most of fiscal 2008, high prices of energy and food. The Mexican gross domestic product (GDP) increased 1.6% during the third quarter of calendar 2008, compared with 3.7% during the same quarter of 2007, the lowest quarterly growth rate in the last five years, affected by a decline of 0.5% in the United States during the same period. Mexico s industrial production has declined during the last five months and for October 2008 it decreased by 1.8%. Analysts surveyed by Banco de México, Mexico s Central Bank, have adjusted their growth estimates due to the prevailing global economic situation, and now expect that the Mexican GDP will increase approximately 1.8%, 0.4% and 2.5% during 2008, 2009 and 2010, respectively. Under the current global economic environment, in which developed economies may already be suffering a contraction, we believe Mexico offers a relatively better economic outlook for the near future.

The high prices of food and energy that prevailed until mid-2008 and the recent devaluation of the peso against the dollar have affected inflation rates, and for the year ended October 31, 2008 the inflation rate amounted to 5.78%, higher than the 3% ±1% target rate set by the Central Bank. Analysts currently believe that Mexico s inflation rate will be 6.3%, 4.4% and 3.9%, during 2008, 2009 and 2010, respectively.

Domestic interest rates remained stable during this fiscal year and at the end of October 2008 ranged from 7.22% for the 28-day Cetes (Treasury Bills) to 8.80% for the 30-year government bonds, denominated in local currency. Emerging markets country risk levels increased during this period as a consequence of the negative impact felt in the financial sector from the credit crisis. As a result, Mexico s country risk, as measured by the spread between the yields of Mexican sovereign debt instruments denominated in dollars and traded abroad versus US Treasury bonds, increased from a minimum historical level of 70 basis points at the end of May 2007 to 349 basis points at the end of October 2008. Compared with other Latin American countries, Mexico s country risk continues to be, together with Chile, the lowest of the region. Analysts estimate that domestic interest rates will be relatively stable during the remainder of 2008 and 2009, and project that the rate of 28-day Cetes will be 8.0% and 7.4%, respectively, at the end of each year.

The Mexican peso suffered a devaluation of 15.8% versus the US dollar during this fiscal year, with most of the devaluation occurring during October 2008. Some factors that affected the value of the peso against the dollar were the volatile performance of global financial markets, in which aversion towards emerging markets currencies was present; important repatriations of financial assets held in Mexico by some international institutions; and a demand for dollars from Mexican corporations that needed to cover financial liabilities, including

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[1] Performance figures consider reinvestment of dividend distributions.

derivative positions. The rate of exchange ended this period at Ps. 12.71 per dollar, compared with Ps. 10.70 one year earlier. This decline in the value of the peso occurred despite intervention from the Central Bank, which used international reserves to auction dollars during the most volatile days of October 2008. Analysts estimate that the currency market will eventually stabilize and that the exchange rate may finish 2008 and 2009 at Ps. 12.84 and Ps. 12.67, respectively.

The Mexican trade balance deficit increased 17.1% during the first nine months of 2008, when exports and imports grew at rates near 15%. The Mexican government purchased derivative instruments to guarantee a minimum price of $70 per barrel for its oil exports, a strategy that has proven successful given the current level of approximately $33 per barrel for the Mexican oil mix. International reserves at the central bank continue growing as a result of this strategy and currently amount to $83.4 billion.

Management Discussion of Fund s Performance and Portfolio Strategy

For the reasons mentioned above, fiscal 2008 was a difficult period for the Fund and world financial markets alike. During this period, the S&P500 Index declined 37.5% while the Dow Jones Industrials Average lost 33.1%. Particularly during October 2008, emerging markets like Mexico suffered even more as a result of increased risk aversion from international investors and a severe contraction of credit availability, which significantly impacted the market prices of small and medium size listed companies. As a result, the Fund s market price and NAV registered negative total returns[1] of 54.4% and 55.1%, respectively, during fiscal 2008, compared with declines of 48.3% and 45.3% for the Morgan Stanley Capital International Mexico Index and the Bolsa IPC Index, respectively.

The Fund s five portfolio holdings that most contributed to the decline of the Fund s NAV per share during fiscal 2008 were: América Móvil (AMX), a telecommunications company; Grupo México, a mining company; Axtel, a domestic provider of fixed telephone lines; Empresas ICA (ICA), dedicated to infrastructure and construction; and Urbi Desarrollos Urbanos (Urbi), a housing company. During this period, the market prices of these five issuers decreased 48.6%, 69.7%, 80.9%, 79.3% and 62.7%, respectively. The negative performance of these five issuers, together with those of Grupo Cementos de Chihuahua (GCC), producer of cement and Tenaris, a pipe producer for the oil industry, generated most of the relative underperformance of the Fund s NAV against the indices during fiscal 2008, despite the fact that the Fund reduced its investments in these companies since July 2008. At the end of October 2008, the Fund had disposed of its holdings in Tenaris and Axtel.

As of October 31, 2008, the Fund had total net assets of $351.3 million. The composite volume of Fund shares traded on all US consolidated markets during fiscal 2008 was 18,452,295 million shares, compared with 18,100,290 shares outstanding at the end of the period.

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The following chart shows the Fund s portfolio composition by sector, expressed as a percentage of the Fund s net assets, as of October 31, 2008. The Fund adopted a defensive strategy at the end of this fiscal year by holding a higher than usual percentage in dollars which, at the same time, provided resources to pay stockholders the dividend distributions under the MDP. More detailed information about the Fund s portfolio is available below in this report.

Portfolio Composition by Sector

Percentage of Net Assets,

October 31, 2008

The economic recession in the United States and significant increases in energy and commodity prices during most of fiscal 2008 affected operating and net results of listed companies. For the first nine months of 2008, compared with the same period of 2007, sales of listed companies increased 10.1%, EBITDA[2] increased 2.5% and net income fell 14.7%. The average price earnings ratio (PER) of the market decreased from 17.86 times at the end of fiscal 2007, to 11.90 times at the end of October 2008 while the price to book value ratio decreased from 3.30 times to 2.14 times during the same period[3].

Despite the negative outlook for the US economy and its inevitable impact on Mexico, we believe that the recent volatile and declining trend of the Mexican equity market represents an excellent investment opportunity in selected issuers, as it has resulted in low valuations of

[2] EBITDA refers to earnings before interests, taxes, depreciation and amortization.
[3] **Source**: Impulsora del Fondo México, S.C. with figures provided by the Mexican Stock Exchange.

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listed companies with positive fundamentals and management quality. The Fund will continue looking for companies with strong balance sheets, positive free cash flow and proven business models.

Long Term Performance

Notwithstanding the Fund s performance in fiscal 2008, it should be noted that during the previous five fiscal years, the Fund s performance has shown strong results, and has generally been competitive with the Morgan Stanley Capital International Mexico Index and the Bolsa IPC Index, as shown in the chart below.

Discount Reduction Efforts

Discounts of closed-end funds increased to record levels during fiscal 2008 as a consequence of investors aversion towards equity investments and the crisis facing funds that issue auction preferred rate shares. The discount between the Fund s market price and NAV ended October 31, 2008 at 14.68%, compared with 11.8% at the end of fiscal 2007. The Board of Directors closely analyzes and continues to monitor the Fund s discount levels, and has implemented an MDP, as described below.

Declaration of Dividends Under MDP

On September 4, 2008, the Fund announced that it had received authorization from the SEC to distribute long-term capital gains to stockholders more frequently than once per year. Accordingly, the Board of Directors formally approved the implementation of a MDP to make quarterly cash distributions to stockholders. On September 24, 2008 and November 25, 2008, the Fund paid cash dividends each of $1.13 per share, the equivalent of 3% of the Fund s NAV per share as of July 31, 2008. The Fund will pay another dividend of $1.2388 per share on January 5, 2009 to stockholders of record on December 18, 2008. Together, these three distributions corresponding to fiscal 2008 represent 21.1% of the Fund s market price at the end of October 2008. These distributions were comprised entirely of realized long-term capital gains. You should not draw any conclusions about the Fund s investment performance from the amount of these distributions or from the terms of the MDP.

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In light of current market circumstances, the Board has decided to reduce from 12% to 10% of NAV the amount of annual distributions that the Fund will pay to stockholders under the MDP during 2009. The Fund intends to pay quarterly cash dividends during April, July and October 2009 and January 2010, each for 2.5% of the NAV per share as of December 31, 2008. The MDP will be subject to regular periodic review by the Fund s Board of Directors.

With each distribution, the Fund will issue a notice to stockholders and an accompanying press release which will provide detailed information regarding the amount and composition of the distribution and other information required by the Fund s exemptive order. The Fund s Board of Directors may amend or terminate the MDP at any time without prior notice to stockholders; however, at this time, there are no reasonably foreseeable circumstances that might cause the termination of the MDP.

Non-Fundamental Investment Policy Change

The Fund has had a non-fundamental investment policy of investing at least 80% of its total assets in equity securities listed on the Mexican Stock Exchange. In December 2008, the Fund s Board of Directors approved a change to this investment policy. Effective March 1, 2009, the Fund may invest at least 80% of its total assets in equity securities listed on the Mexican Stock Exchange, but may reduce its holdings in equity securities listed on the Mexican Stock Exchange below 80% of its total assets for temporary defensive purposes when unusual market or economic conditions occur.

Concentration Policy

The Fund has adopted a concentration policy that permits it to concentrate its investments in any industry or group of industries in the IPC Index (or any successor or comparable index as determined by the Board of Directors to be an appropriate measure of the Mexican market) if, at the time of investment, such industry represents 20% or more of the IPC Index; provided, however, that the Fund will not exceed the IPC Index concentration by more than 5%.

At the end of October 2008, the only industry group that represented 20% or more of the value of the securities included in the IPC Index is the communications industry group. This industry includes local, long-distance, and cellular telephone companies, as well as broadcast and media companies. Approximately 85.32% of this industry group is comprised of stocks of telecommunications companies. At the end of October 2008, 30.69% of the Fund s net assets were invested in this industry group. This is compared with the communications industry group s weighting of approximately 39.77% of the IPC Index. The Fund s Investment Adviser will continue to evaluate the concentration in this industry and may, at its discretion, choose not to concentrate in this industry group in the future or to concentrate in other industries subject to the concentration policy described above.

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Periodic Repurchase Offer Authority

On March 6, 2002, the Fund announced the Board s approval of a policy to conduct periodic in-kind repurchase offers at no less than 98% of NAV for up to 100% of the Fund s outstanding shares. This policy is intended to provide additional liquidity to Fund shares and to reduce the discount at which Fund shares have been trading on the NYSE. Under this policy which was approved by stockholders and is the subject of exemptive relief granted by the Securities and Exchange Commission (SEC), the Fund offers to repurchase no less than five percent of the Fund s outstanding shares each fiscal year, based on the number of shares outstanding at the beginning of the fiscal year. Repurchase offers are in-kind and conducted at least once each fiscal year, but not more frequently than quarterly, and are for between one and one hundred percent of the Fund s outstanding shares. The Board can set or reset the periodic interval between repurchase offers at three, six or twelve months. The Board of Directors of the Fund has announced that the Fund s next repurchase offer will occur during March 2009 for an amount not yet determined.

The repurchase offers are not part of a plan to liquidate the Fund. Stockholder participation in the repurchase offers is not mandatory as stockholders can continue to purchase and sell Fund shares in cash transactions on the NYSE. The Fund continues to provide a convenient professionally managed vehicle for investing in Mexico.

Proxy Voting

Information is available about how the Fund voted proxies during the twelve-month period ending June 30, 2008, without charge, upon request, by calling collect Mr. Eduardo Solano, the Fund s Investor Relations Vice President, and on the SEC s website at www.sec.gov. The Fund s and the Fund s Investment Adviser s proxy voting policies and procedures are on the Fund s website, www.themexicofund.com under the heading Corporate Governance , the SEC s website at www.sec.gov or are available without charge, upon request, by calling Mr. Eduardo Solano. Mr. Solano can be contacted at (+52 55) 5282-8900, during Mexico City business hours (10:00 am to 3:00 pm and 5:00 to 7:00 pm ET).

Bylaw Amendments

The Board of Director approved certain changes to the Fund s Bylaws at its September 18, 2008 meeting. The most significant changes are summarized herein:

Special Meetings of Stockholders These revision update the procedures required for stockholders to call a special meeting of stockholders, including provisions that (a) clarify which stockholders may call a special meeting, and (b) expand the information required to be provided by stockholders requesting a special meeting (such information could include information regarding a stockholder s ownership of shares or other information required to comply with the federal proxy rules).

Voting and Inspector These revisions empower the Board or the chairman of the stockholders meeting to appoint an inspector for any matter, rather than solely with respect to the election of directors.

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Advance Notice of Stockholder Nominations for Director and Other Stockholder Proposals These revisions update the advance notice provisions for stockholder nominations for director and stockholder business proposals. The purpose of these provisions is to provide the Board with sufficient time and information to adequately consider and respond to a stockholder nomination or proposal.

Timing of Notice for Annual Meetings The Bylaws formerly required advance notice of director nominations and other stockholder proposals to be brought at an annual stockholders meeting at least 90 and not more than 120 days prior to the first anniversary of the previous year s annual stockholders meeting. The Bylaws now require advance notice of director nominations and other stockholder proposals to be brought at an annual stockholders meeting not earlier than the 150th day and not later than 5:00 p.m., Eastern Time, on the 120th day prior to the first anniversary of the date of the preceding year s proxy statement.

Timing of Notice for Special Meetings The Bylaws formerly required a 90/120-day advance notice period for director nominations to be brought at a special stockholders meeting. The Bylaws now require notice of director nominations at a special meeting to be delivered not earlier than the 150th day and not later than 5:00 p.m., Eastern Time, on the 120th day prior to the date of any special meeting or, if later, the tenth day after announcement of the meeting date and the Board s nominees.

Content of Notice The revisions (a) expand the information required to be provided by the stockholder making the proposal or nomination, including information regarding the hedging activities and investment strategies of such stockholder and the stockholder s affiliates, and (b) establish procedures for verifying and updating information provided by the stockholder making the proposal. These revisions are intended to promote good corporate governance by providing the Board and stockholders with important information about a proposing stockholder s economic interest in the Fund and whether it is aligned with the interests of other stockholders.

Reliance This revision clarifies that directors and officers may rely on information prepared or presented by others whom the director or officer reasonably believes to be reliable and competent in the matters presented.

Ratification This revision clarifies the power of the Board and stockholders to ratify prior actions or inactions by the Fund, and provide that matters questioned in litigation may be ratified, and that any such ratification bars any claim or execution of any judgment as to such questioned matter.

Emergency Provisions This revision provides the Board with procedural flexibility in the event of an emergency (e.g., a shorter prior notice period and reduced quorum requirement for Board meetings).

Delegation of Board Power to Committees This revision eliminate unnecessary language restricting the Board s power to delegate various matters to committees so that the Bylaws will be no more restrictive than required by applicable law.

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Fixing of Record Date Under Maryland law, a meeting of stockholders may be adjourned to a date not more than 120 days after the original record date without notice other than announcement at the meeting. The revisions clarify that if a meeting of stockholders is adjourned to a date more than 120 days after the original record date, a new record date must be set for the same meeting. If this procedure is followed, any proxies previously solicited from stockholders who continue to be stockholders as of the new record date remain valid.

Indemnification and Insurance The Bylaws now provide that directors and officers are entitled to indemnification, and that the Fund may pay or reimburse expenses of directors and officers, to the maximum extent permitted by Maryland law and the Investment Company Act of 1940, as amended (1940 Act).

Investor Relations; Reports to Stockholders

We are working on an updated and improved version of the Fund s website to now offer additional information about dividend distributions and the recently implemented MDP. We continue to offer a daily update of the Fund s market price and NAV per share and a downloadable database containing the most important historical figures for the Fund. Documentation of the Fund s most recent in-kind repurchase offer and rights offering are available at the website section titled Corporate Actions . The website section Insiders Filings provides direct hyperlinks to filings made by Directors, Officers of the Fund and its Investment Adviser regarding transactions in Fund shares, which are available at the Securities and Exchange Commission s website (http://www.sec.gov). The Fund also has placed governance documents on the website under the section titled Corporate Governance , including the Fund s Articles, By-laws and committee charters.

The Fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The Fund s complete Schedules of Investment and Statements of Assets and Liabilities for the first and third quarters of its fiscal year are also available electronically on the Fund s website under the tab Portfolio . The Fund s Form N-Q filings are available on the SEC s website at www.sec.gov or may be reviewed and copied at the SEC s Public Reference Room in Washington, DC (information regarding which may be obtained by calling 1-800-SEC-0330). Electronic versions of the Fund s semi-annual and annual reports, Monthly Summary Reports and Proxy Statements are published on the Fund s website under the section Investor Reports . Stockholders will receive printed versions of the Fund s semi-annual and annual reports. This information is also available on the Fund s quarterly electronic Form N-Q filings submitted to the SEC. Stockholders who desire to receive, electronically upon their dissemination, public reports and press releases regarding the Fund should contact the Fund s Investor Relations Office via e-mail (see address below). We hope that the Fund s web site is a useful resource for information and we will continue working to improve it.

Stockholders may contact the Investment Adviser via telephone, in Mexico City, at (+52 55) 5282-8900. Please ask for Mr. Eduardo Solano, the Fund s Investor Relations Vice President. Personnel to answer your

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questions are regularly available from 10:00 am to 3:00 pm and from 5:00 pm to 7:00 pm ET. The Fund recently appointed The Altman Group as its Public Relations and Proxy Solicitation Agent. The Fund has developed a database of investors who have opted-in to receive periodic updates about the Fund via e-mail. You can fax or e-mail your request to be included in this list to:

Patricia Baronowski

The Altman Group

(860) 204-9468

pbaronowski@altmangroup.com

If you prefer to directly contact the Fund via e-mail, please direct your e-mail inquiries to:

Investor Relations Office

investor-relations@themexicofund.com

Information on the Fund s NAV and market price per share is also published weekly in The Wall Street Journal, The New York Times and other newspapers in a table called Closed-End Funds . The Fund s NYSE trading symbol is MXF.

The Fund s Dividend Reinvestment Plan and Transfer Agent is:

American Stock Transfer & Trust Company

59 Maiden Lane Plaza Level

New York, NY 10038

(800) 937-5449

Dividend Reinvestment Plan

The Fund s Dividend Reinvestment Plan (the Plan) provides a convenient way to increase your holdings in the Common Stock of the Fund through the reinvestment of net investment income and capital gain distributions. Under the terms of the Plan, Fund shareholders are automatically enrolled as participants in the Plan. If you do not wish to participate in the Plan, please contact the Plan Agent. Upon any termination of participation under the Plan, the Plan Agent will cause a share certificate for the appropriate number of full shares to be delivered to the participant along with a cash adjustment for any fractional shares. At a stockholder s request, the Plan Agent will sell the participant s shares and remit any proceeds to the participant, net of brokerage commissions. Stockholders who do not participate in the Plan will receive all distributions in cash.

Under the terms of the Plan, whenever the Fund declares a distribution, Plan participants will receive their distribution entirely in shares of Common Stock purchased either in the open market or from the Fund. If, on the date a distribution becomes payable or such other date as may be specified by the Fund s Board of Directors (the valuation date), the market price of the Common Stock plus estimated brokerage commissions is equal to or exceeds the NAV per share of Common Stock, the Plan Agent will invest the distribution in newly issued shares of Common

Stock, which will be valued at the greater of NAV per share or the current market price on the valuation date. If on the valuation date, the market price of the Common Stock plus estimated brokerage

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commissions is lower than the NAV per share, the Plan Agent will buy Common Stock in the open market. As a participant in the Plan, you will be charged a *pro-rata* portion of brokerage commissions on all open market purchases.

If your shares are registered or will be registered in the name of a broker-dealer or any other nominee, you must contact the broker-dealer or other nominee regarding his or her status under the Plan, including whether such broker-dealer or nominee will participate in the Plan on your behalf. Generally, shareholders receiving Common Stock under the Plan will be treated as having received a distribution equal to the amount payable to them in cash as a distribution had the stockholder not participated in the Plan.

If you have any questions concerning the Plan or would like a copy of the Plan brochure, please contact the Plan Agent:

American Stock Transfer & Trust Company

Attention: Dividend Reinvestment Department

59 Maiden Lane Plaza Level

New York, NY 10038

(800) 937-5449

New York Stock Exchange Certifications

The Fund is listed on the New York Stock Exchange (NYSE). As a result, it is subject to certain corporate governance rules and related interpretations issued by the NYSE. Pursuant to those requirements, the Fund must include information in this report regarding certain certifications. The Fund s President and Treasurer have filed certifications with the SEC regarding the quality of the Fund s public disclosure. Those certifications were made pursuant to Section 302 of the Sarbanes-Oxley Act (Section 302 Certifications). The Section 302 Certifications were filed as exhibits to the Fund s annual report on Form N-CSR, which included a copy of this annual report along with other information about the Fund. After the Fund s 2008 annual meeting of stockholders, it filed a certification with the NYSE stating that its President was unaware of any violation of the NYSE s Corporate Governance listing standards.

* * *

Despite the negative performance of fiscal 2008, the Fund has experienced five prior fiscal years of positive performance. We will continue working hard to offer stockholders our best efforts to find the most attractive investment opportunities in the Mexican equity market. We hope you find this report useful and informative, and we thank you for your continued confidence in the Fund.

Sincerely yours,

José Luis Gómez Pimienta
President

Emilio Carrillo Gamboa
Chairman of the Board

December 29, 2008

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The Mexico Fund, Inc.

Directors and Officers Biographical Data

(as of November 1, 2008)

Independent Directors

Name, Address and Age	Position(s) Held With the Fund*, Term of Office and Length of Time Served	Principal Occupation for Past Five Years and Other Directorships	Other Directorships Held by Director
Jaime Serra Puche+ Edificio Plaza Prolongación Paseo de la Reforma 600-103 Santa Fe Peña Blanca 01210 México, D.F. México Age: 57	Class I Director; Term expires 2009; Director since 1997.	Dr. Serra is a Senior Partner of the law and economics consulting firm SAI Consultores, S.C. Dr. Serra is a former Secretary of Finance for Mexico and he was the minister in charge of negotiations for NAFTA and trade agreements between Mexico and Chile, Bolivia, Venezuela, Colombia and Costa Rica on behalf of the Mexican government. Formerly, Dr. Serra has served as a Visiting Professor at Princeton University, Stanford University and New York University. He was also Secretary of Trade and Industry (Mexico) and a Distinguished Visiting Associate at the Carnegie Endowment for International Peace. He has a Ph.D. in economics from Yale University. Dr. Serra also serves as Co-Chairman of the President s Council on International Activities of Yale University.	Director, Vitro, S.A. de C.V. (glass manufacturer); Director, Tenaris (tube producer); Director, Chiquita Brands, Inc. (fruit producer).
Marc J. Shapiro+ 707 Travis, 11th Floor Houston, TX 77002 Age: 61	Class I Director; Term expires 2009; Director since 2006.	Since 2003, Mr. Shapiro has served as Non-Executive Chairman of Chase Bank of Texas. Prior to that time, he was Vice Chairman of JPMorgan Chase (banking and financial services).	Director, Burlington Northern Santa Fe (railroad); Director, Kimberly-Clark (consumer goods); Director, Weingarten Realty (real estate investment).

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The Mexico Fund, Inc.

Independent Directors, continued

Name, Address and Age	Position(s) Held With the Fund*, Term of Office and Length of Time Served	Principal Occupation for Past Five Years and Other Directorships	Other Directorships Held by Director
Claudio X. González+ Jaime Balmes 8 Los Morales Polanco México, D.F. 11510 México Age: 74	Class II Director; Term expires 2010; Director since 1981.	Mr. González was President of the Business Coordinating Council of Mexico. He has served as Chairman of the Board (from March 1973 to the present) and Chief Executive Officer (from March 1973 to March 2007) of Kimberly-Clark de México S.A. de C.V., a consumer products company. Mr. González is also on the Board of Directors of several prominent U.S. and Mexican companies, including General Electric Co.	Director, General Electric Co. (industrial and financial products); Director, Investment Company of America (investment fund).
Robert L. Knauss+ c/o Aristóteles 77, 3rd Floor Col. Polanco 11560 México, D.F. México Age: 77	Class II Director; Term expires 2010; Director since 1985.	Mr. Knauss served as Chairman of the Board and Principal Executive Officer of Philips Services Corp. (industrial services) (1998-2003) and also served as Chairman of the Board and Chief Executive Officer of Baltic International USA, Inc. (investments) (1995-2003). During the past twenty years Mr. Knauss has served on the Boards of Directors of eight public companies. Mr. Knauss was the former Dean and Distinguished University Professor of University of Houston Law School and was also Dean of Vanderbilt Law School.	Director, Equus Total Return Inc. (investment company); Director, XO Holdings, Inc. (telecommunications); Director, Westpoint International Inc. (home products).

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The Mexico Fund, Inc.

Independent Directors, continued

Name, Address and Age	Position(s) Held With the Fund*, Term of Office and Length of Time Served	Principal Occupation for Past Five Years and Other Directorships	Other Directorships Held by Director
Eugenio Clariond Reyes-Retana+ Av. Vasconcelos #220 Ote. Col. Santa Engracia 66220 Garza Garcia, N.L. Mexico Age: 65	Class III Director; Term expires 2011; Director since 2005.	From January 1981 to November 2006, Mr. Clariond was Chairman of the Board and Chief Executive Officer of Grupo IMSA, S.A., a manufacturer of steel, aluminum and plastic products for the construction industry. From December 2004 to the present, he has served as the Non-Executive Chairman of Verzatec, S. de R.L. de C.V., a manufacturer of aluminum and plastic products. From June 2007 to the present, Mr. Clariond has served as Chairman of Amanco, a producer of pipe systems, connections and plastic accessories for the conduction of fluids, electricity and gas. Mr. Clariond also acts as Chairman of the Mexico- United States Business Committee of the Mexican Business Council for Foreign Trade, Investment & Technology, and he serves on the boards of various other U.S. and Mexican non-profit organizations and educational institutions.	Director, Navistar International Corp. (truck and engine manufacturer); Director, Johnson Controls, Inc. (automotive components, air conditioning, controls).

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The Mexico Fund, Inc.

Independent Directors, concluded

Name, Address and Age	Position(s) Held With the Fund*, Term of Office and Length of Time Served	Principal Occupation for Past Five Years and Other Directorships	Other Directorships Held by Director
Emilio Carrillo Gamboa+ Blvd. Manuel Avila Camacho No. 1, Ste. 609 Polanco 011009 México, D.F. México Age: 71	Class III Director; Term expires 2011; Director 1981-1987 and since 2002.	Mr. Carrillo Gamboa served as a director of the Fund from inception of the Fund in 1981 to 1987. He resigned as director in 1987 to become Mexico s Ambassador to Canada. Mr. Carrillo Gamboa was reelected as a Director of the Fund in 2002. Mr. Carrillo Gamboa is a prominent lawyer in Mexico with extensive business experience and has been a partner of the Bufete Carrillo Gamboa, S.C. law firm since 1989. He has also served or currently serves on the boards of many Mexican charitable organizations.	Director, Southern Copper Corporation (copper mining).

* There are no other funds in the Fund Complex.

\+ Audit Committee, Contract Review Committee, and Nominating and Corporate Governance Committee member. Member or alternate member of the Valuation Committee.

The directorships required to be reported under this column are those held in a company with a class of securities (1) registered pursuant to Section 12 of the Exchange Act, (2) subject to the reporting requirements of Section 15(d) of the Exchange Act, or (3) registered as an investment company under the 1940 Act.

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The Mexico Fund, Inc.

Interested Director

Name, Address and Age	Position(s) Held With the Fund*, Term of Office and Length of Time Served	Principal Occupation for Past Five Years and Other Directorships	Other Directorships Held by Director
José Luis Gómez Pimienta**+ Aristóteles 77, 3rd Floor Col. Polanco 11560 México, D.F. México Age: 69	President of the Fund; Class II Director; Term expires 2010; Director since 1989.	Mr. Gómez Pimienta has over two decades of experience investing in the Mexican securities market. He has been the President of the Fund since its inception and has also served as a Director since 1989. Mr. Gómez Pimienta has been Chairman of the Board of the Fund s investment adviser, Impulsora del Fondo México, S.C., since 1987 and Chief Executive Officer since inception.	None.

* There are no other funds in the Fund Complex.

** Director is an interested director (as defined in the 1940 Act). Mr. Gómez Pimienta is deemed to be an interested director by reason of his affiliation with the Investment Adviser.

\+ Member or alternate member of the Valuation Committee.

The directorships required to be reported under this column are those held in a company with a class of securities (1) registered pursuant to Section 12 of the Exchange Act, (2) subject to the reporting requirements of Section 15(d) of the Exchange Act, or (3) registered as an investment company under the 1940 Act.

Officers Who Are Not Directors

Name, Address and Age	Position(s) Held With the Fund*, Term of Office+ and Length of Time Served	Principal Occupation(s) During Past Five Years
Samuel García-Cuéllar Creel, García-Cuéllar, Aiza y Enríquez, S.C., Paseo de los Tamarindos 60-3er piso Bosques de las Lomas 05120 México, D.F.	Secretary since 1981.	Mr. García-Cuéllar is a partner of Creel, García-Cuéllar, Aiza y Enríquez, S.C., Mexican counsel to the Fund; Director, GE Capital Bank, S.C. Institución de Banca Múltiple, GE Capital Grupo Financiero (bank) (since 2002); Director, GE Capital Grupo Financiero, S.A. de C.V. (financial group) (since 2002).

México Age: 66		
Alberto Osorio Morales Aristóteles 77, 3rd Floor Col. Polanco 11560 México, D.F. México Age: 40	Senior Vice President since 2008; Treasurer since 2002; formerly, Vice President of Finance from 1999 to 2002.	Mr. Osorio currently serves as Deputy Director of the Fund s investment adviser, Impulsora del Fondo México, S.C. and has been an employee of the Adviser since 1991.

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The Mexico Fund, Inc.

Officers Who Are Not Directors, concluded

Name, Address and Age	Position(s) Held With the Fund*, Term of Office+ and Length of Time Served	Principal Occupation(s) During Past Five Years
Carlos H. Woodworth Ortiz Aristóteles 77, 3rd Floor Col. Polanco 11560 México, D.F. México Age: 65	Chief Compliance Officer and Corporate Governance Vice President since 2002; formerly, Treasurer from 1992 to 2002.	Mr. Woodworth has served on the Board of Directors of the Fund s investment adviser, Impulsora del Fondo México, S.C., as well as Deputy Director of the Adviser since 1981.
Eduardo Solano Arroyo Aristóteles 77, 3rd Floor Col. Polanco 11560 México, D.F. México Age: 40	Investor Relations Vice President since 1997.	Mr. Solano has served as Director of Economic Research of the Fund s investment adviser, Impulsora del Fondo México, S.C. since 1997 and has been an employee of the Adviser since 1991.
Sander M. Bieber 1775 I Street, N.W. Washington, DC 20006 Age: 58	Assistant Secretary since 1989.	Partner of Dechert LLP, U.S. counsel to the Fund and the Independent Directors.

* There are no other funds in the Fund Complex.
\+ Officers of the Fund are appointed by the directors and serve at the pleasure of the Board.

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The Mexico Fund, Inc.

Schedule of Investments

as of October 31, 2008

Shares Held	Value (Note 1)

95% efficacy) from individual patients. CIMM is also developing a process for maintaining and propagating Kupffer's cells reproducibly in defined cell cultures from fine needle liver aspirates from living humans. In January 2001 CIMM filed a Notice of Invention with the U.S. Patent Office. As a result, a patent application entitled "Replication of Human Kupffer's cells obtained from HCV Infected Patients By Fine Needle Biopsy Technique", was submitted. This method can potentially salvage critically needed liver function without major surgery or aggressive medical intervention. We are also evaluating potential novel clinical programs which would involve using Ampligen(R) to treat both HCV and HIV when they coexist on the same patient. We expect to commence these studies in collaboration with one or more prospective corporate partners. A collaborative Clinical study in Europe, in conjunction with Laboratorios Del Dr. Esteve S.A., is expected to commence in early 2004. We have acquired a series of patents on Oragen(TM), potentially an oral broad spectrum antiviral, immunological enhancer through a licensing agreement with Temple University in Philadelphia, PA. We were granted an exclusive worldwide license from Temple for the Oragen(TM) products. Pursuant to the arrangement, we are obligated to pay royalties of 2% on sales of Oragen(TM), depending on how much technological assistance is required of Temple. We currently pay minimum royalties of $30,000 per year to Temple. These compounds have been evaluated in various academic and government laboratories for application to chronic viral and immunological disorders. Research and development of Oragen(TM) is on hold at this time. An FDA authorized Phase I/II study of Ampligen(R) in cancer, including patients with renal cell carcinoma was completed in 1994. The results of this study indicated that patients receiving high doses (200-500mg) twice weekly experienced an increase in medium survival compared to the low dose group and as compared to an historical control group. We received authorization from the FDA to initiate a Phase II 40 study using Ampligen(R) to treat patients with metastatic renal cell carcinoma. Patients with metastatic melanoma were included in the Phase I/II study of Ampligen(R) in cancer. The FDA has authorized us to conduct a Phase II clinical trial using Ampligen(R) in melanoma. We do not expect to devote any significant resources to funding these studies in the near future. ALFERON N INJECTION(R) Interferons are a group of proteins produced and secreted by cells to combat diseases. Researchers have identified four major classes of human interferon: alpha, beta, gamma and omega. The ALFERON N Injection(R) product contains a multi-species form of alpha interferon. The worldwide market for injectable alpha interferon-based products has experienced rapid growth and various alpha interferon injectable products are approved for many major medical uses worldwide. Alpha interferons are manufactured commercially in three ways: by genetic engineering, by cell culture, and from human white blood cells. All three of these types of alpha interferon are or were approved for commercial sale in the U.S. Our natural alpha interferon is produced from human white blood cells. The potential advantages of natural alpha interferon over recombinant interferon may be based upon their respective molecular compositions. natural interferon is composed of a family of proteins containing many molecular species of interferon. In contrast, recombinant alpha interferon each contain only a single species. Researchers have reported that the various species of interferons may have differing antiviral activity depending upon the type of virus. Natural alpha interferon presents a broad complement of species, which we believe may account for its higher efficacy in laboratory studies. Natural alpha interferon is also glycosylated (partially covered with sugar molecules). Such glycosylation is not present on the currently marketed recombinant alpha interferons. We believe that the absence of glycosylation may be, in part, responsible for the production of interferon-neutralizing

antibodies seen in patients treated with recombinant alpha interferon. Although cell culture-derived interferon is also composed of multiple glycosylated alpha interferon species, the types and relative quantity of these species are different from our natural alpha interferon. On October 10, 1989, the FDA approved ALFERON N Injection(R) for the intralesional (within lesions) treatment of refractory (resistant to other treatment) or recurring external genital warts in patients 18 years of age or older. Certain types of human papillomaviruses ("HPV") cause genital warts, a sexually transmitted disease ("STD"). A published report estimates that approximately eight million new and recurrent causes of genital warts occur annually in the United States alone. Basically, our interest in acquiring Alferon N Injection(R) was driven by two factors; (1) Our belief that its use in combination with Ampligen(R) has the potential to increase the positive therapeutic responses in chronic life threatening viral diseases. Combinational therapy is evolving to the standard of acceptable medical care based on a detailed examination of the Biochemistry of the body's natural antiviral immune response, (2) New knowledge about the competitive products in the interferon arena that we believe imply a large untapped market and potential new therapeutic indication for Alferon N Injection(R) which could accelerate its revenues in the near term. Specifically, the recombinant DNA derived alpha interferon are now reported to have dramatically decreased effectiveness after one year, probably due to antibody formation and other severe toxicities. These detrimental effects have not been reported with Alferon N Injection(R) which could allow this product to assume a much larger market share. These 41 revenues would provide operational capital to complete the Phase III clinical trials of our experimental drug, Ampligen(R) in a more cost effective, non-dilutive manner on a shareholder's equity. Alferon N Injection(R) [Interferon alfa-n3 (human leukocyte derived)] is a highly purified, natural-source, glycosylated, multispecies alpha interferon product. There are essentially no antibodies observed against natural interferon to date and the product has a relatively low side-effect profile. Alferon is the only natural-source, multispecies alpha interferon currently sold in the U.S. The Alferon N Injection(R) targeted market consists of urologists, proctologists, dermatologists, and Obstetricians/Gynecologists. These physicians normally see patients with papilloma concondylomas (genital warts) in their practice. This will be done in existing partnership with our strategic partners including Gentiva Health Services, Biovail Corporation and Esteve Laboratories, all of which have proven marketing expertise. According to the NIH, there are one million new cases of venereal warts every year. Pipeline Products (Alpha Interferon) The following products, together with other assets are to be acquired upon the closing of the second ISI agreement, which is anticipated to occur in January 2004. ALFERON N Injection(R) -Other Applications ALFERON N Injection(R) has been approved by the U.S. FDA for the intralesional treatment of refractory or recurring external genital warts in patients 18 years of age or older and has been studied for the potential treatment of HIV, Hepatitis C and other indications. ISI, the company from which we obtained our rights to ALFERON N Injection(R) has conducted clinical trials with regard to the use of ALFERON N Injection(R) in the treatment of HIV and Hepatitis C. While ISI found the results to be encouraging, in both instances, the FDA determined that additional trials were necessary. ALFERON N Gel ALFERON N GEL is a topical (dermatological) Natural Alpha Interferon preparation in a hydrophilic gel base. This product is still in research and development. ALFERON LDO ALFERON LDO is the low-dose, oral liquid formulation of Natural Alpha Interferon. Two Phase 2 clinical trials using ALFERON LDO for the treatment of HIV-infected patients have been completed. There can be no assurance that any of these proposed products will be cost-effective, safe, and effective or that we will be able to obtain FDA approval for such use. Furthermore, even if such approval is obtained, there can be no assurance that such products will be commercially successful or will produce significant revenues or profits for us. EUROPEAN OPERATIONS Our European operations were set up to prepare for the introduction of Hemispherx products and to accelerate market penetration into the European market once full approval is obtained from the European 42 Medicine Evaluation Agency ("EMEA"). The EMEA is the equivalent of the United States FDA. From a regulatory point of view the member countries of the European Economic Union ("EEU") represent a common market under the jurisdiction of the EMEA. However, from a practical point of view, every country is different regarding developing relations with the medical community, patient associations and obtaining reimbursement for treatment from the equivalent of Social Security Agencies and insurance carriers. This program will be integrated into our new commercial asset, ALFERON N Injection(R), as well. Our European operations have assisted the growth of a number of patient/physician educational associations. The French Chronic Fatigue Syndrome Association has grown from ten members in the year 2000 to 800 currently. Every major country now has an active educational association with substantial numbers of members who regularly meet and "network". These programs have been modeled on the successful experience in the U.S. of conducting twice a year meetings on ME/CFS with Health and Human Services, FDA, NIH and Centers for Disease Control. We maintain contact with the EMEA, keeping the agency aware of our

activities, as well as the health ministries in numerous countries in the European Union. In early 2001, our application for "orphan" drug status for the use of Ampligen(R) in ME/CFS was rejected because the Board found that the prevalence of ME/CFS was significantly above the five person per 10,000 limit required to grant orphan drug status in the European Union. In addition, we are exploring various ways to accelerate the commercial availability of our products in the various nations of the EEU, including potential appreciation of the "foreign import" rule for accepting products already approved in the U.S. Limited number ME/CFS patients were treated during 2002 with Ampligen(R) in the United Kingdom, Austria and Belgium under existing regulatory procedures in these countries, which allow the therapeutic use of an experimental drug under certain conditions. These procedures allowed us to recover the cost of Ampligen(R) used as well as to collect additional clinical data. Corresponding procedures are being considered in several other countries at the request of locally based physicians. Our European operations are considering implementing clinical trials in Europe for the use of Ampligen(R) in the treatment of HIV/AIDS on the basis of the new U.S. Protocols involving the use of the drug either in combination with "cocktail" therapies or as part of a strategic interruption of the "cocktail" therapies. We presented results of one these programs (AMP 720) at the LAS Conference on HIV Pathogenesis and Treatment in Paris, France, in July 2003. The efforts of our European operation has started to produce results. In March 2002, our European subsidiary Hemispherx Biopharma Europe, S.A. ("Hemispherx, S.A.") entered into a Sales and Distribution Agreement with Laboratorios Del Dr. Esteve S.A. ("Esteve"). Pursuant to the terms of the Agreement, Esteve was granted the exclusive right to market Ampligen(R) in Spain, Portugal and Andorra ("Territory") for the treatment of ME/CFS. In addition to other terms and other projected payments, Esteve paid an initial and non-refundable fee of 625,000 Euros (approximately $563,000) to Hemispherx, S.A. on April 24, 2002. Esteve is to pay a fee of 1,000,000 Euros after U.S. FDA approval of Ampligen(R) for the treatment of ME/CFS and a fee of 1,000,000 Euros upon Spain's approval of the final marketing authorization for using Ampligen(R) for the treatment of ME/CFS. The agreement runs for the longer of ten years from the date of first arms-length sale in the Territory, the expiration of the last Hemispherx patent exploited by Esteve or the period of regulatory data protection for Ampligen(R) in the applicable territory. Pursuant to the terms of the agreement Esteve is to conduct clinical trials using Ampligen(R) to treat patients with both HCV and HIV and is required to purchase certain minimum annual amounts of Ampligen(R). The agreement is terminable by either party if Ampligen(R) is withdrawn from the territory for a specified period due to serious adverse health or safety reasons, bankruptcy, insolvency or related issues of one of the parties; or material breach of the agreement. Hemispherx may transform the agreement into a non-exclusive agreement or terminate the agreement in the event that Esteve does not meet specified percentages of its 43 annual minimum purchase requirements under the agreement. Esteve may terminate the agreement in the event that Hemispherx fails to supply Ampligen(R) to the territory for a specified period of time or certain clinical trials being conducted by Hemispherx are not successful. We continue negotiations with other prospective partners for the marketing and distribution of Ampligen(R) in other European territories on terms similar to the Esteve agreement. MANUFACTURING We outsource the manufacturing of Ampligen(R) to certain contractor facilities in the United States and South Africa while maintaining full quality control and supervision of the process. Nucleic Acid polymers constitute the raw material used in the production of Ampligen(R). We acquire our raw materials from Ribotech, Ltd. ("Ribotech") located in South Africa. Ribotech, is jointly owned by us (24.9%) and Bioclones (Proprietary), Ltd. (75.1%). Bioclones manages and operates Ribotech. Two manufacturers in the United States are available to provide the polymers if Ribotech is unable to supply our needs. Sourcing our needs from other suppliers could result in a cost increase for our raw materials. Until 1999, we distributed Ampligen(R) in the form of a freeze-dried powder to be formulated by pharmacists at the site of use. We perfected a production process to produce ready to use liquid Ampligen(R) in a dosage form, which will mainly be used upon commercial approval of Ampligen(R). At the present time, we have engaged the services of Schering-Plough Products to mass produce ready-to-use Ampligen(R) doses. There are other pharmaceutical processing companies that can supply our production needs. Bioclones (PTY) Ltd. is headquartered in South Africa and is the majority owner in Ribotech, Ltd. (we own 24.9%) which produces most of the polymers used in manufacturing Ampligen(R). The licensing agreement with Bioclones presently includes South Africa, South America, Ireland, New Zealand and the United Kingdom. We currently occupy and use the New Brunswick, New Jersey laboratory and production facility owned by ISI. We are in the process of acquiring title to these facilities pursuant to our second asset acquisition agreement with ISI (see "Management's Discussion and Analysis of Financial Condition and Results of Operations; Liquidity And Capital Resources" for more details). This facility is approved by the FDA for the manufacture of Alferon N Injection(R). Good Manufacturing Practices (GMP) require that a product be consistently manufactured to an identical potency (strength) and purity with each lot, and that the manufacturing facility itself and all

the equipment therein, be certified to operate within a strict set performance standards. MARKETING/DISTRIBUTION Our marketing strategy for Ampligen(R) reflects the differing health care systems around the world, and the different marketing and distribution systems that are used to supply pharmaceutical products to those systems. In the U.S., we expect that, subject to receipt of regulatory approval, Ampligen(R) will be utilized in four medical arenas: physicians' offices, clinics, hospitals and the home treatment setting. We currently plan to use a service provided in the home infusion (non-hospital) segment of the U.S. market to execute direct marketing activities, conduct physical distribution of the product and handle billing and collections. Accordingly, we are developing marketing plans to facilitate the product distribution and medical support for indication, if and when they are approved, in each arena. We believe that this approach will facilitate the generation of revenue without incurring the substantial costs associated with a sales force. Furthermore, management believes that the approach will enable us to retain many options for future 44 marketing strategies. In February 1998, we and Gentiva Health Services (formerly Olstein Health Services) entered into a Distribution/Specialty Agreement for the distribution of Ampligen(R) for the treatment of ME/CFS patients under the U.S. treatment protocols. In Europe, we plan to adopt a country-by-country and, in certain cases, an indication-by-indication marketing strategy due to the heterogeneity regulation and alternative distribution systems in these area. We also plan to adopt an indication-by-indication strategy in Japan. Subject to receipt of regulatory approval, we plan to seek strategic partnering arrangements with pharmaceutical companies to facilitate introductions in these areas. The relative prevalence of people from target indications for Ampligen(R) varies significantly by geographic region, and we intend to adjust our clinical and marketing planning to reflect the specialty of each area. In South America, the United Kingdom, Ireland, Africa, Australia, Tasmania, New Zealand, and certain other countries and territories, we contemplate marketing our product through our relationship with Bioclones pursuant to the Bioclones Agreement. Our marketing and distribution plan for Alferon N Injection(R) is focused on increasing the sales of Alferon N Injection(R) for the intralesional treatment of refractory and recurring external genital warts in adults. We will reach out to a targeted audience of physicians consisting of OB/GYNSs, Urologists, Proctologists and Dermatologists and simultaneously create product awareness in the patient population through several media and health organizations. Different regional meetings and seminars are scheduled during which guest speakers will explain the therapeutic benefits and safety profile of Alferon. Additional exposure will be created by exhibiting at several STD related conferences, expanded web presence, mailings and publications. We also plan to engage a contract sales organization in order to build up a nationwide network of dedicated representatives in the U.S. and Europe. This will be done while working with our strategic partners including Gentiva Health Services, Biovail Corporation and Esteve Laboratories. For more information about our arrangements with Gentiva Health Services, Bioclones, Esteve and Biovail. See "Research And Development/Collaborative Agreements" below. On August 18, 2003, we entered into a sales and marketing agreement with Engitech, Inc. to distribute Alferon N Injection(R) on a nationwide basis. Engitech, Inc. is to develop and implement marketing plans including extensive scientific and educational programs for use in marketing Alferon N Injection(R). COMPETITION Our potential competitors are among the largest pharmaceutical companies in the world, are well known to the public and the medical community, and have substantially greater financial resources, product development, and manufacturing and marketing capabilities than we have. These companies and their competing products may be more effective and less costly than our products. In addition, conventional drug therapy, surgery and other more familiar treatments will offer competition to our products. Furthermore, our competitors have significantly greater experience than we do in pre-clinical testing and human clinical trials of pharmaceutical products and in obtaining FDA, EMEA Health Protection Branch ("HPB") and other regulatory approvals of products. Accordingly, our competitors may succeed in obtaining FDA EMEA and HPB product approvals more rapidly than us. If any of our products receive regulatory approvals and we commence commercial sales of our products, we will also be competing with respect to manufacturing efficiency and marketing capabilities, areas in which we have no experience. Our competitors may possess or obtain patent protection or other intellectual property rights that prevent, limit or otherwise adversely affect our ability to develop or exploit our products. 45 The major competitors with drugs to treat HIV diseases include Gilead Pharmaceutical, Pfizer, Bristol-Myers, Abbott Labs, Glaxo Smithkline and Schering-Plough Corp. ("Schering"). ALFERON N Injection(R) currently competes with a product produced by Schering for treating genital warts. 3M Pharmaceutical also has received FDA approval for its immune response modifier product for the treatment of genital and perianal warts. GOVERNMENT REGULATION Regulation by governmental authorities in the U.S. and foreign countries is and will be a significant factor in the manufacture and marketing of ALFERON N products and our ongoing research and product development activities. Ampligen(R) and the products developed from the ongoing research and

product development activities will require regulatory clearances prior to commercialization. In particular, new human drug products for humans are subject to rigorous preclinical and clinical testing as a condition for clearance by the FDA and by similar authorities in foreign countries. The lengthy process of seeking these approvals, and the ongoing process of compliance with applicable statutes and regulations, has required, and will continue to require the expenditure of substantial resources. Any failure by us or our collaborators or licensees to obtain, or any delay in obtaining, regulatory approvals could materially adversely affect the marketing of any products developed by us and our ability to receive product or royalty revenue. We have received orphan drug designation for certain therapeutic indications, which might, under certain conditions, accelerate the process of drug commercialization. ALFERON N Injection(R) is only approved for use in intralesional treatment of refractory or recurring external genital warts in patients 18 years of age or older. Use of Alferon N Injection(R) for other applications requires regulatory approval. A "Fast-Track" designation by the FDA, while not affecting any clinical development time per se, has the potential effect of reducing the regulatory review time by fifty percent (50%) from the time that a commercial drug application is actually submitted for final regulatory review. Regulatory agencies may apply a "Fast Track" designation to a potential new drug to accelerate the approval and commercialization process. Criteria for "Fast Track" include: a) a devastating disease without adequate therapy and b) laboratory or clinical evidence that the candidate drug may address the unmet medical need. As of December 17, 2003, we have not received a Fast-Track designation for any of our potential therapeutic indications although we have received "Orphan Drug Designation" for both ME/CFS and HIV/AIDS in the U.S. We will continue to present data from time to time in support of obtaining accelerated review. We have not yet submitted any New Drug Application (NDA) for Ampligen(R) or any other drug to a North American regulatory authority. There are no assurances that such designation will be granted, or if granted, there are no assurances that Fast Track designation will materially increase the prospect of a successful commercial application. In 2000 we submitted an emergency treatment protocol for clinically-resistant HIV patients, which was withdrawn by us during the statutory 30 day regulatory review period in favor of a set of individual physician-generated applications. There are no assurances that authorizations to commence such treatments will be granted by any regulatory authority or that the resultant treatments, if any, will support drug efficacy and safety. In 2001, we did receive FDA authorization for two separate Phase IIb HIV treatment protocols in which our drug is combined with certain presently available antiretroviral agents. Interim results were presented in 2002 and 2003 at various international scientific meetings. We are subject to various federal, state and local laws, regulations and recommendations relating to such matters as safe working conditions, laboratory and manufacturing practices, the experimental use of animals and the use of and disposal of hazardous or potentially hazardous substances, including radioactive compounds and infectious disease agents, used in connection with our research work. We believe that our Rockville, Maryland manufacturing and quality assurance/control facility is in substantial compliance with all material regulations applicable to these activities as advanced by the European Union Inspections team 46 which conducted detailed audits in year 2000. The ISI laboratory and production facility in New Brunswick, New Jersey, which we are currently using and are in the process of acquiring title to, is approved for the manufacture of Alferon N Injection(R) and we believe it is in substantial compliance with all material regulations. However, we cannot give assurances that facilities owned and operated by third parties, that are utilized in the manufacture of our products, are in substantial compliance, or if presently in substantial compliance, will remain so. These third party facilities include manufacturing operations in San Juan, Puerto Rico; Cape town, South Africa; Columbia, Maryland, and Melbourne, Australia. RESEARCH AND DEVELOPMENT/COLLABORATIVE AGREEMENTS In 1994, we entered into a licensing agreement with Bioclones (Proprietory) limited ("Bioclones") for manufacturing and international market development in Africa, Australia, New Zealand, Tasmania, the United Kingdom, Ireland and certain countries in South Africa, of Ampligen(R) and Oragen(TM). Bioclones is to pursue regulatory approval in the areas of its franchise and is required to conduct Hepatitis clinical trials, based on international GMP and GLP standards. Thus far, these Hepatitis studies have not yet commenced to a meaningful level. Bioclones has been given the first right of refusal, subject to pricing, to manufacture that amount of polymers utilized in the production of Ampligen(R) sufficient to satisfy at least one-third of the worldwide sales requirement of Ampligen(R) and other nucleic acid-derived drugs. Pursuant to this arrangement, we received: 1) access to worldwide markets, 2) commercial-scale manufacturing resources, 3) a $3 million cash payment in 1995 from Bioclones, 4) a 24.9% ownership in Ribotech, Ltd., a company set up by Bioclones to develop and manufacture RNA drug compounds, and 5) royalties of 8% on Bioclones nucleic acid-derived drug sales in the licensed territories. The agreement with Bioclones terminates three years after the expiration of the last of the patents supporting the license granted to Bioclones, subject to earlier termination by the parties for uncured defaults under the agreement, or bankruptcy or

insolvency of either party. The last patent expires on December 22, 2012. In August, 1998, we entered into a strategic alliance with Gentiva to develop certain marketing and distribution capacity for Ampligen(R) in the United States. Gentiva is one of the nation's largest home health care companies with over 400 offices and sixty thousand caregivers nationwide. Pursuant to the agreement, Gentiva assumed certain responsibilities for distribution of Ampligen(R) for which they received a fee. Through this arrangement, Hemispherx may mitigate the necessity of incurring certain up-front costs. Gentiva has also worked with us in connection with the Amp 511 ME/CFS cost recovery treatment program, Amp 516 ME/CFS Phase III clinical trial and the Amp 719 (combining Ampligen with other antiviral drugs in HIV-salvage therapy and Amp 720 HIV Phase IIb clinical trials now under way). There can be no assurances that this alliance will develop a significant commercial position in any of its targeted chronic disease markets. The agreement had an initial one year term from February 9, 1998 with successive additional one year terms unless either party notifies the other not less than 180 days prior to the anniversary date of its intent to terminate the agreement. Also, the agreement may be terminated for the uncured defaults, or bankruptcy, or insolvency of either party and will automatically terminate upon our receiving an NDA for Ampligen(R) from the FDA, at which time, a new agreement will need to be negotiated with Gentiva or another major drug distributor. There were no initial fees and subsequent fees paid under this agreement total $59,000 for services performed. We have acquired a series of patents on Oragen(TM), potentially an oral broad spectrum antiviral, immunological enhancer through a licensing agreement with Temple University. We were granted an exclusive worldwide license from Temple for the Oragen(TM) products. Pursuant to the arrangement, we are obligated to pay royalties of 2% to 4% on sales of Oragen(TM), depending on how much technological assistance is required of Temple. There were no initial fees and we currently pay minimum royalties of $30,000 per year to Temple. These compounds have been evaluated in various academic and government 47 laboratories for application to chronic viral and immunological disorders. This agreement is to remain in effect until the date that the last licensed patent expires unless terminated sooner by mutual consent or default due to royalties not being paid. The last Oragen(TM) patent expires on August 22, 2015. In December, 1999, we entered into an agreement with Biovail Corporation International ("Biovail"). Biovail is an international full service pharmaceutical company engaged in the formulation, clinical testing, registration and manufacture of drug products utilizing advanced drug delivery systems. Biovail is headquartered in Toronto, Canada. The agreement grants Biovail the exclusive distributorship of our product in the Canadian territories subject to certain terms and conditions. In return, Biovail agrees to conduct certain pre-marketing clinical studies and market development programs, including without limitation, expansion of the Emergency Drug Release Program in Canada with respect to our products. In addition, Biovail agrees to work with us in preparing and filing a New Drug Submission with Canadian Regulatory Authorities. Biovail invested $2,250,000 in Hemispherx equity at prices above the then current market price and agreed to make an additional investment of $1,750,000 based on receiving approval to market Ampligen(R) in Canada from the appropriate regulatory authorities in Canada. The agreement requires Biovail to buy exclusively from us and penetrate certain market segments at specific rates in order to maintain market exclusivity. The agreement terminates on December 15, 2009, subject to successive two year extensions by the parties and subject to earlier termination by the parties for uncured defaults under the agreement, bankruptcy or insolvency of either party, or withdrawal of our product from Canada for a period of more than ninety days for serious adverse health or safety reasons. In 1998, we invested $1,074,000 for a 3.3% equity interest in R.E.D. Laboratory ("R.E.D."). R.E.D. is a privately held biotechnology company for the development of diagnostic markers for Chronic Fatigue Syndrome and other chronic immune diseases. Primarily, R.E.D.'s research and development is based on certain technology owned by Temple University and licensed to R.E.D. We have an informal collaboration arrangement with R.E.D. to assist in this development. We have supplied scientific data with respect to ME/CFS and engaged R.E.D. to conduct certain blood tests for our ME/CFS clinical trials. We have no other obligations to R.E.D. R.E.D. is headquartered in Belgium. The investment was recorded at cost in 1998. During the three months ended June 2002 and December 2002 respectively, we recorded a non-cash charge of $678,000 and $396,000, respectively, to operations with respect to our investment in R.E.D. These charges were the result of our determination that R.E.D.'s business and financial position had deteriorated to the point that our investment had been permanently impaired. In May 2000, we acquired an interest in Chronix Biomedical Corp. ("CHRONIX"). Chronix focuses upon the development of diagnostics for chronic diseases. We issued 100,000 shares of common stock to Chronix toward a total equity investment of $700,000. Pursuant to a strategic alliance agreement, we provided Chronix with $250,000 to conduct research in an effort to develop intellectual property on potential new products for diagnosing and treating various chronic illnesses such as ME/CFS. The strategic alliance agreement provides us certain royalty rights with respect to certain diagnostic technology developed from this research and a right of first refusal to license certain

therapeutic technology developed from this research. The strategic alliance agreement provides us with a royalty payment of 10% of all net sales of diagnostic technology developed by Chronix for diagnosing Chronic Fatigue Syndrome, Gulf War Syndrome and Human Herpes Virus-6 associated diseases. The royalty continues for the longer of 12 years from September 15, 2000 or the life of any patent(s) issued with regard to the diagnostic technology. The strategic alliance agreement also provides us with the right of first refusal to acquire an exclusive worldwide license for any and all therapeutic technology developed by Chronix on or before September 14, 2012 for treating Chronic Fatigue Syndrome, Gulf War Syndrome and Human Herpes Virus-6 associated diseases. During the quarter ended December 31, 2002, we recorded a noncash charge of $292,000 with respect to our investment in Chronix. This impairment reduces our carrying value to reflect a permanent decline in Chronix's market value based on their current proposed equity offerings. 48 In April, 1999 we acquired a 30% equity position in the California Institute of Molecular Medicine ("CIMM") for $750,000. CIMM'S research is focused on developing therapies for use in treating patients affected by Hepatitis C ("HCV"). We use the equity method of accounting with respect to this investment. During the fourth quarter of 2001 we recorded a non-cash charge of $485,000 with respect to our investment in CIMM. This was a result of our determination that CIMM's operations have not yet evolved to the point where the full carrying value of our investment could be supported based on that company's financial position and operating results. During 2002, CIMM continued to suffer significant losses resulting in a deterioration of its financial condition. The $485,000 written off during 2001 represented the unamortized balance of goodwill included as part of our investment. Additionally, during 2001 we reduced our investment in CIMM based on out percentage interest in CIMM's continued operating losses. Our remaining investment at December 31, 2001 in CIMM, representing our 30% interest in CIMM's equity at such date, was not deemed to be permanently impaired, but was completely written off during 2002. Such amount was not material. These charges are reflected in the Consolidated Statements of Operations under the caption "Equity loss in unconsolidated affiliate". We still believe CIMM will succeed in their efforts to advance therapeutic treatment of HCV. We believe that CIMM's Hepatitis C diagnostic technology has great promise and will fill a long-standing global void in the collective abilities to diagnose and treat Hepatitis C infection at an early stage of the disorder. In March 2002, our European subsidiary Hemispherx S.A. entered into a Sales and Distribution agreement with Esteve. Pursuant to the terms of the Agreement, Esteve was granted the exclusive right to market Ampligen(R) in Spain, Portugal and Andorra for the treatment of ME/CFS. In addition to other terms and other projected payments, Esteve agreed to conduct certain clinical trials using Ampligen(R) in the patient population coinfected with hepatitis C and HIV viruses. The Agreement runs for the longer of ten years from the date of first arms-length sale in the Territory, the expiration of the last Hemispherx patent exploited by Esteve or the period of regulatory data protection for Ampligen(R) in the applicable territory. Pursuant to the terms of the agreement Esteve is to conduct clinical trials using Ampligen(R) to treat patients with both HCV and HIV and is required to purchase certain minimum annual amounts of Ampligen(R). The agreement is terminable by either party if Ampligen(R) is withdrawn form the territory for a specified period due to serious adverse health or safety reasons; bankruptcy, insolvency or related issues of one of the parties; or material breach of the agreement. Hemispherx may transform the agreement into a non-exclusive agreement or terminate the agreement in the event that Esteve does not meet specified percentages of its annual minimum purchase requirements under the agreement. Esteve may terminate the agreement in the event that Hemispherx fails to supply Ampligen(R) to the territory for a specified period of time or certain clinical trials being conducted by Hemispherx are not successful. The last patent with respect to this agreement expires on June 5, 2012. The development of our nucleic acid based products requires the commitment of substantial resources to conduct the time-consuming research, preclinical development, and clinical trials that are necessary to bring pharmaceutical products to market and to establish commercial-scale production and marketing capabilities. During our last three fiscal years, we have directly spent approximately $16,862,000 in research and development, of which approximately $4,946,000 was expended in the year ended December 31, 2002. These direct costs do not include the overhead and administrative costs necessary to support the research and development effort. Our European subsidiary has an exclusive license on all the technology and support from us concerning Ampligen(R) for the use of ME/CFS and other applications for all countries of the European Union (excluding the UK where Bioclones has a marketing license) and Norway, Switzerland, Hungary, Poland, the Balkans, Russia, Ukraine, Romania, Bulgaria, Slovakia, Turkey, Iceland and Liechtenstein. As mentioned above, Hemispherx S.A. entered into a Sales and Distribution Agreement with Esteve. Pursuant to the terms of this agreement, Esteve has been granted the exclusive right in Spain, Portugal and Andorra to market Ampligen(R) for the treatment of ME/CFS. See "European Operations", above for more detailed information. 49 HUMAN RESOURCES As of December 17, 2003, we had 32 personnel working on the development of Ampligen(R)

consisting of 16 full time employees, five regulatory/research medical personnel on a part-time basis, and 11 clinical investigator's. Part time parties are paid on a per diem or monthly basis. 22 personnel are engaged in our research, development, clinical, and manufacturing effort. 10 of our personnel perform regulatory, general administration, data processing, including bio-statistics, financial and investor relations functions. In addition to the foregoing personnel, on March 11, 2003, pursuant to our agreement with ISI, we added personnel from ISI to our payroll consisting of five part-time and 12 full-time employees. We believe that the combination of Hemispherx and ISI Scientific employees has 1) significantly strengthened our overall organization, 2) added expertise to monitor and complete our ongoing clinical trials and 3) improved our data management and system administration. While we have been successful in attracting skilled and experienced scientific personnel, there can be no assurance that we will be able to attract or retain the necessary qualified employees and/or consultants in the future. SCIENTIFIC ADVISORY BOARD We recently reestablished a Scientific Advisory Board. consisting of individuals who we believe have particular scientific and medical expertise in Virology, Cancer, Immunology, Biochemistry and related fields. These individuals will advise us about current and long term scientific planning including research and development. The Scientific Advisory board will hold periodic meetings as needed by the clinical studies in progress by us. In addition, individual Scientific Advisory Board Members sometimes will consult with, and meet informally with our employees. All members of the Scientific Advisory are employed by others and may have commitments to and/or consulting agreements with other entities, including our potential competitors. Members of the Scientific Advisory Board are compensated at the rate of $1,000 per meeting attended or per day devoted to our affairs. FACILITIES We currently lease and occupy a total of approximately 18,850 square feet of laboratory and office space in two states and some office space in Paris, France. Our headquarters is located in Philadelphia, Pennsylvania consisting of a suite of offices of approximately 15,000 square feet. We also lease space of approximately 3,850 square feet in Rockville, Maryland for research of development, our pharmacy, packaging, quality assurance and quality control laboratories, as well as additional office space. Approximately 2,000 square feet are dedicated to the pharmacy, packaging, quality assurance and control functions. We believe that our Rockville facilities will meet our requirements, for planned clinical trials and treatment protocols through 2004 and possibly longer after which time we may need to increase our Rockville facilities either through third parties or by building or acquiring commercial-scale facilities. We currently occupy and use the New Brunswick, New Jersey laboratory and production facility owned by ISI. We are in the process of acquiring title to these facilities pursuant to our second asset acquisition agreement with ISI. This acquisition consists of two buildings located on 2.8 acres. One building is a two story facility consisting of a total of 31,300 square feet. This facility has offices, laboratories production space, shipping and receiving areas. Building Two has 11,670 square feet consisting of offices, laboratories and warehouse space. The property has parking space for approximately 100 vehicles. 50 We also have a 24.9% interest in Ribotech, Ltd. located in South Africa. Ribotech was established by Bioclones to develop and operate a manufacturing facility. Manufacturing at the pilot facility commenced in 1996. We expect that Ribotech will start construction on a new commercial production facility in the future, although no assurance can be given that this will occur. We have no obligation to fund this construction. Our interest in Ribotech, is a result of the marketing and manufacturing agreement executed with Bioclones in 1994. LEGAL PROCEEDINGS On September 30, 1998, we filed a multi-count complaint against Manuel P. Asensio, Asensio & Company, Inc. ("Asensio"). The action included claims of defamation, disparagement, tortuous interference with existing and prospective business relations and conspiracy, arising out of Asensio's false and defamatory statements. The complaint further alleged that Asensio defamed and disparaged us in furtherance of a manipulative, deceptive and unlawful short-selling scheme in August and September, 1998. In 1999, Asensio filed an answer and counterclaim alleging that in response to Asensio's strong sell recommendation and other press releases, we made defamatory statements about Asensio. We denied the material allegations of the counterclaim. In July 2000, following dismissal in federal court for lack of subject matter jurisdiction, we transferred the action to the Pennsylvania State Court. In March 2001, the defendants responded to the complaints as amended and a trial commenced on January 30, 2002. A jury verdict disallowed the claims against the defendants for defamation and disparagement and the court granted us a directed verdict on the counterclaim. On July 2, 2002 the Court entered an order granting us a new trial against Asensio for defamation and disparagement. Thereafter, Asensio appealed the granting of a new trial. This appeal is now pending in the Superior Court of Pennsylvania. In June 2002, a former ME/CFS clinical trial patient and her husband filed a claim in the Superior Court of New Jersey, Middlesex County, against us, one of our clinical trial investigators and others alleging that she was harmed in the ME/CFS clinical trial as a result of negligence and breach of warranties. We believe the claim is without merit and we are defending the claim against us through our product liability insurance carrier. In June 2002, a former

ME/CFS clinical trial patient in Belgium filed a claim in Belgium, against Hemispherx Biopharma Europe, NV/SA, our Belgian subsidiary, and one of our clinical trial investigators alleging that she was harmed in the Belgium ME/CFS clinical trial as a result of negligence and breach of warranties. We believe the claim is without merit and we are defending the claim against us through our product liability insurance carrier. In March 2003, the law firm of Schnader, Harrison, Segal & Lewis, LLP filed a complaint in the Court of Common Pleas of Philadelphia County against us for alleged legal fees in the sum of $65,051. The suit was settled for $12,000 and dismissed. On September 16, 2003, we filed and subsequently served and moved for expedited proceedings on, a complaint filed in the Court Of Chancery of the State of Delaware, New Castle County, against ISI. The Complaint seeks specific performance, and declaratory and injunctive relief related to the first and second asset acquisition agreements with ISI. Specifically, we allege that ISI has delayed its performance pursuant to the agreements and, as a result, the second asset purchase did not close within 180 days of the date of the agreements. Paragraph 7.7 of the second asset purchase agreement states that either party to the agreement may terminate the agreement if there is no closing within 180 days of the date of the agreement. We request that the Court require ISI to specifically perform its obligations under the agreement or, in the alternative, that paragraph 7.7 of the agreement be eliminated or reformed to eliminate ISI's ability to terminate pursuant to that paragraph. We also request that ISI, as a result of its 51 conduct, not be permitted to terminate the agreements pursuant to paragraph 7.7 or due to the passage of time. At a hearing held on September 29, 2003, the Court set a trial of our case for January 6-7, 2004 and accepted the agreement of the parties pursuant to which the date on which ISI may exercise its termination right is extended until no earlier than two weeks following trial. In response to our complaint, ISI has filed a motion to dismiss. MANAGEMENT The following sets forth biographical information about each of our directors and executive officers as of the date of this prospectus: Name Age Position William A. Carter, M.D. 65 Chairman, Chief Executive Officer, and President Robert E. Peterson 66 Chief Financial Officer David R. Strayer, M.D. 57 Medical Director, Regulatory Affairs Carol A. Smith, Ph.D. 51 Director of Manufacturing and Process Development Richard C. Piani 76 Director William M. Mitchell, M.D. 68 Director Ransom W. Etheridge 64 Director and Secretary Eraj Kiani 58 Director Antoni Esteve 45 Director Each director has been elected to serve until the next annual meeting of stockholders, or until his earlier resignation, removal from office, death or incapacity. Each executive officer serves at the discretion of the Board of Directors, subject to rights, if any, under contracts of employment. WILLIAM A. CARTER, M.D., the co-inventor of Ampligen, joined Hemispherx in 1978, and has served as: (a) Hemispherx's Chief Scientific Officer since May 1989; (b) the Chairman of Hemispherx's Board of Directors since January 1992; (c) Hemispherx's Chief Executive Officer since July 1993; (d) Hemispherx's President since April, 1995; and (e) a director since 1987. From 1987 to 1988, Dr. Carter served as Hemispherx's Chairman. Dr. Carter was a leading innovator in the development of human interferon for a variety of treatment indications including various viral diseases and cancer. Dr. Carter received the first FDA approval to initiate clinical trials on a beta interferon product manufactured in the U.S. under his supervision. From 1985 to October 1988, Dr. Carter served as Hemispherx's Chief Executive Officer and Chief Scientist. He received his M.D. degree from Duke University and underwent his post-doctoral training at the National Institutes of Health and Johns Hopkins University. Dr. Carter also served as Professor of Neoplastic Diseases at Hahnemann Medical University, a position he held from 1980 to 1998. Dr. Carter served as Director of Clinical Research for Hahnemann Medical University's Institute for Cancer and Blood Diseases, and as a professor at Johns Hopkins School of Medicine and the State University of New York at Buffalo. Dr. Carter is a Board certified physician and author of more than 200 scientific articles, including the editing of various textbooks on anti-viral and immune therapy. ROBERT E. PETERSON has served as our Chief Financial Officer since April, 1993 and served as an Independent Financial Advisor to us from 1989 to April, 1993. Also, Mr. Peterson has served as Vice President of the Omni Group, Inc., a business consulting group based in Tulsa, Oklahoma since 1985. From 1971 to 1984, Mr. Peterson worked for PepsiCo, Inc. and served in various financial management positions including Vice President and Chief Financial Officer of PepsiCo Foods International and PepsiCo Transportation, Inc. Mr. Peterson is a graduate of Eastern New Mexico University. 52 DAVID R. STRAYER, M.D. who served as Professor of Medicine at the Medical College of Pennsylvania and Hahnemann University, has acted as our Medical Director since 1986. He is Board Certified in Medical Oncology and Internal Medicine with research interests in the fields of cancer and immune system disorders. Dr. Strayer has served as principal investigator in studies funded by the Leukemia Society of America, the American Cancer Society, and the National Institutes of Health. Dr. Strayer attended the School of Medicine at the University of California at Los Angeles where he received his M.D. in 1972. CAROL A. SMITH, Ph.D. has served as our Director of Manufacturing and Process Development since April 1995, as Director of Operations since 1993 and as the Manager of Quality Control from 1991 to 1993, with responsibility for the

manufacture, control and chemistry of Ampligen(R). Dr. Smith was Scientist/Quality Assurance Officer for Virotech International, Inc. from 1989 to 1991 and Director of the Reverse Transcriptase and Interferon Laboratories and a Clinical Monitor for Life Sciences, Inc. from 1983 to 1989. She received her Ph.D. from the University of South Florida College of Medicine in 1980 and was an NIH post-doctoral fellow at the Pennsylvania State University College of Medicine. RICHARD C. PIANI has been a director of Hemispherx since 1995. Mr. Piani has been employed as a principal delegate for Industry to the City of Science and Industry, Paris, France, a billion dollar scientific and educational complex. Mr. Piani provided consulting to Hemispherx in 1993, with respect to general business strategies for Hemispherx's European operations and markets. Mr. Piani served as Chairman of Industrielle du Batiment-Morin, a building materials corporation, from 1986 to 1993. Previously Mr. Piani was a Professor of International Strategy at Paris Dauphine University from 1984 to 1993. From 1979 to 1985, Mr. Piani served as Group Director in Charge of International and Commercial Affairs for Rhone-Poulenc and from 1973 to 1979 he was Chairman and Chief Executive Officer of Societe "La Cellophane", the French company which invented cellophane and several other worldwide products. Mr. Piani has a Law degree from Faculte de Droit, Paris Sorbonne and a Business Administration degree from Ecole des Hautes Etudes Commerciales, Paris. RANSOM W. ETHERIDGE has been a director of Hemispherx since October 1997, and presently serves as our Secretary. Mr. Etheridge first became associated with Hemispherx in 1980 when he provided consulting services to Hemispherx and participated in negotiations with respect to Hemispherx's initial private placement through Oppenheimer & Co., Inc. Mr. Etheridge has been practicing law since 1967, specializing in transactional law. Mr. Etheridge is a member of the Virginia State Bar, a Judicial Remedies Award Scholar, and has served as President of the Tidewater Arthritis Foundation. He is a graduate of Duke University, and received his Law degree from the University of Richmond School of Law. WILLIAM M. MITCHELL, M.D. has been a director of Hemispherx since July 1998. Dr. Mitchell is a Professor of Pathology at Vanderbilt University School of Medicine. Dr. Mitchell earned a M.D. from Vanderbilt and a Ph.D. from Johns Hopkins University, where he served as an Intern in Internal Medicine, followed by a Fellowship at its School of Medicine. Dr. Mitchell has published over 200 papers, reviews and abstracts dealing with viruses and anti-viral drugs. Dr. Mitchell has worked for and with many professional societies, including the International Society for Interferon Research, and committees, among them the National Institutes of Health, AIDS and Related Research Review Group. Dr. Mitchell previously served as a director of Hemispherx from 1987 to 1989. IRAJ E. KIANI, M.B.A., Ph.D., was appointed to the Board of Directors on May 1, 2002. Dr. Kiani is a citizen of England and resides in Newport, California. Dr. Kiani served in various local government position including the Governor of Yasoi, Capital of Boyerahmand, Iran. In 1980, Dr. Kiani moved to England, where he established and managed several trading companies over a period of some 20 years. Dr. Kiani is a planning and logistic specialist who is now applying his knowledge and experience to build a 53 worldwide immunology network, which will use our proprietary technology. Dr. Kiani received his Ph.D. degree from the University of Warwick in England. ANTONI ESTEVE became a member of our Board of Directors in November 2003. Dr. Esteve is a Member of the Executive Committee and Director of Scientific and Commercial Operations for Laboratorios del Dr. Esteve S.A. He has been engaged at Laboratorios del Dr. Esteve since 1984. Since 1986 he is Professor at the Autonomous University of Barcelona, School of Pharmacy. In 2001 he was elected as member of the Advisory Board for R&D of the Spanish Ministry of Science and Technology. Since 2002 he also has been President of Centre de Transfussio i Banc de Teixits (the Transfusion and Tissues Bank Center of Catalonia). Dr. Esteve received a degree in Pharmacy from the University of Barcelona, Faculty of Pharmacy, in 1981 and a Ph.D. in Pharmaceutical Science in 1990. Committees of the Board The board of directors maintains the following committees: Audit Committee. Our Audit Committee of the Board of Directors consists of Richard Piani, Committee Chairman, William Mitchell, M.D. and Iraj-Eqhbal Kiani. Mr. Piani, Dr. Mitchell and Iraj-Eqhbal Kiani are Independent Directors. We do not have a financial expert as defined in Securities and Exchange Commission rules on the committee in the true sense of the description. However, Mr. Piani is a Businessman and has 40 years of experience of working with budgets, analyzing financials and dealing with financial institutions. We believe Mr. Piani, Dr. Mitchell and Iraj-Eqhbal Kiani to be independent of management and free of any relationship that would interfere with their exercise of independent judgment as members of this committee. The principal functions of the Audit Committee are to recommend our independent auditors, review the scope of their engagement, consult with the auditors, review the results of their examination, act as liaison between the Board of Directors and the auditors and review various company policies, including those relating to accounting and internal controls. Executive Committee. The Executive Committee is composed of William A. Carter, Chief Executive Officer and President, Ransom W. Etheridge, Secretary and Iraj-Eqhbal Kiani. The Executive Committee makes recommendations to management regarding general business

matters of Hemispherx. Compensation Committee. The Compensation Committee is composed of Ransom W. Etheridge, Secretary and director, and Richard C. Piani, director. The Compensation Committee makes recommendations concerning salaries and compensation for employees of and consultants to Hemispherx. Compensation of Directors Prior to September 10, 2003, Board member compensation consisted of an annual retainer of $35,000 plus $1,000 per meeting attended. Committee chairmen each received an additional retainer of $5,000 per year and committee members each receive an additional retainer of $3,000 per year. On September 10, 2003, the Board of Directors revised compensation for directors to consist of an annual retainer of $50,000 per director and $50,000 in common stock. All non-employee directors received some compensation in 2001 for special project work performed on our behalf. All directors have been granted options to purchase common stock under our 1990 Stock Option Plan and/or Warrants to purchase common stock. We believe such compensation and payments are necessary in order for us to attract and retain qualified outside directors. 54 Executive Compensation The summary compensation table below sets forth the aggregate compensation paid or accrued by us for the fiscal years ended December 31, 2002, 2001 and 2000 to (i) our Chief Executive Officer and (ii) our four most highly paid executive officers other than the CEO who were serving as executive officers at the end of the last completed fiscal year and whose total annual salary and bonus exceeded $100,000 (collectively, the "Named Executives"). EXECUTIVE COMPENSATION SUMMARY COMPENSATION TABLE Name and Year Salary ($) Restricted Warrants & All Other Principal Stock Options Compensation Position Awards Awards (1) ---------- William A. Carter 2002 $468,830 -- (8)1,000,000 $25,747 Chairman of 2001 (4) 456,608 -- (2) 386,650 22,917 the 2000 (4) 539,620 -- (5) 100,000 17,672 Board and CEO Robert E. Peterson 2002 $151,055 -- (8) 200,000 -- Chief 2001 146,880 -- (3) 40,000 -- Financial 2000 145,944 -- -- -- Officer David R. Strayer, 2002 $178,594 -- (8) 50,000 -- M.D. 2001 174,591 -- (7) 10,000 -- Medical Director 2000 (6) 172,317 -- -- -- Carol A. Smith, 2002 $128,346 -- (8) 20,000 -- Ph.D. 2001 124,800 -- (7) 10,000 -- Director 2000 124,800 -- -- -- of Manufacturing ---------- (1) Consists of insurance premiums paid by Hemispherx with respect to term life and disability insurance for the benefit of the named executive officer. (2) Consists of 188,325 warrants to purchase common stock at $6.00 per share and 188,325 warrants to purchase common stock at $9.00 per share. Also includes a stock option grant of 10,000 shares exercisable at $4.03 per share. (3) Consist of a stock option grant of 10,000 shares exercisable at $4.03 per share and 30,000 warrants to purchase common stock at $5.00 per share. (4) Includes a bonus of $90,397 paid in 2000. Also includes funds previously paid to Dr. Carter by Hahnemann Medical University where he served as a professor until 1998. This compensation was continued by us and totaled $79,826 in 2000 and 2001, and $82,095 in 2002. (5) Represents warrants to purchase common stock exercisable at $6.25 per share. 55 (6) Includes $98,926 paid by Hahnemann Medical University where Dr. Strayer served as a professor until 1998. This compensation was continued by us in 2000, 2001 and 2002. (7) Consist of stock option grant of 10,000 shares exercisable at $4.03 per share. (8) Represents number of warrants to purchase shares of common stock at $2 per share. The following table sets forth certain information regarding stock warrants granted during 2002 to the executive officers named in the Summary Compensation Table.

INDIVIDUAL GRANTS

PERCENTAGE OF NUMBER OF TOTAL WARRANTS POTENTIAL REALIZABLE VALUE AT SECURITIES GRANTED TO ASSUMED RATES OF STOCK PRICE UNDERLYING EMPLOYEES IN APPRECIATION FOR WARRANTS TERM WARRANTS GRANTED FISCAL YEAR EXERCISE PRICE ---------- NAME (1) 2002(2) PER SHARE (3) EXPIRATION DATE 5% (4) 10%(4)

Carter, W.A. 1,000,000 61.6% $2 8/13/07 $1,879,500 $1,969,000

Peterson, R. 200,000 12.3% $2 8/13/07 $375,900 $393,800

Smith, C. 20,000 1.2% $2 8/13/07 $37,590 $39,380

Strayer, D. 50,000 3.1% $2 8/13/07 $93,975 $98,450

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(1) Warrants vest over a period ranging from two to four years. (2) Total warrants issued to employees in 2002 were

1,622,000. (3) The exercise price is equal to the closing price of our common stock at the date of issuance. (4) Potential realizable value is based on an assumption that the market price of the common stock appreciates at the stated rates compounded annually, from the date of grant until the end of the respective option term. These values are calculated based on requirements promulgated by the Securities and Exchange Commission and do not reflect our estimate of future stock price appreciation. The following table sets forth certain information regarding the stock options held as of December 31, 2002 by the individuals named in the above Summary Compensation Table. 56 AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUE Securities Underlying Value of Unexercised Unexercised Options at In-the-Money-Options Fiscal Year End Numbers At Fiscal Year End(1) Dollars Name Shares Value Exercisable Unexercisable Exercisable Unexercisable Acquired on Realized ($) Exercise (#) ---------- William Carter -- -- 3,552,044(2) 753,334(3) $ 209,200 $ 97,500 Robert Peterson -- -- 300,416(4) 103,334(5) 6,300 6,300 David Strayer -- -- 101,666(6) 28,334(7) 3,250 3,250 Carol Smith -- -- 28,457(8) 13,334(9) 1,300 1,300 ---------- (1) Computation based on $2.13, the December 31, 2002 closing bid price for the common stock on the American Stock Exchange. (2) Consists of (i) 250,000 warrants exercisable at $2.00 per share expiring on August 13, 2007, (ii) 188,325 warrants exercisable at $6.00 per share expiring on February 22, 2006, (iii) 188,325 warrants exercisable at $9.00 per share expiring on February 22, 2006, (iv) 100,000 warrants exercisable at $6.25 per share expiring on April 8, 2004, (v) 25,000 warrants exercisable at $6.50 per share expiring on September 17, 2004 (vi) 25,000 warrants to purchase common stock at $8.00 per share expiring September 17, 2004 and 6,666 stock option exercisable at $8.00 per share expiring on January 3, 2011. Also include 2,768,728 warrants and options held in the name of Carter Investments, L.C. of which W. A. Carter is the principal beneficiary. These securities consist of (i) 340,000 warrants exercisable at $4.00 per share expiring on January 1, 2008, (ii) 170,000 warrants exercisable at $5.00 per share expiring on January 1, 2005, (iii) 300,000 warrants exercisable at $6.00 per share expiring on January 1, 2005, (iv) 20,000 warrants exercisable at $4.00 per share expiring on January 1, 2008, (v) 465,000 warrants exercisable at $1.75 expiring on June 3, 2005, (vi) 1, 400,000 warrants exercisable at $3.50 per share expiring on October 16, 2004 and 73,728 stock options exercisable at $2.71 per share until exercised. (3) Consists of (i) 750,000 warrants exercisable at $2.00 per share expiring on August 13, 2007 and (ii) 3,334 start options exercisable at $4.03 per share expiring on January 3, 2011. (4) Consists of (i) 6,666 stock options exercisable at $4.03 per share expiring on January 3, 2011 (ii) 13,750 stock options exercisable at $3.50 per share expiring on January 22, 2007, (iii) 100,000 warrants exercisable at $2.00 per share expiring on August 13, 2007, (iv) 50,000 warrants exercisable at $3.50 57 expiring on March 1, 2006, (v) 100,000 warrants exercisable at $5.00 per share expiring on April 14, 2006 and (vi) 30,000 warrants exercisable at $5.00 per share expiring on February 28, 2009. (5) Consists of (i) 100,000 warrants exercisable at $2.00 per share expiring on August 13, 2007 and (ii) 3,334 stock options exercisable at $4.03 per share expiring on January 3, 2011. (6) Consists of (i) 25,000 warrants exercisable at $2.00 per share expiring on August 13, 2007, (ii) 50,000 warrants exercisable at $4.00 per share expiring on February 28, 2008, (iii) 6,666 stock options exercisable at $4.08 expiring on January 3, 2011 and (iv) 20,000 stock options exercisable at $3.50 per share expiring on January 22, 2007. (7) Consists of 25,000 warrants exercisable at $2.00 per share expiring on August 13, 2007 and 3,334 stock options exercisable at $4.03 per share expiring on August 13, 2007. (8) Consists of (i) 10,000 warrants exercisable at $2.00 per share expiring on August 13, 2007, (ii) 5,000 warrants exercisable at $4.00 per share expiring on June 7, 2008, (iii) 6,666 stock options exercisable at $4.03 per share expiring on January 3, 2016, and (iv) 6,791 stock options exercisable at $3.50 per share expiring on January 22, 2007. (9) Consists of 10,000 warrants exercisable at $2.00 per share and 3,334 stock options exercisable at $4.03 per share expiring on January 3, 2004. Equity Compensation Plan Information The following table gives information about our Common Stock that may be issued upon the exercise of options, warrants and rights under all of our equity compensation plans as of December 31, 2002. Number of Number of securities Securities to be Remaining available issued upon Weighted-average For future issuance exercise of Exercise price of under equity outstanding outstanding compensation plans options, warrants Options, warrants (excluding securities And rights And rights Reflected in column ---------- ---------- ---------- Plan Category (a) (b) (c) Equity compensation plans approved by security holders: 294,665 $ 3.57 258,293 Equity compensation plans not approved by security holders: -- -- -- ------- -------- ------- Total 294,665 $ 3.57 258,293 58 Employment Agreements We entered into an amended and restated employment agreement with our President and Chief Executive Officer, Dr. William A. Carter, dated as of December 3, 1998, which provided for his employment until May 8, 2004 at an initial base annual salary of $361,586, subject to annual cost of living increases. In addition, Dr. Carter could receive an annual performance bonus of up to 25% of his base salary, at the sole discretion of the board of directors. Dr. Carter will not

participate in any discussions concerning the determination of his annual bonus. Dr. Carter is also entitled to an incentive bonus of 0.5% of the gross proceeds received by us from any joint venture or corporate partnering arrangement, up to an aggregate maximum incentive bonus of $250,000 for all such transactions. Dr. Carter's agreement also provides that he be paid a base salary and benefits through May 8, 2004 if he is terminated without "cause", as that term is defined in the agreement. This agreement was extended to May 8, 2008. Pursuant to his original agreement, as amended on August 8, 1991, Dr. Carter was granted options to purchase 73,728 shares of our common stock at an exercise price of $2.71 per share. Dr. Carter has the right to terminate his employment upon not less than 30 days prior written notice. Prior to our annual meeting of stockholders in September 2003, we had a limited number of shares of Common Stock authorized but not issued or reserved for issuance upon conversion or exercise of outstanding convertible and exercisable securities such as debentures, options and warrants. Prior to the meeting, in order to facilitate our need to obtain financing, Dr. Carter agreed that he would not exercise his warrants or options unless and until our stockholders approve an increase in our authorized shares of common stock. For Dr. Carter's waiver of his right to exercise certain options and warrants prior to approval of the increase in our authorized shares, we agreed to compensate Dr. Carter. In October 2003, in recognition of this action as well as Dr. Carter's prior and on-going efforts relating to product development, securing critically needed financing and the acquisition of a new product line, the Compensation Committee determined that Dr. Carter be awarded bonus compensation in 2003 consisting of $196,636 and a grant of 1,450,000 stock warrants with an exercise price of $2.20 per share. This additional compensation was reviewed by an independent valuation firm and found to be fair and reasonable within the context of total compensation paid to chief executive officers of comparable biotechnology companies. We entered into an amended and restated engagement agreement with Robert E. Peterson dated April 1, 2001 which provides for Mr. Peterson's employment as our Chief Financial Officer until December 31, 2003 at an annual base salary of $155,988 per year, subject to annual cost of living increases. In addition, Mr. Peterson shall receive bonus compensation upon Federal Drug Administration approval of Ampligen based on the number of years of his employment by us up to the date of such approval. During 2002, Mr. Peterson also received 200,000 warrants to purchase shares of common stock with an exercise price of $2.00. 1993 Stock Option Plan Our 1993 Stock Option Plan ("1993 Plan"), provides for the grant of options for the purchase of up to an aggregate of 138,240 shares of common stock to our employees, directors, consultants and others whose efforts are important to the success of Hemispherx. The 1993 Plan is administered by the Compensation Committee of the board of directors, which has complete discretion to select the eligible individuals to receive and to establish the terms of option grants. The 1993 Plan provides for the issuance of either non-qualified options or incentive stock options, provided that incentive stock options must be granted with an exercise price of not less than fair market value at the time of grant and that non-qualified stock options may not be granted with an exercise price of less than 85% of the fair market value at the time of grant. The number of shares of common stock available for grant under the 1993 Plan is subject to adjustment for changes in capitalization. This plan terminated as of July 7, 2003. No options were granted under the 1993 Plan. 59 1992 Stock Option Plan Our 1992 Stock Option Plan ("1992 Plan"), provides for the grant of options for the purchase of up to an aggregate of 92,160 shares of common stock to our employees, directors, consultants and others whose efforts are important to the success of Hemispherx. The 1992 Plan is administered by the Compensation Committee of the board of directors, which has complete discretion to select the eligible individuals to receive and to establish the terms of option grants. The 1992 Plan provides for the issuance of either non-qualified options or incentive stock options, provided that incentive stock options must be granted with an exercise price of not less than fair market value at the time of grant and that non-qualified stock options may not be granted with an exercise price of less than 50% of the fair market value at the time of grant. The number of shares of common stock available for grant under the 1992 Plan is subject to adjustment for changes in capitalization. This plan expired as of December 3, 2002. No options were granted under the 1992 Plan. 1990 Stock Option Plan Our 1990 Stock Option Plan, as amended ("1990 Plan"), provides for the grant of options to employees, directors, officers, consultants and advisors of Hemispherx for the purchase of up to an aggregate of 460,798 shares of common stock. The 1990 plan is administered by the Compensation Committee of the board of directors, which has complete discretion to select eligible individuals to receive and to establish the terms of option grants. The number of shares of common stock available for grant under the 1990 Plan is subject to adjustment for changes in capitalization. As of December 17, 2003, options to acquire an aggregate of 449 shares of the common stock were available for grants under the 1990 plan. This plan remains in effect until terminated by the Board of Directors or until all options are issued. 401(K) Plan In December 1995, we established a defined contribution plan, effective January 1, 1995, entitled the Hemispherx Biopharma employees 401(K) Plan and Trust Agreement. All full time employees of Hemispherx are

eligible to participate in the 401(K) plan following one year of employment. Subject to certain limitations imposed by federal tax laws, participants are eligible to contribute up to 15% of their salary (including bonuses and/or commissions) per annum. Participants' contributions to the 401(K) plan may be matched by Hemispherx at a rate determined annually by the board of directors. Each participant immediately vests in his or her deferred salary contributions, while Hemispherx contributions will vest over one year. In 2002 Hemispherx provided matching contributions to each employee for up to 6% of annual pay for a total of $38,000 for all employees. PRINCIPAL STOCKHOLDERS The following table sets forth as of December 17, 2003, the number and percentage of outstanding shares of common stock beneficially owned by: o Each person, individually or as a group, known to us to be deemed the beneficial owners of five percent or more of our issued and outstanding common stock; o each of our directors and the Named Executives; and o all of our officers and directors as a group. This table is based upon information supplied by Schedules 13D and 13G, if any, filed with the Securities and Exchange Commission, and information obtained from our directors and named executives. For purposes of this table, a person or group of persons is deemed to have "beneficial ownership" of any 60 shares of common stock which such person has the right to acquire within 60 days of December 17, 2003. For purposes of computing the percentage of outstanding shares of common stock held by each person or group of persons named in the table, any security which such person or persons has or have the right to acquire within such date is deemed to be outstanding but is not deemed to be outstanding for the purpose of computing the percentage ownership of any other person. Except as indicated in the footnotes to this table and pursuant to applicable community property laws, we believe, based on information supplied by such persons, that the persons named in this table have sole voting and investment power with respect to all shares common stock which they beneficially own. As of December 17, 2003, 38,998,413 shares of our common stock were outstanding. Unless otherwise noted, the address of each of the principal stockholders is care of us at One Penn Center, 1617 JFK Boulevard, Philadelphia, Pennsylvania 19103. Name and Address Shares % Of Share of Beneficial Owner Beneficially Owned Beneficially Owned
---------- William A. Carter, M.D. 5,618,607(1) 12.8% Robert E. Peterson 300,416(2) * Ransom W. Etheridge 430,006(3) * 2610 Potters Rd Virginia Beach, VA 23452 Richard C. Piani 212,437(4) * 97 Rue Jeans-Jaures Levaillois-Perret France 92300 William M. Mitchell, M.D. 191,330(5) * Vanderbilt University Department of Pathology Medical Center North 21st and Garland Nashville, TN 37232 Antoni Esteve 347,445(6) * Laboratorios Del Dr. Esteve S.A. AV. Mare de Deu de Montserat Barcelona, 08041, Spain David R. Strayer, M.D. 87,246(7) * Carol A. Smith 28,457(8) * 61 Iraj-Eqhbal Kiani 12,000(9) * Orange County Immune Institute 18800 Delaware Street Huntingdon Beach, CA 92648 All directors and executive officers as a 7,227,944 16.0% group (9 persons) ---------- * Less than 1% (1) Includes (i) an option to purchase 73,728 shares of common stock from Hemispherx at an exercise price of $2.71 per share and expiring on August 8 2004, (ii) Rule 701 Warrants to purchase 1,400,000 shares of common stock at a price of $3.50 per share, originally expiring on September 30, 2002 was extended to September 30, 2007; (iii) warrants to purchase 465,000 shares of common stock at $1.75 per share issued in connection with the 1995 Standby Financing Agreement and expiring on June 30, 2005; (iv) 340,000 common stock warrants exercisable at $4.00 per share and originally expiring on January 1, 2003 was extended to January 1, 2008; (v) 170,000 common stock warrants exercisable at $5.00 per share and expiring on January 2, 2005; (vi) 25,000 warrants to purchase common stock at $6.50 per share and expiring on September 17, 2008; (vii) 25,000 warrants to purchase common stock at $8.00 per share and expiring on September 17, 2004; (viii) 100,000 warrants to purchase common stock at $6.25 per share and expiring on April 8, 2004; (ix) 20,000 warrants to purchase common stock at $4.00 per share originally expiring January 1, 2003 was extended to January 1, 2008, (x) 188,325 common stock warrants exercisable at $6.00 per share and expiring on February 22, 2006; (xi) 188,325 common stock warrants exercisable at $9.00 per share and expiring on February 22, 2006 (xii) 300,000 common stock warrants granted in 1998 that are exercisable at $6.00 per share and expiring on January 1, 2006 (xiii) options to purchase 6,666 shares of common stock at $4.03 per share and expiring on January 3, 2011 (xiv) 250,000 warrants exercisable $2.00 per share on August 13, 2007 and 1,450,000 warrants to purchase common stock at $2.20 per share and expiring on September 9, 2008 and 616,560 shares of common stock. (2) Includes (i) 13,750 options to purchase common stock at an average exercise price of $3.50 per share, expiring on January 22, 2007 (ii) warrants to purchase 50,000 shares of common stock at an exercise price of $3.50 per share, expiring on March 1, 2006 (iii) warrants to purchase 100,000 shares of common stock at $5.00 per share, expiring April 14, 2006 (iv) 30,000 warrants to purchase common stock at $5.00 per share, expiring on February 28, 2009 (v) options to purchase 6,666 shares at $4.03 per share that expires on January 3, 2011 (vi) 100,000 warrants exercised at $2.00 per share expiring on November 13, 2007 and (v) 500 shares of common stock. (3) Includes 20,000 warrants to purchase

common stock at $4.00 per share, originally expiring on January 1, 2003 and was extended to January 1, 2008; 25,000 warrants to purchase common stock at $6.50 per share; 25,000 warrants to purchase common stock at $8.00 per share, all expiring on September 12, 2004; 100,000 warrants exercisable $2.00 per share expiring on August 13, 2007, 200,000 stock options exercisable at $2.75 per share expiring on December 4, 2013; and 60,006 shares of common stock. (4) Includes (i) 20,000 warrants to purchase 25,000 shares of common stock at $6.50 per share (ii) warrants to purchase 25,000 shares of common stock at $6.50 per share (iii) 25,000 warrants to purchase at $8.00 per share, all expiring on September 17, 2004; (iv) 100,000 warrants exercisable at $2.00 per share expiring on August 13, 2007, (v) 24,537 shares of common stock owned by Mr. Piani (vi) 12,900 62 shares of common stock owned jointly by Mr. And Mrs. Piani; and (vii) 5,000 shares of common stock owned by Mrs. Piani. (5) Includes (i) warrants to purchase 12,000 shares of common stock at $6.00 per share, expiring on August 25, 2008; (ii) 25,000 warrants to purchase common stock at $6.50 per share; (iii) 25,000 warrants to purchase common stock at $8.00 per share all expiring on September 17, 2004; (iv) 100,000 warrants exercisable at $2.00 per share expiring on August 13, 2007 and 29,330 shares of common stock. (6) Consists of 347,445 shares of our common stock owned by Provesan SA, an affiliate of Laboratorios Del Dr. Esteve S.A. Dr. Esteve is a Member of the Executive Committee and Director of Scientific and Commercial Operations of Laboratorios Del Dr. Esteve S.A. (7) Includes (i) stock options to purchase 20,000 shares of common stock at $3.50 per share; (ii) 50,000 warrants to purchase common stock at $4.00 per share; (iii) 2,500 stock options exercisable at $4.03 per share and expiring on January 3, 2011 and; (iv) 14,746 shares of common stock. (8) Consists of 5,000 warrants to purchase common stock at $4.00 per share expiring June 7, 2008; 6,791 stock options exercisable at $3.50 expiring January 22, 2007, 10,000 warrants exercisable at $2.00 per share expiring in August 13, 2007 and options to purchase 6,666 shares of common stock at $4.03 per share expiring on January 3, 2011. (9) Consist s of 12,000 warrants exercisable at $3.86 per share expiring on April 30, 2005. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS Ransom W. Etheridge, one of our directors is an attorney in private practice who has rendered corporate legal services to us from time to time, for which he has received fees. Richard C. Piani, another of our directors, lives in Paris, France and assists our European subsidiary in dealings with medical institutions and the European Medical Evaluation Authority. William M. Mitchell, M.D., another of our directors, works with David R. Strayer, M.D. (our Medical Director) in establishing clinical trial protocols as well as other scientific work for us from time to time. For these services, these directors were paid an aggregate of $170,150 in the year 2002. No individual director was paid in excess of $60,000. William A. Carter, our Chief Executive Officer, received an aggregate of $12,486 in short term advances in 2002 which were repaid as of December 31, 2002. All advances bear interest at 6% per annum. We loaned $60,000 to Ransom W. Etheridge, a director in November, 2002 for the purpose of exercising 15,000 Class A Redeemable warrants. This loan remains outstanding and bears interest at 6% per annum. Dr. Carter's short term advances and Mr. Etheridge's loan were approved by the Board of Directors. We paid $33,450 to Carter Realty for the rental of property used by us for business purposes at various times in 2002. The property is owned by others and managed by Carter Realty. Carter Realty is owned by Robert Carter, the brother of William A. Carter. Antoni Esteve, one of our directors, is a Member of the Executive Committee and Director of Scientific and Commercial Operations of Laboratorios Del Dr. Esteve S.A. In March 2002, our European subsidiary Hemispherx S.A. entered into a Sales and Distribution Agreement with Laboratorios Del Dr. Esteve S.A. For more information about our activities with Laboratorios Del Dr. Esteve S.A. see "European Operations" in "Our Business" above. In addition, in March 2003, we issued 347,445 shares of our common stock to Provesan SA, an affiliate of Laboratorios Del Dr. Esteve S.A., in exchange for 1,000,000 Euros of convertible preferred equity certificates of Hemispherx S.A., owned by Laboratorios Del Dr. Esteve S.A. 63 SELLING STOCKHOLDERS We have registered all 10,879,501 shares of common stock covered by this prospectus on behalf of the selling stockholders named in the table below. We issued the shares, the Debentures convertible into shares, and the warrants exercisable for shares to the selling stockholders in private transactions. We have registered the shares to permit the selling stockholders and their respective transferees, assignees or other successors-in-interest that receive their shares from a selling stockholder to resell the shares, from time to time, when they deem appropriate. The table below identifies the selling stockholders who will be offering shares and other information regarding the beneficial ownership of the common stock held by each of the selling stockholders. For the Debenture holders (the first two stockholders listed below), the second column lists the number of shares of common stock beneficially owned by each selling stockholder as of December 17, 2003, based on each selling stockholder's ownership of Debentures and warrants, and assumes the conversion of all the Debentures, the payment of all interest in stock and the exercise of all warrants. Because the conversion price of the Debentures and the exercise price of the warrants are subject to adjustment for anti-dilution protection, the interest on the Debentures may be paid in cash

or common stock, and the value attributed to any shares issued to the investors as interest (the "Interest Shares") depends on the average closing price of the common stock during the five consecutive business days ending on the third business day immediately preceding the applicable interest payment date, and the number of repayment shares depends on the amount of our consolidated revenues, the numbers listed in the second column may change. For the other selling stockholders, the second column lists the number of shares of common stock beneficially owned by the selling stockholder as of December 17, 2003, based on each selling stockholder's ownership of shares of common stock, and does not assume the conversion of any of the Debentures, the exercise of any warrants or the payment of any interest on the Debentures in the form of common stock rather than cash. The third column lists each selling stockholder's portion, based on agreements with us, of the 10,879,501 shares of common stock being offered by this prospectus. With regard to the first two selling stockholders, the number of shares being offered by this prospectus was determined in accordance with the terms of the registration rights agreement with them, in which we agreed to register the resale of 135% of (w) the number of shares of common stock issuable upon conversion of the July and October Debentures, plus (x) the number of shares of common stock issuable upon exercise of the related July and October 2008 Warrants, plus (y) an estimate of the number of Interest Shares that may be issued to the selling stockholders as interest payments on the July and October Debentures (assuming interest is paid exclusively in Interest Shares over the full term of these debentures, rather than in cash), plus (z) the number of shares of common stock issuable upon exercise of the June 2008 Warrants. As we stated above, the number of shares that will actually be issued may be more or less than the 10,879,501 shares being offered by this prospectus. Under the terms of the July and October Debentures, the related July and October 2008 Warrants and the June 2008 Warrants, no selling stockholder who owns any of these securities may convert any of their debentures or exercise any of the foregoing warrants to the extent that the conversion or exercise would cause the selling stockholder, together with its affiliates, to beneficially own more than 4.99% of the shares of our then outstanding common stock following such conversion or exercise. For purposes of making this determination, shares of common stock issuable upon conversion of those debentures which have not been converted and upon exercise of the warrants which have not been exercised are excluded. The number of shares in the second and third columns does not reflect this limitation. 64 Any selling stockholder may sell all, some or none of its respective shares in this offering. See "How The Shares May Be Distributed" below. Common Stock Common Stock Owned Prior No. of Shares Owned After Selling Stockholder To Offering Being Offered The Offering ---------- Portside Growth & Opportunity Fund 2,893,835(1) 2,893,835 -- ---------- Leonardo L.P. 3,419,416(2) 3,419,416 -- ---------- The American National Red Cross 314,465 314,465(3) -- ---------- GP Strategies Corporation 213,516 213,516(3) -- ---------- Cardinal Securities LLC 478,750(4) 478,750(4) -- ---------- H. David Coherd 478,750(5) 478,750(5) -- ---------- Robert L. Rosenstein 483,750(5) 483,750(5) -- ---------- Scott Koch 479,750(5) 479,750(5) -- ---------- Bridge Ventures, Inc. 405,160(6) 310,000(3) 95,160 ---------- Sharon Will 430,000(7) 325,000(3) 105,000 ---------- CEOCast, Inc. 15,000 15,000 -- ---------- Stephen H. Lieberman 5,682 5,682 -- ---------- ========== (1) Represents (a) up to 909,869 shares of common stock issuable upon conversion of the July Debentures, (b) up to 253,551 shares of common stock issuable upon exercise of the July 2008 Warrants, (c) up to 500,000 shares of common stock issuable upon exercise of the June 2008 Warrants, (d) up to 1,025,348 shares of common stock issuable upon conversion of the October Debentures, and (e) up to 205,067 shares of common stock issuable upon exercise of the October 2008 Warrants. Ramius Capital Group, LLC ("Ramius Capital") is the investment adviser of Portside Growth & Opportunity Fund ("Portside") and consequently has voting control and investment discretion over securities held by Portside. Ramius Capital disclaims beneficial ownership of the shares held by Portside. Peter A. Cohen, Morgan B. Stark, Thomas W. Strauss and Jeffrey M. Solomon are the sole managing members of C4S& Co., LLC, the sole managing member of Ramius Capital. As a result, Messrs. Cohen, Stark, Strauss and Solomon may be considered beneficial owners of any shares deemed to be beneficially owned by Ramius Capital. Messrs. Cohen, Stark, Strauss and Solomon disclaim beneficial ownership of these shares. (2) Represents (a) up to 1,435,450 shares of common stock issuable upon

conversion of the July Debentures, (b) up to 253,551 shares of common stock issuable upon exercise of the July 2008 Warrants (c) up to 500,000 shares of common stock issuable upon exercise of the June 2008 Warrants, (d) up to 1,025,348 shares of common stock issuable upon conversion of the October Debentures, and (e) up to 205,067 shares of common stock issuable upon exercise of the October 2008 Warrants. Angelo, Gordon & Co., L.P. ("Angelo, Gordon") is the sole director of the general partner of Leonardo, L.P. ("Leonardo") and consequently has voting control and investment discretion over securities held by Leonardo. Angelo, Gordon disclaims beneficial ownership of the shares held by Leonardo. Mr. John M. Angelo, the Chief Executive Officer of Angelo, Gordon, and Mr. Michael L. Gordon, the Chief Operating Officer of Angelo, Gordon, are the sole general partners of AG Partners, L.P., the sole general partner of Angelo, Gordon. As a result, Messrs. Angelo and Gordon may be considered beneficial owners of any shares deemed to be 65 beneficially owned by Angelo, Gordon. Messrs. Angelo and Gordon disclaim beneficial ownership of these shares. (3) These Selling Stockholders have agreed to certain periodic limitations on the number of shares that they sell. (4) Represents up to 478,750 shares of common stock issuable upon exercise of warrants owned by Cardinal of which (i) 78,750 of which are exercisable at a price of $1.74 per share, (ii)112,500 are exercisable at a price of $2.57 per share, and (iii) 200,000 shares of common stock issuable upon exercise of additional warrants at an exercise price of $2.50 per share. The members of Cardinal are H. David Coherd, Robert Rosenstein and Scott Koch. Excludes 6,000 unsold shares issued to Cardinal's members. (5) The selling stockholder is one of the three members of Cardinal Securities LLC. Accordingly, the shares beneficially owned by Cardinal are deemed to be beneficially owned by each of Cardinal's members. In the second column, represents (a) 5,000 shares of common stock owned by Mr. Rosenstein, 1,000 shares owned by Mr. Kock and no shares owned by Mr. Coherd and, for each of these stockholders (b) up to 478,750 shares of common stock issuable upon exercise of warrants owned by Cardinal of which (i) 78,750 of which are exercisable at a price of $1.74 per share, (ii)112,500 are exercisable at a price of $2.57 per share, (iii) 200,000 shares of common stock issuable upon exercise of additional warrants at an exercise price of $2.50 per share and (iv) 87,500 shares of common stock exercisable at $2.42 per share. The third column excludes all of the shares issuable upon exercise of the warrants owned by Cardinal. (6) In the second column, represents 310,000 shares issuable upon exercise of warrants exercisable at $1.75 per share expiring on June 30, 2005 and 95,160 shares issuable upon exercise of warrants exercisable at $3.50 expiring on October 15, 2004 owned of record by Bridge Ventures. The third column excludes the 95,160 shares at $3.50 per share. The principal shareholders, officers and directors of Bridge Ventures are Harris Freedman and Annelies Freedman. (7) In the second column, represents 325,000 shares issuable upon exercise of warrants exercisable at $1.75 per shares expiring on June 30, 2005 owned of record by Sharon Will and 105,000 shares issuable upon exercise of warrants exercisable at $3.50 per share expiring on October 15, 2004 owned by SAGGI Capital Corp. Sharon Will is the sole shareholder, officer and director of SAGGI. The third column excludes the shares issuable upon exercise of the SAGGI warrants. THE SELLING STOCKHOLDERS HAVE NOT BEEN EMPLOYED BY, HELD OFFICE IN, OR HAD ANY OTHER MATERIAL RELATIONSHIP WITH US OR ANY OF OUR AFFILIATES WITHIN THE PAST THREE YEARS EXCEPT AS DESCRIBED BELOW. HOW THE SHARES MAY BE DISTRIBUTED The shares to be sold in this offering have been or are in the process of being listed on the American Stock Exchange, subject to official notice of issuance. The selling stockholders may sell their shares of common stock from time to time in various ways and at various prices. The shares may be sold in one or more transactions at fixed prices, at prevailing market prices at the time of the sale, at varying prices determined at the time of sale, or at negotiated prices. These sales may be effected in transactions that may involve crosses or block transactions. Some of the methods by which the selling stockholders may sell the shares include: 66 o on any national securities exchange or quotation service on which the shares may be listed or quoted at the time of sale; o in the over-the-counter market; o in transactions otherwise than on these exchanges or systems or in the over-the-counter market; o through the writing of options, whether such options are listed on an options exchange or otherwise; o ordinary brokerage transactions and transactions in which the broker solicits purchasers; o privately negotiated transactions; o block trades in which the broker or dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction; o purchases by a broker or dealer as principal and resale by that broker or dealer for the selling stockholder's account under this prospectus; o sales under Rule 144 rather than by using this prospectus; o through the settlement of short sales; o a combination of any of these methods of sale; or o any other legally permitted method. In connection with sales of the shares or otherwise, the selling stockholders may enter into hedging transactions with broker-dealers, which may in turn engage in short sales of the shares in the course of hedging in positions they assume. The selling stockholders may also sell shares short and deliver shares to close out short positions, provided that the selling stockholders may not close out short positions entered into

prior to the effective date of the registration statement of which this prospectus is a part with any shares included in this prospectus. The selling stockholders may also pledge their shares as collateral for a margin loan under their customer agreements with their brokers. If there is a default by the selling stockholders, the brokers may offer and sell the pledged shares from time to time under this prospectus or an amendment to this prospectus under Rule 424(b)(3) or other applicable provisions of the Securities Act amending the list of selling stockholders to include the pledgee, transferee or other successors in interest as selling stockholders under this prospectus. Brokers or dealers may receive commissions or discounts from the selling stockholders (or, if the broker-dealer acts as agent for the purchaser of the shares, from that purchaser) in amounts to be negotiated. These commissions may exceed those customary in the types of transactions involved. We cannot estimate at the present time the amount of commissions or discounts, if any, that will be paid by the selling stockholders in connection with sales of the shares. The selling stockholders and any broker-dealers or agents that participate with the selling stockholders in sales of the shares may be deemed to be "underwriters" within the meaning of the Securities Act in connection with such sales. In that event, any commissions received by the broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. The selling stockholders have advised us that they have not entered into any agreements, understandings or arrangements with any underwriters or broker-dealers regarding the sale of the shares. There is no underwriter or coordinating broker acting in connection with the proposed sale of shares by the selling stockholders. In addition, each of the selling stockholders who is a registered broker-dealer or is affiliated with a registered broker-dealer has advised us that: 67 o it purchased the shares in the ordinary course of business; and o at the time of the purchase of the shares to be resold, it had no agreements or understandings, directly or indirectly, with any person to distribute the shares. Under the securities laws of certain states, the shares may be sold in those states only through registered or licensed broker-dealers. In addition, the shares may not be sold unless they have been registered or qualified for sale in the relevant state or unless they qualify for an exemption from registration or qualification. We do not know whether any selling stockholder will sell any or all of the shares registered by the shelf registration statement of which this prospectus forms a part. We have agreed to pay all fees and expenses incident to the registration of the shares, including certain fees and disbursements of counsel to certain of the selling stockholders. We have agreed to indemnify the selling stockholders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act. Certain of the selling stockholders have also agreed to indemnify us, our directors, officers, agents and representatives against certain liabilities, including certain liabilities under the Securities Act. The selling stockholders and other persons participating in the distribution of the shares offered under this prospectus are subject to the applicable requirements of Regulation M promulgated under the Exchange Act in connection with sales of the shares. We have agreed with the selling stockholders to keep the registration statement of which this prospectus is a part effective until all the shares registered under the registration statement have been resold. DESCRIPTION OF SECURITIES BEING REGISTERED The following section does not purport to be complete and is qualified in all respects by reference to the detailed provisions of our certificate of incorporation and by-laws, as amended, copies of which have been filed with the Securities and Exchange Commission. Our authorized capital stock consist of: (i) 100,000,000 shares of common stock, $.001 par value; and (ii) 5,000,000 shares of preferred stock, $.01 par value. 38,998,413 shares of common stock were issued and outstanding as of the date of this prospectus. Common Stock Shares of our common stock are entitled to one vote per share, either in person or by proxy, on all matters that may be voted upon by the owners of our shares at meetings of our stockholders. There is no provision for cumulative voting with respect to the election of directors by the holders of common stock. Therefore, the holder of more than 50% of our shares of outstanding common stock can, if they choose to do so, elect all of our directors. In this event, the holders of the remaining shares of common stock will not be able to elect any directors. 68 The holders of common stock: o have equal rights to dividends from funds legally available therefore, when and if declared by our board of directors; o are entitled to share ratably in all of our assets available for distribution to holders of common stock upon liquidation, dissolution or winding up of our affairs; and o do not have preemptive rights, conversion rights, or redemption of sinking fund provisions. The outstanding shares of our common stock are duly authorized, validly issued, fully paid and nonassessable. Anti-Takeover Provisions Delaware Law We are subject to the provisions of Section 203 of the Delaware General Corporation Law, as amended, which restricts certain business combinations with interested stockholders even if such a combination would be beneficial to all stockholders. In general, Section 203 would require a two-thirds vote of stockholders for any business combination (such as a merger or sale of all or substantially all of our assets) between us and an "interested stockholder" unless such transaction is approved by a majority of the disinterested directors or meets certain other requirements. An "interested stockholder" is a person who, together with

affiliates and associates, owns (or within three years, did own) 15% or more of our voting stock. These provisions could deprive stockholders of an opportunity to receive a premium for their common stock as part of a sale of us or may otherwise discourage a potential acquirer from attempting to obtain control of us. Certificate of Incorporation Provisions of our Certificate of Incorporation may make it more difficult for someone to acquire control of us or for our stockholders to remove existing management, and might discourage a third party from offering to acquire us, even if a change in control or in management would be beneficial to our stockholders. For example, our Certificate of Incorporation allows us to issue shares of preferred stock without any vote or further action by our stockholders. Our Board of Directors has the authority to fix and determine the relative rights and preferences of preferred stock. Our Board of Directors also has the authority to issue preferred stock without further stockholder approval. As a result, our Board of Directors could authorize the issuance of a series of preferred stock that would grant to holders the preferred right to our assets upon liquidation, the right to receive dividend payments before dividends are distributed to the holders of common stock and the right to the redemption of the shares, together with a premium, prior to the redemption of our common stock. Shareholder rights plan In November, 2002 we adopted a shareholder rights plan and, under the Plan, our Board of Directors declared a dividend distribution of one Right for each outstanding share of Common Stock to stockholders of record at the close of business on November 29, 2002. Each Right initially entitles holders to buy one unit of preferred stock for $30.00. The Rights generally are not transferable apart from the common stock and will not be exercisable unless and until a person or group acquires or commences a tender or exchange offer to acquire, beneficial ownership of 15% or more of our common stock. However, for William A. Carter, M.D., our chief executive officer, who already beneficial owns 9.2% of our common 69 stock, the Plan's threshold will be 20%, instead of 15%. The Rights will expire on November 19, 2012, and may be redeemed prior thereto at $.01 per Right under certain circumstances. The rights have certain anti-takeover effects. The rights will cause substantial dilution to a person or group that attempts to acquire us on terms not approved by our Board of Directors. The rights should not interfere with any merger or business combination approved by the Board of Directors. Transfer Agent And Registrar The transfer agent and registrar for our common stock and warrants is Continental Stock Transfer and Trust Co., 17 Battery Place, 8th Floor, New York, New York 10004. LEGAL MATTERS The validity of the common stock offered in this prospectus has been passed upon for us by Silverman Sclar Shin & Byrne P.C., 381 Park Avenue South, Suite 1601, New York, New York 10016. EXPERTS Our consolidated financial statements included in this prospectus have been audited by BDO Siedman, LLP, independent certified public accountants, to the extent and for the periods set forth in their report appearing elsewhere herein, and are included in reliance upon such report given upon the authority of said firm as experts in auditing and accounting. The consolidated financial statements and schedule of Interferon Sciences, Inc. as of December 31, 2002 and 2001 and for each of the years in the three year period ended December 31, 2002 included in this prospectus have been so included in reliance on the report (which contains an explanatory paragraph relating to substantial doubt about Interferon Sciences, Inc. ability to continue as a going concern) of Eisner LLP, independent auditors, given on authority of said firm as experts in auditing and accounting. WHERE YOU CAN FIND MORE INFORMATION We have filed with the Securities and Exchange Commission a registration statement (which contains this prospectus) on Form S-1 under the Securities Act of 1933. The registration statement relates to the shares offered by the selling stockholders. This prospectus does not contain all of the information set forth in the registration statement and the exhibits and schedules to the registration statement. Please refer to the registration statement and its exhibits and schedules for further information with respect to us, the common stock and the Warrants. Statements contained in this prospectus as to the contents of any contract or other document are not necessarily complete and, in each instance, we refer you to the copy of that contract or document filed as an exhibit to the Registration Statement. You may read and obtain a copy of the registration statement and its exhibits and schedules from the SEC, as described below. We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document we file at the Securities and Exchange Commission's public reference rooms at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference rooms. Many of our Securities and Exchange Commission filings are also available to the public from the Securities and Exchange Commission's Website at "http://www.sec.gov." 70 HEMISPHERX BIOPHARMA, INC. AND SUBSIDIARIES Index to Financial Section Item Page No. Financials for the nine F-2 Months Ended September 30, 2003 for Hemispherx Biopharma, Inc. and subsidiaries ("Hemispherx") (unaudited) Financials for the Year Ended F-20 December 31, 2000, 2001, and 2002 for Hemispherx Financials for the Year Ended F-51 December 31, 2001 and 2002 for Interferon Sciences, Inc. and subsidiaries ("ISI") Unaudited Proforma Financial F-79 Statements Related to the

Acquisition of Certain Assets of ISI by Hemispherx F-1 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (in thousands) December 31, September 30, 2002 2003 ---------- ---------- (Unaudited) ASSETS Current assets: Cash and cash equivalents $ 2,256 $ 5,061 Short term investments 555 -- Inventory -- 2,545 Accounts and other receivables 1,507 141 Prepaid expenses and other current assets 71 309 -------- --------- Total current assets 4,389 8,056 Property and equipment, net 155 112 Patent and trademark rights, net 995 1,076 Investments in unconsolidated affiliates 408 408 Deferred acquisition costs -- 1,068 Deferred financing costs -- 270 Advance receivable -- 951 Other assets 93 51 -------- --------- Total assets $ 6,040 $ 11,992 ======= ========= LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities: Accounts payable $ 786 $ 857 Accrued expenses 678 857 Current portion of long-term debt -- 349 -------- --------- Total current liabilities 1,464 2,063 Long-Term Debt-net of current portion -- 969 Commitments and contingencies: Minority interest in subsidiary 946 -- Redeemable Common Stock -- 1,600 Stockholders' equity: Common stock 33 38 Additional paid-in capital 107,155 117,145 Accumulated other comprehensive income 35 -- Treasury stock - at cost (4,520) (21) Accumulated deficit (99,073) (109,802) -------- --------- Total stockholders' equity 3,630 7,360 -------- --------- Total liabilities and stockholders' equity $ 6,040 $ 11,992 ======== ========= See accompanying notes to condensed consolidated financial statements. F-2 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS (in thousands, except share and per share data) For the Three months ended September 30, ---------- 2002 2003 ---------- ---------- (Unaudited) (Unaudited) Revenues: Sales of product, net $ -- $ 157 Clinical treatment programs 79 37 ---------- ---------- 79 194 Costs and expenses: Cost of Goods sold -- 69 Research and development 1,194 846 General and administrative 767 1,045 ---------- ---------- Total cost and expenses 1,961 1,960 Interest and other income 23 10 Interest and related expenses -- (3,666) Equity in loss of unconsolidated affiliate (32) -- ---------- ---------- Net loss $ (1,891) $ (5,422) ========== ========== Basic and diluted loss per share $ (.06) $ (.15) ========== ========== Basic and diluted weighted average common shares outstanding 32,093,066 36,830,633 ========== ========== See accompanying notes to condensed consolidated financial statements. F-3 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS (in thousands, except share and per share data) For the Nine months ended September 30, ---------- 2002 2003 ---------- ---------- (Unaudited) (Unaudited) Revenues: Sales of product, net $ -- $ 236 Clinical treatment programs 263 118 License fee income 563 -- ---------- ---------- 826 354 Costs and expenses: Production/Cost of Goods sold -- 224 Research and development 3,732 2,574 General and administrative 2,447 2,550 ---------- ---------- Total cost and expenses 6,179 5,348 Interest and other income 90 61 Interest and related expenses -- (5,795) Equity in loss of unconsolidated affiliate (72) -- Loss on investment due to impairment (678) -- ---------- ---------- Net loss $ (6,013) $ (10,728) ========== ========== Basic and diluted loss per share $ (.19) $ (.31) ========== ========== Basic and diluted weighted average common shares outstanding 32,083,957 34,210,987 ========== ========== See accompanying notes to condensed consolidated financial statements. F-4 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (in thousands) (Unaudited) For the Nine months ended September 30, ---------- 2002 2003 ------- -------- Cash flows from operating activities: Net loss $(6,013) $(10,728) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation of property and equipment 69 62 Amortization of patents rights 81 97 Amortization of deferred financing and debt discount costs -- 5,795 Stock option and warrant compensation and service expense 132 -- Equity in loss of unconsolidated affiliates 72 -- Loss on investment due to impairment 678 Changes in assets and liabilities: Inventory -- (926) Other receivable (4) 1,314 Prepaid expenses and other current assets 283 (186) Accounts payable (190) (575) Accrued expenses (62) 179 Advance receivavle -- (673) Other assets 27 42 ------- -------- Net cash used in operations (4,927) (5,599) ------- -------- Cash flows from investing activities: Purchase of property and equipment -- (19) Additions to patent rights (143) (178) Maturity of short term investments 5,310 520 Purchase of short term investments (837) -- Deferred acquisition costs -- (160) ------- -------- Net cash provided by investing activities 4,330 163 ------- -------- Cash flows from financing activities: Proceeds from issuance of common stock 6 -- Proceeds from exercise of warrants 59 1,178 Proceeds from issuance of preferred Stock of subsidiary 946 -- Proceeds from long-term borrowings -- 7,750 Deferred financing costs -- (687) Purchase of treasury stock (50) -- ------- -------- Net cash provided by financing activities 961 8,241 ------- -------- Net increase in cash and cash equivalents 364 2,805 Cash and cash equivalents at beginning of period 3,107 $ 2,256 ------- -------- Cash and cash equivalents at end of period $ 3,471 $ 5,061 ======= ======== See accompanying notes to condensed consolidated financial statements. F-5 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS NOTE 1: BASIS OF PRESENTATION The accompanying consolidated financial

statements include the accounts of Hemispherx BioPharma, Inc., a Delaware corporation and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments necessary for a fair presentation of such consolidated financial statements have been included. Such adjustments consist of normal recurring items. Interim results are not necessarily indicative of results for a full year. The interim consolidated financial statements and notes thereto are presented as permitted by the Securities and Exchange Commission (SEC), and do not contain certain information which will be included in our annual consolidated financial statements and notes thereto. These consolidated financial statements should be read in conjunction with our consolidated financial statements included in amendment no. 1 to our annual report on Form 10-K for the year ended December 31, 2002, as filed with the SEC on May 20, 2003. NOTE 2: STOCK BASED COMPENSATION The Company follows Statement of Financial Accounting Standards(SFAS) No. 123, "Accounting for Stock-Based Compensation." We chose to apply Accounting Principal Board Opinion 25 and related interpretations in accounting for stock options granted to our employees. The Company provides pro forma disclosures of compensation expense under the fair value method of SFAS No. 123, "Accounting for Stock-Based Compensation," and SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." The weighted average assumptions used for the period presented are as follows: September 30, ---------- 2002 2003 ---- ---- Risk-free interest rate 5.23% 5.23% Expected dividend yield -- -- Expected lives 2.5 years 2.5 years Expected volatility 63.17% 63.17% F-6 Had compensation cost for the Company's option plans been determined using the fair value method at the grant dates, the effect on the Company's net loss and loss per share for the three months and nine months ended September 30, 2002 and 2003 would have been as follows: (In Thousands) Three Months Ended Nine Months Ended ---------- ---------- September 30, September 30, ---------- ---------- 2002 2003 2002 2003 ------- ------- ------- -------- Net (loss) as reported $(1,891) $(5,422) $(6,013) $(10,728) Add: Stock based employee compensation expense Included in reported net loss, net of Related tax effects -- -- -- -- Deduct: Total stock based employee compensation determined under fair value method for all awards, net of related tax effects $ (411) (271) (137) (813) ------- ------- ------- -------- Pro forma net loss $(2,162) $(5,559) $(6,826) $(11,139) ======= ======= ======= ======== Basic and diluted loss per share As reported $ (.06) $ (.15) $ (.19) $ (.31) Pro forma $ (.07) $ (.17) $ (.20) $ (.33) Note 3: INVESTMENT In unconsolidated affiliates Investments include an initial equity investment of $290,625 in Chronix Biomedical ("Chronix"). Chronix focuses upon the development of diagnostics for chronic diseases. This initial investment was made in May 31, 2000 by the issuance of 50,000 shares of Hemispherx Biopharma, Inc. common stock from the treasury. On October 12, 2000, the Company issued an additional 50,000 shares of Hemispherx Biopharma, Inc. common stock and on March 7, 2001 the Company issued 12,000 more shares of Hemispherx F-7 Biopharma, Inc. common stock from the treasury to Chronix for an aggregate equity investment of $700,000. The percentage ownership in Chronix is approximately 5.4% and is accounted for under the cost method of accounting. During the quarter ended December 31, 2002, we recorded a non cash charge of $292,000 with respect to our investment in Chronix. This impairment reduces our carrying value to reflect a permanent decline in Chronix's market value based on their recent investment offerings. NOTE 4: INVENTORIES The Company uses the lower of first-in, first-out ("FIFO") cost or market method of accounting for inventory. Inventories consist of the following: September 30, 2003 ---------- Raw materials-Work in process $ 2,489,480 Finished goods 55,571 ---------- $ 2,545,051 ========== NOTE 5: REVENUE AND LICENSING FEE INCOME On March 20, 2002 our European Subsidiary Hemispherx Biopharma Europe, S.A. ("Hemispherx, S.A.") entered into a Sales and Distribution agreement with Laboratorios del Dr. Esteve S.A. ("Esteve"). Pursuant to the terms of the Agreement, Esteve was granted the exclusive right to market Ampligen(R)in Spain, Portugal and Andorra for the treatment of Myalgic Encephalitis/Chronic Fatigue Syndrome ("ME/CFS"). Esteve paid the initial and non refundable fee of 625,000 Euros (approximately $563,000) to Hemispherx S.A. on April 24, 2002. The terms of the agreement granting the licensee marketing rights for Ampligen(R) for the treatment of myalgic/chronic fatigue syndrome ("ME/CFS") in Spain, Portugal and Andorra require the Company to provide the licensee with technical, scientific and commercial information. The Company fulfilled the requirements during the first quarter of 2002. The agreement terms required no additional performance on the part of the Company. The agreement also requires the licensee to pay of 1,000,000 Euros after FDA approval of Ampligen(R) for the treatment of ME/CFS and a fee of 1,000,000 after issuance in Spain of final marketing approval authorization for Ampligen(R) for the treatment of ME/CFS. F-8 Revenues for non-refundable license fees are recognized under the Performance Method-Expected Revenue. This method considers the total amount of expected revenue during the performance period, but limits the amount of revenue recognized in a period to total non-refundable cash received to date. This limitation is appropriate because future milestone payments are contingent on future events. Upon receipt, the upfront non-refundable

payment is deferred. The non-refundable upfront payments plus non-refundable payments arising from the achievement of defined milestones are recognized as revenue over the performance period based on the lesser of (a) percentage of completion or (b)non-refundable cash earned (including the upfront payment). This method requires the computation of a ratio of cost incurred to date to total expected costs and then apply that ratio to total expected revenue. The amount of revenue recognized is limited to the total non-refundable cash received to date. The percentage of expenses incurred to date to total expected expenses in connection with the research and development project, exceed the percentage of license fees received compared to total license fees to be earned per the agreement. Therefore the amount of revenue recognized by the Company was limited to the total non-refundable cash received to date of approximately $563,000. During the periods ending December 31, 2002 and September 30, 2003. The Company did not receive any grant monies from local, state and or Federal Agencies. Revenue from the sale of Ampligen(R) under cost recovery clinical treatment protocols approved by the FDA is recognized when the treatment is provided to the patient. Revenues from the sale of product are recognized when the product is shipped, as title is transferred to the customer. The Company has no other obligation associated with its products once shipment has occurred. Note 6: MINORITY SHAREHOLDER INTEREST On March 20, 2002 our European Subsidiary Hemispherx, S.A. entered into a Sales and Distribution agreement with Esteve. Pursuant to the terms of the Agreement, Esteve was granted the exclusive right to market Ampligen(R) in Spain, Portugal and Andorra for the treatment of Myalgic Encephalitis/Chronic Fatigue Syndrome ("ME/CFS"). In addition to other terms and other projected payments, Esteve paid an initial and non refundable fee of 625,000 Euros (approximately $563,000) to Hemispherx S.A. on April 24, 2002 as the first part of a series of milestone based payments. F-9 During March 2002, Hemispherx, S.A. was authorized to issue up to 22,000,000 Euros of seven percent (7%) convertible preferred securities. Such securities will be guaranteed by the parent company and will be converted into a specified number of shares of Hemispherx S.A. pursuant to the securities agreement. Conversion is to occur on the earlier of an initial public offering of Hemispherx S.A. on a European stock exchange or September 30, 2003. Esteve purchased 1,000,000 Euros of Hemispherx, S.A.'s convertible preferred equity certificates on May 23, 2002. During 2002, the terms and conditions of these securities were changed so that these preferred equity certificates would be converted into the common stock of the Company in the event that a European IPO is not completed by September 30, 2003. The conversion rate is to be 300 shares of the Company's common shares for each 1,000 Euro convertible preferred certificate. As a result the Company recorded approximately $946,000 as minority interest in subsidiary on its balance sheet. On December 18, 2002, we proposed that Esteve convert its convertible preferred equity certificates into Company common stock pursuant to the terms of the agreement and all unpaid dividends at the market price on that conversion date. On January 9, 2003, Esteve accepted our proposal. On March 13, 2003, we issued 347,445 shares of our common stock to Provesan SA, an affiliate of Esteve, in exchange for the 1,000,000 Euros of convertible preferred equity certificates issued to Esteve and any unpaid dividends. We have registered these shares for public sale by Provesan SA. As a result of the exchange, minority interest in our subsidiary was transferred to stockholders' equity on such date. The contingent conversion price was more than the then market value of the parent company's or subsidiaries' common stock at each of the respective measurement dates. As a result and in accordance with Emerging Issues Task Force (EITF) No. 00-27 "Application of Issue No. 98-5 (Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios) to Certain Convertible Instruments", the Company did not ascribe any value to any contingent conversion feature. Note 7: RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS In January 2003, FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities". ("Interpretation No. 46"), which clarifies the application of F-10 Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Interpretation No. 46 is applicable immediately for variable interest entities created after January 31, 2003. For variable interest entities created prior to January 31, 2003, the provision of Interpretation No. 46 are applicable no later than July 1, 2003. This Interpretation did not have an effect on the consolidated financial statements. In May 2003, FASB issued Statement of Financial Accounting Standards ("SFAS") No. 150 "Accounting for Certain Financial Instruments with Characteristics of Both Liability and Equity". This Statement establishes standards for how an issuer classifies and measures in statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is with its scope as a liability (or assets in some circumstances) because that financial instrument embodies an obligation. This statement shall be effective for finical instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first

interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of a nonpublic entity. To date, the adoption of this interpretation did not have an effect on the consolidated financial statements. Note 8: ACQUISITION OF ASSETS OF INTERFERON SCIENCES, INC. On March 11, 2003, we acquired from Interferon Sciences, Inc.'s ("ISI") inventory of ALFERON N Injection, a pharmaceutical product used for the treatment of certain types of genital warts, and a limited license for the production, manufacture, use, marketing and sale of this product. As consideration, we issued 487,028 shares of our common stock and agreed to pay ISI 6% of the net sales of the product. Pursuant to our agreements with ISI, we have registered the foregoing shares for public sale. Except for 62,500 of the shares issued to ISI, we have guaranteed the market value of the shares retained by ISI as of March 11, 2005, the termination date, to be $1.59 per share. ISI is permitted to periodically sell certain amounts of its shares. If, within 30 days after the termination date, holders of the guaranteed shares request that we honor the guarantee, we will be obligated to reacquire the holders' remaining guaranteed shares and pay the holders $1.59 per share for a total of $675,000. Accordingly, certain shares issued in connection with this transaction are and will be recorded as redeemable common stock outside of stockholders' equity. F-11 On March 11, 2003, we also entered into an agreement to purchase from ISI all of its rights to the product and other assets related to the product including, but not limited to, real estate and machinery. For these assets, we agreed to issue to ISI an additional 487,028 shares and to issue 314,465 shares and 267,296 shares, respectively to The American National Red Cross and GP Strategies, two creditors of ISI, to continue to pay royalties of 6% on net sales of Alferon N. and other consideration, e.g., paying off a third creditor and paying a real estate tax liability. On May 30, 2003, we issued the shares to GP Strategies and the American National Red Cross. Pursuant to our agreements with ISI and these two creditors, we have agreed to register the foregoing shares for public sale. The acquisition of the real estate and machinery is contingent on our receiving appropriate governmental and shareholder approval. The value of these guaranteed shares totaled $925,000 and are redeemable under certain conditions, accordingly they are reflected as redeemable common stock and deferred acquisition costs on the accompanying financial statements as of September 30, 2003. We have guaranteed the market value of all but 62,500 of these shares on terms substantially similar to those for the initial acquisition of the ISI assets. The termination date for these guarantees is 18 months after the date of issuance of the guaranteed shares to GP Strategies, 24 months after the date of issuance of the additional 487,028 guaranteed shares to ISI and 12 months after the date of issuance of the guaranteed shares to the American National Red Cross. We will account for these transactions as a Business Combination under Statement of Financial Accounting Standards ("SFAS") No. 141 Accounting for Business Combinations. As a result of the first agreement, the following table summarize the estimated fair values of the assets and liabilities assumed at the acquisition date. At March 11, 2003 ---------- Inventory $ 1,840,762 Fair Value of liabilities Assumed (1,081,041) ---------- Fair Value of Common Shares Issued $ 759,720 The above table is subject to further adjustment upon final determination of estimated fair values as well as the additional accounting for the effects of the second agreement as described above. F-12 The following table represents the unaudited pro forma results of operations as though the acquisition, described in the first agreement, of certain net assets of ISI occurred on January 1, 2002. Nine Months ended September 30, ---------- 2002 2003 ---- ---- (in thousands except for share data) Net revenues $ 2,473 $ 596 Operating expense 10,244 11,874 ---------- ---------- Net loss $ (7,771) (11,278) ========== ========== Basic and diluted loss per share $ (.24) $ (.33) ---------- ---------- Weighted average Shares Outstanding 32,570,957 34,697,987 ========== ========== In giving effect to the additional shares that would be issued as a result of the second agreement with ISI the weighted average shares outstanding during the nine months ending September 30, 2002 and 2003 would have been 33,057,957 and 35,184,987 resulting in a pro forma loss per share as adjusted of $ (.24) and $(.32) for said periods respectively. Note 9: CONVERTIBLE DEBENTURES On March 12, 2003, We issued an aggregate of $5,426,000 in principal amount of 6% Senior Convertible Debentures due January 31, 2005 the ("March Debentures") and an aggregate of 743,288 Warrants expiring on March 12, 2008 to two investors in a private placement for an aggregate gross proceeds of $4,650,000. Pursuant to the terms of the Debentures, $1,550,000 of the proceeds from the sale of the Debentures were to have held back and to be released to us if, and only if, we acquire ISI's facility with in a set timeframe. In June 2003 each of the investors collectively funded the $1,550,000 and waived the requirement to perfect a security interest in the building to be acquired. In addition, each of the investors waived the requirement that the company acquire the assets of ISI pursuant to the terms of the F-13 second ISI Asset Purchase Agreement. The Debentures mature on January 31, 2005 and bear interest at 6% per annum, payable quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest shall be valued at 95% of the average closing price of the common stock during the five consecutive business days ending on the third business day

immediately proceeding the applicable interest payment date. Pursuant to the terms and conditions of the Senior Convertible Debentures, we have pledged all of our assets other than intellectual property, as collateral and are subject to comply with certain financial and negative covenants, which include but are not limited to the repayment of principal balances upon achieving certain revenue milestones. The conversion rate is fixed at $1.46 per share subject to adjustment for anti-dilution protection. The investors also received Warrants exercisable at any time through March 12, 2008 to purchase an aggregate of 743,288 shares of common stock at a price of $1.68 per share. On March 12, 2004, the exercise price of the Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between March 13, 2003 and March 11, 2004 (but in no event less than $1.176 per share). The exercise price (and the reset price) under the Warrants also is subject to similar adjustments for anti-dilution protection. All of these warrants were exercised in June 2003. On June 25, 2003, in connection with the March 12, 2003 $5,426,000 6% convertible debentures offering, we issued an additional warrant to each of the Debenture holders to acquire at any time through June 25, 2008 an aggregate of 500,000 shares of common stock at a price of $2.40 per share. On June 25, 2004, the exercise price of these June 2008 Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between June 26, 2003 and June 24, 2004 (but in no event less than $1.68 per share.) The exercise price (and the reset price) is also subject to adjustments for anti-dilution protection. On July 10, 2003, we issued an aggregate of $5,426,000 in principal amount of 6% Senior Convertible Debentures due July 31, 2005 (the "July debentures") and an aggregate of 507,102 Warrants due July 2008 to the same investors who purchased the March Debentures due January 2005 in a private placement for aggregate anticipated gross proceeds of $4,650,000. Pursuant to the terms of the July Debentures, $1,550,000 of the proceeds from the sale of the July Debentures have been held back and were to have been released to us if, and only if, we acquire ISI's facility with in a set timeframe. Although we have not acquired ISI's facility yet, these funds were released (see discussion below). The Debentures mature on July 31, 2005 and bear F-14 interest at 6% per annum, payable quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest shall be valued at 95% of the average closing price of the common stock during the five consecutive business days ending on the third business day immediately preceding the applicable interest payment date. The investors accepted the same collateral as was pledged in the March 12, 2003 transaction. The Debentures are convertible at the option of the investors at any time through July 31, 2005 into shares of our common stock. The conversion price under the Debentures was fixed at $2.14 per share: however, as part of the subsequent debenture placement that closed on October 29, 2003 (see below), the conversion price under the July debentures was lowered to $1.89 per share. The conversion price is subject to adjustment for anti-dilution protection for issuance of common stock or securities convertible or exchangeable into common stock at a price less than the conversion price then in effect. The warrants received by the investors are exercisable at any time through July 31, 2008 to purchase an aggregate of 507,102 shares of common stock at a price of $2.46 per share. On July 10, 2004, the exercise price of these July 2008 Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between July 11, 2003 and July 9, 2004 (but in no event less than $1.72 per share). The exercise price (and the reset price) under the July 2008 warrants also is subject to similar adjustments for anti-dilution protection. We entered into registration rights agreements with the investors in connection with the issuance of the March debentures and warrants and the July debenture and warrants. The registration rights agreement required that we register the shares of common stock issuable upon conversion of the debentures, shares for interest accrued and upon exercise of the warrants issued in March, June and July. In accordance with the agreement, we have registered these shares for public sale. On October 29, 2003, we issued an aggregate of $4,142,357 in the principal amount of 6% Senior Convertible Debentures due October 31, 2005 (the "October Debentures") and an aggregate of 410,134 Warrants (the "October 2008 Warrants") in a private placement for aggregate anticipated gross proceeds of $3,550,000 ($3,275.000 net of expenses). Pursuant to the terms of the October Debentures, $1,550,000 of the proceeds from the sale of the October Debentures have been held back and will be released to us if, and only if, we acquired ISI's facility within 90 days of October 29, 2003 and provide a mortgage on the facility as further security for the October Debentures. The October Debentures mature on October 31, 2005 and bear interest at 6% per annum, payable F-15 quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest shall be valued at 95% of the average closing price of the common stock during the five consecutive business days ending on the third business day immediately preceding the applicable interest payment date. Upon completing the sale of the October Debentures, we received $3,275,000 in net proceeds consisting of $1,725,000 (net) from the October Debenture and $1,550,000 that was withheld from the July,

debentures. As noted above, $1,550.000 of the October Debenure proceeds have been held back pending our completing the acquisition of the ISI facility. The October Debentures are convertible at the option of the investors at any time through October 31, 2005 into shares of our common stock. The conversion price under the October Debentures is fixed at $2.02 per share, subject to adjustment for anti-dilution protection for issuance of common stock or securities convertible or exchangeable into common stock at a price less than the conversion price then in effect. The October 2008 Warrants received by the investors are to acquire at any time through October 31, 2008 an aggregate of 410,134 shares of common stock at a price of $2.32 per share. On October 29, 2004, the exercise price of these October 2008 Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between October 29, 2003 and October 27, 2004 (but in no event less than $1.624 per share). The exercise price (and the reset price) under the October 2008 Warrants also is subject to similar adjustments for anti-dilution protection. We entered into a Registration Rights Agreement with the investors in connection with the issuance of the October Debentures and the October 2008 Warrants. The Registration Rights Agreement requires that we register on behalf of the holders the shares of common stock issuable upon conversion of the Debentures, as interest shares under the Debentures and upon exercise of the October 2008 Warrants. If the Registration Statement containing these shares is not filed within the time period required by the agreement, not declared effective within the time period required by the agreement or, after it is declared effective and subject to certain exceptions, sales of all shares required to be registered thereon cannot be made pursuant thereto, then we will be required to pay to the investors their pro rata share of $3,635 for each day any of the above conditions exist with respect to this Registration Statement. F-16 As of October 28, 2003, the investors had converted $4,427,580 of debt into 3,032,589 shares of our common stock. The remaining principal balance on the debentures is convertible into shares of our stock at the option of the investors at any time, through the maturity date. In addition, we have paid $1.3 million ($951,000 paid through September 30, 2003) into the debenture cash collateral account as required by the terms of the October Debentures. These amounts have been accounted for as advances receivable and are reflected as such on the accompanying balance sheet as of September 30, 2003. The cash collateral account provides partial security for repayment of the March, July and October, 2008 debentures in the event of default. In conjunction with both the March and July 2003 6% convertible debenture placements we paid the placement agent, Cardinal Capital, an investment banking fee equal to 7% of the investments made by the Debenture holders. A portion of this fee was paid with the issuance of 30,000 shares of our common stock. Placement agent also received 425,000 warrants to purchase common stock, of which 112,500 are exercisable at $1.74 per share, 112,500 are exercisable at $2.57 per share and 200,000 are exercisable at $2.50 per share. The $1.74 warrants expire on July 10, 2008 and the other warrants expire on March 12, 2008. By agreement with Cardinal Capital, we registered all shares and warrants for public sale. In conjunction with the October 2003 private debenture offering, we paid Cardinal an investments banking fee of $245,000 and Cardinal will receive 87,500 five year warrants to purchase an aggregate of 87,500 shares at an exercise price of $2.42 per share. The March, 2008 and the July, 2008 debenture issuances of $5,426,000 and $5,426,000, respectively, and the October 29, 2003 issuance of $4,142,357 debentures and related embedded conversion features and warrant issuances, were accounted for in accordance with EITF 98-5: Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion and with EITF No. 00-27: Application of issue No. 98-5 to Certain convertible instrument, the Company determined the fair values to be ascribed to detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. These pronouncements also provide for fair values of contingent conversion features of convertible debt securities to be determined when the contingent conversion price of is less than the market value of the underlying parent company or subsidiary common stock at the measurement date. As a result the Company recorded debt discounts of approximately $9.0 million which, in effect, reduced the carrying value of our debt to $1.3 million. These costs are deferred and charged to interest expense over the life of the debentures. As of F-17 September 30, 2003, the amount of debt discount amortized to interest expense totaled approximately $5.4 million. Recorded debt discounts on these debentures include an Original Issue Discount ("OID") of approximately $1.3 million as additional cost of the offerings. These costs are also deferred and expensed as interest over the life of the debentures. Excluding the application of related accounting standards, our outstanding debt as of September 30, 2003 totaled $4.9 million. In connection with the debenture agreements, the Company has outstanding letters of credit totaling $1 million as additional collateral. In addition, as of September 30, 2003, the Company has $200,000 in restricted cash under other letter of credit agreements required by our insurance carrier. Note 10: AUTHORIZED SHARES: On July 31, 2003, we had approximately 104,000 shares of our authorized shares of Common Stock that were not issued or reserved for issuance. In order to accommodate the shares needed for the July Debenture,

Dr. Carter, our Chief Executive Officer and Cardinal Capital, the placement agent, agreed that they would not exercise their warrants or options unless and until our stockholders approved an increase in our authorized shares of common stock (see note 11). This action freed up 3,206,650 shares. One of the proposals for the annual meeting of our stockholders that was held in September 2003 was an amendment to our certificate of incorporation to increase the authorized shares of common stock from 50,000,000 to 100,000,000 (the "Proposal"). We could not be assured that the Proposal would be approved. Our stockholders approved an amendment to our corporate charter at the Annual Stockholder meeting held in Philadelphia, PA on September 10, 2003. This amendment increased our authorized shares from 50,000,000 to 100,000,000. As of September 30, 2003, we have issued and outstanding shares totaling 37,654,543 and 16,393,990 shares reserved for use upon the conversion of the debenture and the exercise of outstanding warrants and options. Note 11: EXECUTIVE COMPENSATION In order to facilitate the Company's need to obtain financing and prior to our shareholders approving an amendment to our corporate charter to merge the number of authorized shares, Dr. Carter agreed to waive his right to exercise certain warrants F-18 and options unless and until our shareholder approved an increase in our authorized shares of Common Stock. In October 2003, in recognition of this action as well as Dr. Carter's prior and on-going efforts relating to product development securing critically needed financing and the acquisition of a new product line, the Compensation Committee determined that Dr. Carter be awarded bonus compensation in 2003 consisting of $196,636 and a grant of 1,450,000 stock warrants with an exercise price of $2.20 per share. This additional compensation was reviewed by an independent valuation firm and found to be fair and reasonable within the context of total compensation paid to chief executive officers of comparable biotechnology companies. F-19 HEMISPHERX BIOPHARMA, INC. AND SUBSIDIARIES Index to Consolidated Financial Statements - 2002 Report of Independent Certified Public Accountants ..... F-21 Consolidated Balance Sheets at December 31, 2001 and 2002 ..... F-22 Consolidated Statements of Operations for each of the years in the three-year period ended December 31, 2002 ..... F-23 Consolidated Statements of Changes in Stockholders' Equity and Comprehensive (Loss) for each of the years in the three-year period ended December 31, 2002 ..... F-24 Consolidated Statements of Cash Flows for each of the years in the three-year period ended December 31, 2002 ..... F-25 Notes to Consolidated Financial Statements ..... F-27 F-20 Report of Independent Certified Public Accountants The Board of Directors and Stockholders Hemispherx Biopharma, Inc. We have audited the accompanying consolidated balance sheets of Hemispherx Biopharma, Inc. and subsidiaries as of December 31, 2001 and 2002 the related consolidated statements of operations, changes in stockholders' equity and comprehensive (loss) and cash flows for each of the three years in the period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hemispherx Biopharma, Inc. and subsidiaries as of December 31, 2001 and 2002 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. /s/ BDO SEIDMAN, LLP Philadelphia, Pennsylvania March 13, 2003, except for note 12, which is as of March 31, 2003 F-21 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES Consolidated Balance Sheets December 31, 2001 and 2002 (in thousands) December 31, ---------- 2001 2002 -------- -------- ASSETS Current assets: Cash and cash equivalents ..... $ 3,107 $ 2,256 Short term investments (Note 3) ..... 5,310 555 Other receivables (Note 12) ..... 8 1,507 Prepaid expenses and other current assets ..... 381 71 -------- -------- Total current assets ..... 8,806 4,389 Property and equipment, net ..... 246 155 Patent and trademark rights, net ..... 1,025 995 Investments in unconsolidated affiliates ..... 1,878 408 Other assets ..... 80 93 -------- -------- Total assets ..... $ 12,035 $ 6,040 ======== ======== LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities: Accounts payable ..... $ 979 $ 786 Accrued expenses (Note 4) ..... 293 678 -------- -------- Total current liabilities ..... 1,272 1,464 -------- -------- Commitments and contingencies (Notes 7,9, 10 and 12) Minority Interest in subsidiary (Note (5c) .... -- 946 Stockholders' equity (Note 5): Common stock ..... 33 33 Additional paid-in capital .....

106,832 107,155 Accumulated other comprehensive income (Note 2i) ..... 17 35 Accumulated deficit ..... (91,649) (99,073) Treasury stock ..... (4,470) (4,520) -------- -------- Total stockholders' equity ..... 10,763 3,630 -------- -------- Total liabilities and stockholders' equity ..... $ 12,035 $ 6,040 ======== ======== See accompanying notes to consolidated financial statements. F-22 HEMISPHERX BIOPHARMA, INC. AND SUBSIDIARIES Consolidated Statements of Operations For each of the years in the three-year period ended December 31, 2002 (in thousands, except share and per share data) December 31, ---------- 2000 2001 2002 ---------- ---------- ---------- Revenue: ..... $ 788 $ 390 $ 341 License Fee income (Note 9) ..... -- -- 563 ---------- ---------- ---------- 788 390 904 Costs and expenses: Research and development ..... 6,136 5,780 4,946 General and administrative ..... 3,695 3,412 2,015 ---------- ---------- ---------- Total costs and expenses ..... 9,831 9,192 6,961 Equity loss and write offs of investments in unconsolidated affiliates (Note 2c) ..... (81) (565) (1,470) Interest and other income ..... 572 284 103 ---------- ---------- ---------- Net loss ..... $ (8,552) $ (9,083) $ (7,424) ========== ========== ========== Basic and diluted loss per share .. $ (.29) $ (.29) $ (.23) ========== ========== ========== Weighted average shares outstanding ..... 29,251,846 31,433,208 32,085,776 ========== ========== ========== See accompanying notes to consolidated financial statements. F-23 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES Consolidated Statements of Changes in Stockholders' Equity and Comprehensive (loss) For each of the years in the three-year period ended December 31, 2002 (in thousands except share data) Common Accumulated Common Stock Additional other Treasury Total Stock .001 Par paid-in Deferred Comprehensive Accumulated stock Treasury stockholders Shares Value capital compensation Income (loss) deficit shares Stock equity ------ -------- ---------- ---------- ---------- ---------- -------- -------- ---------- Balance at December 31, 1999 27,974,507 $28 $ 87,972 $(310) $ -- $(74,014) 167,935 $(1,019) $12,657 Common stock issued 2,393,381 2 9,860 -- -- -- (20,000) 123 9,985 Purchase of equity -- -- 67 -- -- -- (100,000) 551 618 investment Treasury stock purchased -- -- -- -- -- 350,800 (3,591) (3,591) Treasury stock issued in settlement of debt -- -- 8 -- -- -- (3,089) 26 34 Stock compensation and service expense, net -- -- 87 310 -- -- -- -- 397 Registration costs -- -- (10) -- -- -- -- -- (10) Net comprehensive (loss) -- -- -- -- 34 (8,552) -- -- (8,518) ---------- --- -------- ----- ---- -------- ------- ------- ------- Balance at December 31, 2000 30,367,888 30 97,984 -- 34 (82,566) 395,646 (3,910) 11,572 Common stock issued 2,155,900 3 8,072 -- -- -- -- -- 8,075 Purchase of equity investment 12,000 -- 72 -- -- -- -- -- 72 Treasury stock purchased -- -- -- -- -- -- 120,060 (560) (560) Note issued for purchase of stock -- -- (60) -- -- -- -- -- (60) Stock issued in settlement of debt 21,198 -- 91 -- -- -- -- -- 91 Stock and stock warrant compensation expense 19,000 -- 673 -- -- -- -- -- 673 Net comprehensive (loss) -- -- -- -- (17) (9,083) -- -- (9,100) ---------- --- -------- ----- ---- -------- ------- ------- ------- Balance at December 31, 2001 32,575,986 33 106,832 -- 17 (91,649) 515,706 (4,470) 10,763 Common stock issued 25,800 -- 37 -- -- -- -- -- 37 Treasury stock Purchased -- -- -- -- -- -- P27,500 (50) (50) Stock issued in settlement of debt 48,392 -- 154 -- -- -- -- -- 154 Stock and stock warrant compensation expense -- -- 132 -- -- -- -- -- 132 Net comprehensive (loss) -- -- -- -- 18 (7,424) -- -- (7,406) ---------- --- -------- ----- ---- -------- ------- ------- ------- Balance at December 31, 2002 32,650,178 $33 $107,155 $ -- $ 35 $(99,073) 543,206 $(4,520) $ 3,630 ========== === ======== ===== ==== ======== ======= ======= ======= F-24 HEMISPHERx BIOPHARMA, INC. AND SUBSIDIARIES Consolidated Statements of Cash Flows for each of the years in the three-year period ended December 31, 2002 (in thousands) December 31, ---------- 2000 2001 2002 ------- ------- ------- Cash flows from operating activities: Net loss ..... $(8,552) $(9,083) $(7,424) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation of property and equipment ..... 131 127 91 Amortization of patent and trademark rights ..... 356 397 206 Equity loss and write offs of investments in unconsolidated affiliates ..... 81 565 1,470 Stock compensation and service expense ..... 397 673 132 Changes in assets and liabilities: Other receivables ..... 15 52 (1,293) Prepaid expenses and other current assets ..... (463) 202 104 Accounts payable ..... 210 (271) (67) Accrued expenses ..... (266) 139 385 Security deposits ..... 17 (82) (13) ------- ------- ------- Net cash used in operating activities ..... (8,074) (7,281) (6,409) ------- ------- ------- Cash flows from investing activities: Purchase of property and equipment ..... (171) -- -- Additions to patent and trademark rights ..... (197) (218) (176) Maturity of short term investments ..... 2,157 4,613 5,293 Purchase of short term investments ..... (4,589) (5,293) (520) Investments in unconsolidated affiliates ..... (411) (22) (--) Other investments ..... (34) -- -- ------- ------- ------- Net (used in) cash provided by investing activities ..... (3,245) (920) 4,597 ------- ------- ------- F-25 (CONTINUED) HEMISPHERX BIOPHARMA, INC. AND SUBSIDIARIES Consolidated Statements of Cash Flows (Continued) (in thousands) December 31, ---------- 2000 2001 2002 ------- ------- ------- Cash

flows from financing activities: Proceeds from stock subscriptions and issuance of common stock, net ..... $ 2,250 $ 72 $ 65 Proceeds from issuance of preferred stock of .... -- -- 946 subsidiary Proceeds from exercise of stock warrants ..... 9,985 8,075 -- Purchase of treasury stock ..... (3,591) (560) (50) ------- ------- ------- Net cash provided by financing activities ..... 8,644 7,587 961 ------- ------- ------- Net decrease in cash and cash equivalents ..... (2,675) (614) (851) Cash and cash equivalents at beginning of year ..... 6,396 3,721 3,107 ------- ------- ------- Cash and cash equivalents at end of year ..... $ 3,721 $ 3,107 $ 2,256 ======= ======= ======= ======= Supplemental disclosures of cash flow information: Issuance of treasury stock for Investment ..... $ 618 $ -- $ -- ======= ======= ======= Issuance of common stock for accrued expenses ..... $ 34 $ 91 $ 154 ======= ======= ======= Issuance of common stock for note receivable ..... $ -- $ 60 $ -- ======= ======= ======= See accompanying notes to consolidated financial statements. F-26 HEMISPHERX BIOPHARMA, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (1) Business Hemispherx BioPharma, Inc. and subsidiaries (the Company) is a pharmaceutical company using nucleic acid technologies to develop therapeutic products for the treatment of viral diseases and certain cancers. The Company's drug technology uses specially configured ribonucleic acid (RNA). The Company's double-stranded RNA drug product, trademarked Ampligen(R), is in human clinical development for various therapeutic indications. The potential efficacy and safety of Ampligen(R) is being evaluated clinically for three anti-viral indications: myalgic encephalomyelitis, also known as chronic fatigue syndrome ("ME/CFS"), human immunodeficiency virus (HIV) associated disorders, and chronic hepatitis C (HVC) virus infection. The Company also has clinical experience with Ampligen(R) used in treating patients with certain cancers including renal cell carcinoma (kidney cancer) and metastatic malignant melanoma. The Company has other compounds to be evaluated. The consolidated financial statements include the financial statements of Hemispherx BioPharma, Inc. and its wholly-owned subsidiaries BioPro Corp., BioAegean Corp. and Core BioTech Corp. which were incorporated in September 1994, and are inactive, and Hemispherx Biopharma-Europe N.V./S.A. which was incorporated in 1998 and Hemispherx Biopharma Europe S.A., which was incorporated during 2002. All significant intercompany balances and transactions have been eliminated in consolidation. The Company also has investments in unconsolidated affiliates which are accounted for on the equity or cost method of accounting (see note 2c). On March 11, 2003, we acquired from Interferon Sciences, Inc. ("ISI") ISI's inventory of ALFERON N Injection(R), a pharmaceutical product used for the treatment of certain types of genital warts, and a limited license for the production, manufacturing, use, marketing and sale of this product. As partial consideration, we issued 487,028 shares of our common stock to ISI. Pursuant to our agreements with ISI, we are in the process of registering the foregoing shares for public sale. Except for 62,500 of the shares issued to ISI, we have guaranteed the market value of the shares retained by ISI through March 11, 2005 to be $1.59 per share. On March 11, 2003, we also entered into an agreement to purchase from ISI all of its rights to the product and other assets related to the product including, but not limited to, real estate and machinery. This purchase is contingent on us receiving the appropriate governmental approval. For these assets, we have agreed to issue to ISI an additional 487,028 shares and to issue 314,465 shares and 267,296 shares, respectively to two creditors of ISI. The Company will be required to satisfy other liabilities of ISI which aggregate approximately $521,000 and which are secured by a lien on ISI's real estate. We have guaranteed the market value of all but 62,500 of these shares on terms substantially similar to those for the initial acquisition of the ISI assets. We will account for these transactions as a Business Combination under Statement of Financial Accounting Standards ("SFAS") No. 141 Accounting for Business Combinations. On May 1, 1997, the Company received permission from the U.S. Food and Drug Administration ("FDA") to recover the cost of Ampligen(R) from patients enrolled in the Company's AMP-511 ME/CFS open-label treatment protocol. The cost of Ampligen(R) to the patient is $2,100 for the first eight weeks of treatment and $2,400 for each additional eight-week period thereafter. F-27 In 1998, the Company initiated the recruitment of clinical investigators to enroll ME/CFS patients in the confirmatory Phase III double blind placebo-controlled clinical study of Ampligen(R). This clinical trial was approved by the FDA in 1998 and is designed to test the safety and efficiency of Ampligen(R) in treating ME/CFS. The ME/CFS Cost Recovery Treatment Program in Belgium was started in 1994 with the approval of the Belgian Regulatory authorities. Since its inception, over 150 patients have participated in this program. Clinical data collected in the treatment of these ME/CFS patients will be used to support the Company's European Medical Evaluation Agency ("EMEA") Drug Approval Application and in applications in other regulatory jurisdictions. A similar program underway in Austria is undergoing expansion. (2) Summary of Significant Accounting Policies (a) Cash and Cash Equivalents Cash equivalents consist of money market certificates and overnight repurchase agreements collateralized by money market securities with original maturities of

less than three months, with both a cost and fair value of $2,552,000 and $1,404,000 at December 31, 2001 and 2002, respectively. (b) Short-term Investments Investments with original maturities of more than three months and marketable equity securities are considered available for sale. The investments classified as available for sale include debt securities and equity securities carried at estimated fair value of $5,310,000 and $555,000 at December 31, 2001 and 2002 respectively. The unrealized gains and losses are recorded as a component of shareholders' equity. (c) Investments in unconsolidated affiliates Investments in Companies in which the Company owns 20% or more and not more than 50% are accounted for using the equity method of accounting. Investments in Companies in which the Company owns less than 20% of and does not exercise a significant influence are accounted for using the cost method of accounting. In 1998, the Company invested $1,074,000 for a 3.3% equity interest in R.E.D. Laboratory ("R.E.D."). R.E.D. is a privately held biotechnology company for the development of diagnostic markers for Chronic Fatigue Syndrome and other chronic immune diseases. We have a research collaboration agreement with R.E.D. to assist in this development. R.E.D. is headquartered in Belgium. The investment was recorded at cost. During the three months ended June 30, 2002 and December 31, 2002 we recorded non-cash charges of $678,000 and $396,000 respectively, to operations with respect to our investment in R.E.D. These charges were the result of our determination that R.E.D.'s business and financial position had deteriorated to the point that our investments had been permanently impaired. F-28 In April, 1999 we acquired a 30% equity position in the California Institute of Molecular Medicine ("CIMM") for $750,000 and entered into a research and development arrangement. CIMM'S research is focused on developing therapies for use in treating patients affected by Hepatitis C ("HCV"). We use the equity method of accounting with respect to this investment. During the fourth quarter of 2001 we recorded a non-cash charge of $485,000 with respect to our investment in CIMM. This was a result of our determination that CIMM's operations have not yet evolved to the point where the full carrying value of our investment could be supported based on that company's financial position and operating results. During 2002, CIMM continued to suffer significant losses resulting in a deterioration of its financial condition. The $485,000 written off during 2001 represented the unamortized balance of goodwill included as part of the Company's investment. Additionally, during 2001 the Company reduced its investment in CIMM based on its percentage interest in CIMM's continued operating losses. The Company's remaining investment at December 31, 2001 in CIMM, representing its 30% interest in CIMM's equity at such date, was not deemed to be permanently, but was completely written off during 2002. Such amount was not material. These charges are reflected in the Consolidated Statements of Operations under the caption "Equity loss in unconsolidated affiliates". We still believe CIMM will succeed in their efforts to advance therapeutic treatment of HCV. We believe that CIMM's Hepatitis C diagnostic technology has great promise and fills a long-standing global void in the collective abilities to diagnose and treat Hepatitis C infection at an early stage of the disorder. The Company's investment in Ribotech, Ltd. is also accounted for using the equity method of accounting. The Company received 24.9% of Ribotech, Ltd. as partial compensation under the license agreement described in note 10. Ribotech, Ltd. has incurred net losses since inception. The Company does not share in those losses in accordance with the licensing agreement and is not obligated to fund such losses. The net investment in Ribotech is zero as of December 31, 2001 and 2002. During 2000, the Company prepaid $500,000 to Ribotech, Ltd. for raw material purchases. $110,000 of materials were delivered in 2000 and the balance of $390,000 was applied towards the purchase of materials during 2001. Investments in unconsolidated affiliates also includes an equity investment in Chronix Biomedical ("Chronix"). Chronix focuses upon the development of diagnostics for chronic diseases. The initial investment was made in May 31, 2000 through the issuance of 50,000 shares of Hemispherx Biopharma, Inc. common stock from the treasury. On October 12, 2000 an additional 50,000 shares of common stock were issued from the treasury for a total investment of approximately $678,000. During 2001 additional common stock plus cash were given to Chronix for a total investment at $700,000. The percentage ownership in Chronix is approximately 5.4% and is accounted for under the cost method of accounting. During the quarter ended December 31, 2002, we recorded a noncash charge of $292,000 with respect to our investment in Chronix. This impairment reduces our carrying value to reflect a permanent decline in Chronix's market value based on their current proposed investment offerings. Pursuant to a strategic alliance agreement, the Company provided Chronix with $250,000 during 2000 to conduct research in an effort to develop intellectual property on potential new products for diagnosing and treating various chronic F-29 illnesses including chronic fatigue syndrome. The strategic alliance agreement provides the Company certain royalty rights with respect to certain diagnostic technology developed from this research and a right of first refusal to license certain therapeutic technology developed from this research. The payment of $250,000 was charged to research and development expense during 2000. (d) Property and Equipment 000 omitted) December 31, ---------- 2001 2002 ---- ---- Furniture, fixtures, and equipment $ 1,178 $ 760 Leasehold

improvements 96 85 ------- ----- Total property and equipment 1,274 845 Less accumulated depreciation 1,028 690 ------- ----- Property and equipment, net $ 246 $ 155 ======= ===== Property and equipment consists of furniture, fixtures, office equipment, and leasehold improvements and is recorded at cost. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the respective assets, ranging from five to seven years. Depreciation and amortization expense was $131,000, $127,000 and $91,000 for 2000, 2001 and 2002, respectively. In 2002, fully depreciated equipment in the amount of $418,000 and fully depreciated leasehold improvements in Europe in the amount of $12,000 were written-off due to the closing of European offices. (e) Patent and Trademark Rights Effective October 1, 2001, the Company adopted a 17 year estimated useful life for amortization of its patent and trademark rights in order to more accurately reflect their useful life. Prior to October 1, 2001, the Company was using a 10 year estimated useful life. The adoption of the 17 year life had been accounted for as a change in accounting estimate. Patents and trademarks are stated at cost (primarily legal fees) and are amortized using the straight line method over the life of the assets. The Company reviews its patents and trademark rights periodically to determine whether they have continuing value. Such review includes an analysis of the patent and trademark's ultimate revenue and profitability potential on an undiscounted cash flow basis to support the realizability of its respective capitalized cost. Management's review addresses whether each patent continues to fit into the Company's strategic business plans. During the years ended December 31, 2000, 2001 and 2002, the Company decided not to pursue the technology in certain countries for strategic reasons and recorded charges of $32,000, $38,000 and $5,000, respectively. Amortization expense was $324,000, $359,000 and $201,000 in 2000, 2001 and 2002, respectively. The accumulated amortization as of December 31, 2001 and 2002 is $2,096,000 and $1,996,000, respectively. F-30 (f) Revenue Revenue from the sale of Ampligen(R) under cost recovery clinical treatment protocols approved by the FDA is recognized when the treatment is provided to the patient. Under the terms of an agreement granting the licensee marketing rights for Ampligen(R) for the treatment of myalgic/chronic fatigue syndrome ("ME/CFS") in Spain, Portugal and Andorra require the Company to provide the licensee with technical, scientific and commercial information. The Company fulfilled the requirements during the first quarter of 2002. The agreement terms required no additional performance on the part of the Company. The agreement also requires the licensee to pay of 1,000,000 Euros after FDA approval of Ampligen(R) for the treatment of ME/CFS and a fee of 1,000,000 after issuance in Spain of final marketing approval authorization for Ampligen(R) for the treatment of ME/CFS. See Note 6 for more detailed information. Revenues for non-refundable license fees are recognized under the Performance Method-Expected Revenue. This method considers the total amount of expected revenue during the performance period, but limits the amount of revenue recognized in a period to total non-refundable cash received to date. This limitation is appropriate because future milestone payments are contingent on future events. Upon receipt, the upfront non - refundable payment is deferred. The non-refundable upfront payment plus non-refundable payments arising from the achievement of defined milestones are recognized as revenue over the performance period based on the lesser of (a) percentage of completion or (b) non-refundable cash earned (including the upfront payment). This method requires the computation of a ratio of cost incurred to date to total expected costs and then applies that ratio to total expected revenue. The amount of revenue recognized is limited to the total non-refundable cash received to date. The percentage of expenses incurred to date to total expected expenses in connection with the research and development project, exceed the percentage of license fees received compared to total license fees to be earned per the agreement. Therefore the amount of revenue recognized by the Company was limited to the total non-refundable cash received to date of approximately $563,000. During the periods ending December 31, 2000, 2001 and 2002 the Company did not receive any grant monies from local, state and or Federal Agencies. (g) Net Loss Per Share Basic and diluted net loss per share is computed using the weighted average number of shares of common stock outstanding during the period. Equivalent common shares, consisting of stock options and warrants, are excluded from a calculation of diluted net loss per share since their effect is antidilutive. F-31 (h) Accounting for Income taxes Deferred income tax assets and liabilities are determined based on differences between the financial statement reporting and tax bases of assets and Liabilities and are measured using the enacted tax rates and laws in effect when the differences are expected to reverse. The measurement of deferred income tax assets is reduced, if necessary, by a valuation allowance for any tax benefits, which are not expected to be realized. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the period that such tax rate changes are enacted. (i) Comprehensive (loss) On January 1, 1998, the Company adopted SFAS No. 130, Reporting Comprehensive Income. Statement of Financial Accounting Standards (SFAS) No. 130 establishes standards for reporting and presentation of the Company's comprehensive (loss) and its components in a full set of financial statements. Comprehensive (loss) consists of net loss and net unrealized gains (losses) on securities and is presented in the

consolidated statements of changes in stockholders' equity and comprehensive (loss). (j) Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from those estimates. (k) Foreign currency translations Assets and liabilities of the Company's foreign operations are generally translated into U.S. dollars at current exchange rates as of balance sheet date. Revenues and expenses are translated at average exchange rates during each period. Transaction gains and losses that arise from exchange rate fluctuations are included in the results of operations as incurred. The resulting translation adjustments are immaterial for all years presented. (l) Recent Accounting Standard and Pronouncements: In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("Interpretation No. 46"), that clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, "to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Interpretation No. 46 is applicable immediately for variable interest entities created after January 31, 2003. For variable interest entities created to January 31, 2003, the provision of Interpretation No. 46 are applicable no later than July 1, 2003. The Company does not expect this Interpretation to have an effect on the consolidated financial statements. F-32 In August 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligation" ("SFAS 143"), which provides the accounting requirements for retirement obligation associated with tangible long-lived assets. SFAS 143 requires entities to record the fair value of the liability for an asset retirement obligation in the period in which it is incurred and is effective for the Company's 2003 fiscal year. The adoption of SFAS 143 is not expected to have a material impact on the Company's consolidated results of operations, financial position or cash flows. In October 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets" ("SFAS 144"). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, " and the accounting and reporting provision of APB Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and transactions. "This new pronouncement also amends Accounting Research Bulletin (ARB) No. 51 "Consolidated Financial Statements, "to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. SFAS 144 required that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired and also broadens the presentation of discontinued operation to include more disposal transactions. SFAS 144 is effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. Adoption of SFAS 144 on January 1, 2002, did not have impact on the Company's financial position, cash flows or results of operation for the year ended December 31, 2002. In June 2002, the FASB issued Statement No. 146, "Accounting for Cost Associated with Exit or Disposal Activities" ("SFAS 146"), which addresses financial accounting and reporting for costs associated with exit or disposal activities, and nullifies Emerging Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee termination Benefits and Other Costs to Exit and Activity (including Certain Costs Incurred in a Restructuring)" which previously governed the accounting treatment for restructuring activities. SFAS 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with disposal activity covered by SFAS 144. Those costs include, but are not limited to, the following: (1) termination benefits provide to current employees that are involuntarily terminated under the terms of a benefit arrangement that, in substance, is not an ongoing benefit arrangement or individual deferred-compensation contract,(2) costs to terminate a contract that is not a capital lease, and (3) costs to consolidated facilities or relocated employees. SFAS 146 does not apply to costs associated with the retirement of long-lived assets covered by SFAS 143. SFAS 146 will be applied prospectively and is effective for exit or disposal activities after December 31, 2002. In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure", and amendment of FASB Statement No. 123 ("SFAS"). SFAS 148 amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative method of transition for an entity that voluntarily changes to the fair value based of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net F-33 income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, this Statement amends

Accounting Principles Board ("APB") Opinion No. 28, Interim Financial Reporting to require disclosure about those effects in interim financial information. SFAS 148 is effective for financial statements for fiscal years ending after December 15, 2002. The Company will continue to account for stock-based compensation using the intrinsic value method of APB Opinion No. 25, "Accounting for Stock Issued to Employees, "but has adopted the enhance disclosure requirements of SFAS 148 (See Note 10). (m) Research and Development Costs Research and development related to both future and present products are charged to operation as incurred. (n) Stock Compensation The Company applies the intrinsic value method in accordance Accounting Principles Bulletin (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" in accounting for stock-based compensation of its employees and, accordingly, no compensation cost has been recognized for stock purchase warrants and options issued to employees. Had the Company determined compensation cost based on the fair value at the grant date for its stock-based compensation of its employees in accordance with FASB 123 the Company's net loss would have been increased to the pro forma amounts indicated below: (In Thousands except for per share data) For the years ended December 31, 2000 2001 2002 ---------- ---- ---- ---- Net loss-as reported $(8,552) $(9,083) $(7,424) Add: Stock based compensation included in net loss as reported, net of related tax effects -- -- -- Deduct: Stock based compensation determined under fair value based method for all awards, net of related tax effects (237) (632) (1,085) ------- ------- ------- Net loss - pro forma $(8,789) $(9,715) $(8,509) ======= ======= ======= Basic and diluted loss per share - as reported $ (.29) $ (.29) $ (.23) ======= ======= ======= Basic and diluted loss per share - pro forma $ (.30) $ (.31) $ (.27) ======= ======= ======= In 1999, the Company granted 275,000 warrants to employees in recognition of services performed and services to be performed. The fair value of the stock purchase warrants granted during 1999 was also determined using the Black- F-34 Scholes option pricing model with a rate of 5.18%, volatility of 135.4%-294.31%, and expected lives of 2 years. These warrants are included in the 2,633,000 non-public warrants outstanding as of December 31, 2000 as described in footnote 5 (ii). There were no warrants granted to employees during 2000. During 2001 the Company granted 406,650 warrants to employees. The Company granted to employees 8,000 options in 2000 and 94,000 options in 2001. See footnote 5(i). The fair value of stock options and warrants granted during 2001 was determined using Black Scholes Option Pricing Model with a rate of 4.23%, volatility of 69.7% to 74.9% and expected life of three years. In 2002 1,622,000 warrants were issued to employees in recognition of services performed and services to be performed. The fair value of the warrants granted during 2002 was determined using Black Scholes Option Pricing model with a rate of 5.23%, volatility of 63.17%, and expected life of 2.5 and 4 years. The weighted average fair value of those options and warrants granted during the years ended December 31, 2002, 2001 and 2000, were estimated as $0.62, $1.57 and $1.09, respectively. For stock warrants granted to non-employees, the Company measures fair value of the equity instruments utilizing the Black-Scholes method if that value is more reliably measurable than the fair value of the consideration or service received. The Company amortizes such cost over the related period of service. The exercise price of all stock warrants granted was equal to the fair market value of the underlying common stock as defined by APB 25 on the date of the grant. (3) Short-term investments: Securities classified as available for sale are summarized below: (000's omitted) December 31, 2001 ---------- Unrealized ---------- Adjusted Carrying cost Gains (Losses) Value -------- ----- -------- -------- General Motors Commercial Paper $3,977 $13 $ -- $3,990 Ford Motors commercial paper 795 1 -- 796 Calamos Mutual Market 521 3 -- 524 ------ --- ----- ------ Total $5,293 $17 $ -- $5,310 ====== === ===== ====== F-35 December 31, 2002 ---------- Unrealized ---------- Adjusted Carrying cost Gains (Losses) Value -------- ----- -------- -------- Calamos Mutual Market $ 521 $34 $ -- $ 555 ------ --- ----- ------ Total $ 521 $34 $ -- $ 555 ====== === ===== ====== (4) Accrued Expenses Accrued expenses at December 31, 2001 and 2002 consists of the following: (000's omitted) December 31, ---------- 2001 2002 ----- ----- Salaries . . . . . $ 85 $ 6 Other Accrued expenses . . . . . 208 222 Fees Associated with Litigation Settlement. 450 ----- ----- $ 293 $ 678 ===== ===== (5) Stockholders' Equity (a) Preferred Stock The Company is authorized to issue 5,000,000 shares of $.01 per value preferred stock with such designations, rights and preferences as may be determined by the board of directors. There were no preferred shares issued and outstanding at December 31, 2001 and 2002. (b) Common Stock and Exercise of Stock Warrants The Company is authorized to issue 50,000,000 shares of $.001 par value Common Stock. As of December 31, 2001 and 2002, 32,060,280 and 32,106,972 shares, net of shares held in the treasury, were outstanding, respectively. The exercise of stock warrants generated $9,985,000 and $8,075,000 in net proceeds to the Company in 2000 and 2001, respectively. There were no exercises during 2002. F-36 (c) New Equity Financing On March 20, 2002 our European Subsidiary Hemispherx Biopharma Europe, S.A. ("Hemispherx, S.A.") entered into a Sales and Distribution agreement with Laboratorios del Dr. Esteve S.A. ("Esteve"). Pursuant to the terms of the Agreement, Esteve

was granted the exclusive right to market Ampligen(R) in Spain Portugal and Andorra for the treatment of Myalgic Encephalitis/Chronic Fatigue Syndrome ("ME/CFS"). In addition to other terms and other projected payments, Esteve paid an initial and non refundable fee of 625,000 Euros (approximately $563,000) to Hemispherx S.A. on April 24, 2002 as the first part of a series of milestone based payments. During March 2002, Hemispherx Biopharma Europe, S.A. (Hemispherx S.A.) was authorized to issue up to 22,000,000 Euros of seven percent (7%) convertible preferred securities. Such securities will be guaranteed by the parent company and will be converted into a specified number of shares of Hemispherx S.A. pursuant to the securities agreement. Conversion is to occur on the earlier of an initial public offering of Hemispherx S.A. on a European stock exchange or September 30, 2003. Esteve purchased 1,000,000 Euros of Hemispherx Biopharma Europe S.A.'s convertible preferred equity certificates on May 23, 2002. During 2002, the terms and conditions of these securities were changed so that these preferred equity certificates will be converted into the common stock of Hemispherx Biopharma, Inc. (HEB) in the event that a European IPO is not completed by September 30, 2003. The conversion rate is to be 300 shares of Hemispherx Biopharma, Inc.'s common shares for each 1,000 Euro convertible preferred certificate. As a result the Company recorded approximately $946,000 as minority interest in subsidiary on its balance sheet. On December 18, 2002, we proposed that Esteve convert their convertible preferred equity certificates into Hemispherx common stock pursuant to the terms of the agreement and all unpaid dividends at the market price on that conversion date. On January 9, 2003, Esteve accepted our proposal. We are in the process of registering these shares for public sale. On March 13, 2003, we issued 347,445 shares of our common stock to Provesan SA, an affiliate of Esteve S.A., in exchange for 1,000,000 Euros of convertible preferred equity certificates and any unpaid dividends. As a result of the exchange, minority and subsidiary was transfer to stockholders' equity on such date. The contingent conversion price was more than the then market value of the parent company's or subsidiaries' common stock at each of that respective measurement dates. As a result and in accordance with Emerging Issues Task Force (EITF) No. 00-27 "Application of Issue No. 98-5 (Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios) to Certain Convertible Instruments", the Company did not ascribe any value to any contingent conversion feature. F-37 (d) Common Stock Options and Warrants (i) Stock Options The 1990 Stock Option Plan provides for the grant of options to purchase up to 460,798 shares of the Company's Common Stock to employees, directors, and officers of the Company and to consultants, advisors, and other persons whose contributions are important to the success of the Company. The recipients of options granted under the 1990 Stock Option Plan, the number of shares to be converted by each option, and the exercise price, vesting terms, if any, duration and other terms of each option shall be determined by the Company's board of directors or, if delegated by the board, its Compensation Committee. No option is exercisable more than 10 years and one month from the date as of which an option agreement is executed. These shares become vested through various periods not to exceed four years from the date of grant. The option price represents the fair market value of each underlying share of Common Stock at the date of grant, based upon the public trading price. Information regarding the options approved by the Board of Directors under the 1990 Stock Option Plan is summarized below: 2000 2001 2002 ---------- ---------- ---------- Weighted Weighted Weighted Average Average Average Option Exercise Option Exercise Option Exercise Shares Price Price Shares Price Price Shares Price Price ------ ----- -------- ------ ----- -------- ------ ----- ----- Outstanding, beginning of year 294,000 $1.06-6.00 $3.60 218,567 $1.06-6.81 $3.45 306,263 $1.06-4.34 $3.58 Granted 8,000 $3.00-6.81 $4.88 94,000 $4.03 $4.03 -- -- - Canceled (76,677) $3.50-4.34 $4.09 (6,304) $4.34-6.81 $5.91 (11,598) $3.00-4.34 $3.71 Exercised (6,756) $1.06-3.50 $2.75 -- -- -- -- -- - ------- ------ ------- Outstanding, end of year 218,567 $1.06-6.81 $3.45 306,263 $1.06-4.34 $3.58 294,665 $1.06-434 $3.57 ======= ======= ======= Exercisable 198,717 $1.06-6.81 $3.48 234,263 $1.06-4.34 $4.67 252,746 $1.06-4.34 $3.50 ======= ======= ======= Weighted average remaining contractual life (years) 3.83 years 3.57 years 3.68 years ========== ========== ========== Exercised in current and prior years (37,791) (37,791) (37,791) ======= ======= ======= Available for future grants 204,440 116,744 170,261 ======= ======= ======= In December 1992, the Board of Directors approved the 1992 Stock Option Plan (the 1992 Stock Option Plan) which provides for the grant of options to purchase up to 92,160 shares of the Company's Common Stock to employees, directors, and officers of the Company and to consultants, advisers, and other F-38 persons whose contributions are important to the success of the Company. The recipients of the options granted under the 1992 Stock Option Plan, the number of shares to be covered by each option, and the exercise price, vesting terms, if any, duration and other terms of each option shall be determined by the Company's board of directors. No option is exercisable more than 10 years and one month from the date as of which an option agreement is executed. To date, no options have been granted under the 1992 Stock Option Plan. The Company's 1993 Employee Stock Purchase

Plan (the 1993 Purchase Plan) was approved by the board of directors in July 1993. The outline of the 1993 Purchase Plan provides for the issuance, subject to adjustment for capital changes, of an aggregate of 138,240 shares of Common Stock to employees. The 1993 Purchase Plan is administered by the Compensation Committee of the board of directors. Under the 1993 Purchase Plan, Company employees are eligible to participate in semi-annual plan offerings in which payroll deductions may be used to purchase shares of Common Stock. The purchase price for such shares is equal to the lower of 85% of the fair market value of such shares on the date of grant or 85% of its fair market value of such shares on the date such right is exercised. There have been no offerings under the 1993 Purchase Plan to date and no shares of Common Stock have been issued thereunder. (ii) Stock warrants Number of warrants exercisable into shares of common stock 2000 2001 2002 ---------- ---------- ---------- Weighted Weighted Weighted Average Average Average Option Exercise Option Exercise Option Exercise Shares Price Price Shares Price Price Shares Price Price ------ ----- -------- ------ ------ -------- ------ ----- ----- Outstanding, beginning of year 14,058,010 $1.75-10.85 $3.90 11,624,168 $1.75-12.00 $4.05 6,927,110 $1.75-16.00 $4.77 Granted 293,800 $6.00-12.00 6.40 856,650 $5.00-16.00 $9.89 1,802,000 $2.00-6.00 $2.07 Canceled (341,017) $2.00-10.85 6.01 (3,396,508) $2.50-4.00 $3.89 (750,000) $3.50-6.00 $3.72 Exercised (2,386,625) $1.75-4.00 4.19 (2,157,200) $1.75-4.00 $3.75 (11,300) $1.75-7.50 $3.30 ---------- ---------- -------- Outstanding, end of year 11,624,168 $1.75-12.00 $4.05 6,927,110 $1.75-16.00 $4.77 7,967,810 $1.75-16.00 $3.18 ========== ===== ========= ========= Exercisable 11,624,168 $1.75-12.00 $4.05 6,927,110 $1.75-16.00 $4.77 6,345,810 $1.75-16.00 $3.48 ========== ===== ========= ========= Weighted average remaining contractual life (years) 2.66 years 4.05 years 4 .03 years ========== ========== ========== Years exercisable 2001-2006 2002-2006 2003-2008 ========= ========= ========= Certain of the stock warrants outstanding are subject to adjustments for stock splits and dividends. F-39 Warrants issued to stockholders In 2000, 149,807 warrants expired and 147,000 warrants were converted to common stock. At December 31, 2000, there were 305,160 warrants remaining. In 2001, 73,000 were converted to common stock. At December 31, 2001 there were 232,160 warrants remaining. In 2002, 10,000 were converted to common stock. At December 31, 2002 there were 222,160 warrants remaining. These warrants have an exercise price of $3.50 per share and expire in October 2004. Other stock warrants In addition, the Company has other issued warrants outstanding - totaling 7,745,650 which consists of the following: In November 1994, the Company granted Rule 701 Warrants to purchase an aggregate of 2,080,000 shares of Common Stock to certain officers and directors. These Warrants are exercisable at $3.50 per share and, if not exercised, were to expire in September, 1999. On February 19, 1999 the Board of Directors extended the expiration date for three more years. This extension resulted in a non-cash charge of approximately $3,097,000. In 1999 235,000 warrants were exercised and 5,000 warrants were exercised in 2000. At December 31, 2000, there were 1,840,000 Rule 701 warrants remaining. In 2001 20,000 of these warrants expired, leaving a balance of 1,820,000 in warrants outstanding at December 31, 2001. During 2002, 420,000 warrants expired and the Company extended the expiration date of the remaining balance of 1,400,000 for a period of five years to now expire on September 30, 2007. These stock warrants have an exercise price of $3.50. In accordance with FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, no compensation expense was recognized as the exercise price at the extension date exceeded the fair value of the underlying common stock. In May 1995, the Company and certain officers, directors and shareholders entered into a standby finance agreement pursuant to which the parties agreed to provide an aggregate of $5,500,000 in financing to the Company during 1995 in the event that existing and additional financing was insufficient to cover the cash needs of the Company through December 31, 1996. In exchange, the Company issued warrants to purchase an aggregate of 2,750,000 shares of Common Stock at $1.75 per share to the parties. In 1999, 290,000, in 2000, 216,500, in 2001, 200,000 and in 2002, 1,300 of these warrants were exercised, leaving a balance of these warrants of 1,450,200. These warrants expire June 30, 2005. In connection with the stock issued in September, 1997, the Company issued 385,067 warrants to several entities to purchase common stock at $4 per share, 149,034 of these warrants were exercised in 1998, 173,300 were exercised in 1999, and 34,333 were exercised in 2000. The remaining 28,400 warrants expired December 31, 2001. In the years 2000, 2001 and 2002 the Company issued 293,800, 450,000 and 25,000 warrants, respectively, to investment banking firms for services performed on behalf of the Company. Accordingly, the company recorded stock compensation expense of $397,000, $673,000 and $133,000 for the years 2000, 2001 and 2002 respectively. These warrants have various vesting dates and exercise prices ranging from $4.00 to $16.00 per share. In 2000, 75,000 of these warrants were exercised. 1,193,800 warrants were outstanding at December 31, 2002. These warrants are exercisable in five years from the date of issuance. F-40 In 2000 2001 and 2002 the Company had non-public warrants outstanding of 2,633,000 2,254,650 and 3,701,650 respectively. These warrants

are exercisable at rates of $2.50 to $10.00 per share of common stock. The exercise price was equal to the fair market value of the stock on the date of grant. During 2002, the Company granted 1,777,000 warrants to employees for services performed. These warrants have a weighted average exercise price of $2.07 per share, and have been included in the pro-forma loss calculation in note 2(n). During 2001, 370,000 of the non public warrants were exercised and 415,000 expired without being exercised. 2,254,650 of the non-public warrants were outstanding at December 31, 2001. During 2002, none of these warrants were exercised and 750,000 expired. 3,701,650 of the non-public warrants were outstanding at December 31, 2002. During 2002 the Company also extended the expiration date of 322,000 of these warrants for a period of five years to now expire in the years ending 2007 and 2008. These stock warrants have exercise prices ranging from $3.50 to $4.00 In accordance FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, no compensation expense was recognized as the exercise price at the extension date exceeded the fair value of the underlying common stock. (e) Stock Repurchase On February 19, 1999, the Board of Directors authorized the repurchase of up to 200,000 shares of the Company's common stock on the open market. On February 8, 2000, the Board authorized the repurchase of another 200,000 shares. The Company's repurchases of shares of common stock are recorded as "Treasury Stock" and result in a reduction of "Stockholders' equity." When treasury shares are reissued, the Company uses a first-in, first-out method and the excess of repurchase cost over reissuance price is treated as a reduction of "Additional paid-in capital." (f) Rights offering On November 19, 2002, the Board of Directors of Hemispherx Biopharma, Inc. (the "Company") declared a dividend distribution of one Right for each outstanding share of Common Stock to stockholders of record at the close of business on November 29, 2002 (the "Record Date"). Each Right entitles the registered holder to purchase from the Company a unit consisting of one one-hundredth of a share (a "Unit") of Series A Junior Participating Preferred Stock, par value $.01 per share (the "Series A Preferred Stock") at a Purchase Price of $30.00 per Unit, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement") between the Company and Continental Stock Transfer & Trust Company, as Rights Agent. Initially, the Rights are attached to all Common Stock certificates representing shares then outstanding, and no separate Rights Certificates will be distributed. Subject to certain exceptions specified in the Rights Agreement, the Rights will separate from the Common Stock and a Distribution Date F-41 will occur upon the earlier of (i) 10 days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired beneficial ownership of 15% or more (or 20% or more for William A. Carter, M.D.) of the outstanding shares of Common Stock (the "Stock Acquisition Date"), other than as a result of repurchases of stock by the Company or certain inadvertent actions by institutional or certain other stockholders or (ii) 10 business days (or such later date as the Board shall determine) following the commencement of a tender offer or exchange offer that would result in a person or group becoming an Acquiring Person. Until the Distribution Date, (i) the Rights will be evidenced by the Common Stock certificates and will be transferred with and only with such Common Stock certificates, (ii) new Common Stock certificates issued after the Record Date will contain a notation incorporating the Rights Agreement by reference and (iii) the surrender for transfer of any certificates for Common Stock outstanding will also constitute the transfer of the Rights associated with the Common Stock represented by such certificate. Pursuant to the Rights Agreement, the Company reserves the right to require prior to the occurrence of a Triggering Event (as defined below) that, upon any exercise of Rights, a number of Rights be exercised so that only whole shares of Preferred Stock will be issued. (6) Segment and Related Information The Company operates in one segment, which is the performance of research and development activities related to Ampligen(R) and other drugs under development. The following table present revenues by country based on the location of the use of the product services. (000's omitted) 2000 2001 2002 ---- ---- ---- United States $506 $274 $237 Belgium 272 107 74 Other 10 9 30 ---- ---- ---- $788 $ 390 $341 ==== ===== ==== In addition, the Company recorded License Fee Income in the amount of $563,000 from a Company located in Europe. The Company employs an insignificant amount of net property and equipment in its foreign operations. (7) Research, Consulting and Supply Agreements In December, 1999, the Company entered into an agreement with Biovail Corporation International ("Biovail"). Biovail is an international full service pharmaceutical company engaged in the formulation, clinical testing, registration and manufacture of drug products utilizing advanced drug delivery systems. Biovail is headquartered in Toronto, Canada. The agreement grants Biovail the exclusive distributorship of the Company's product in the Canadian territories subjects to certain terms and conditions. In return, Biovail agrees to conduct certain pre-marketing clinical studies and market development F-42 programs, including without limitation, expansion of the Emergency Drug Release Program in Canada with respect to the Company' products. Biovail agrees to work with the Company in preparing and filing of a New Drug Submission with Canadian Regulatory Authorities. Biovail invested $2.25 million in Hemispherx

equity at prices above the then current market price and agreed to make further payments based on reaching certain regulatory milestones. The Agreement requires Biovail to penetrate certain market segments at specific rates in order to maintain market exclusivity. The Company has entered into agreements for consulting services, which are performed at medical research institutions and by medical and clinical research individuals. The Company's obligation to fund these agreements can be terminated after the initial funding period, which generally ranges from one to three years or on an as-needed monthly basis. During the year ending December 31, 2000, 2001 and 2002 the Company incurred approximately $924,000, $595,000 and $395,000 respectively, of consulting service fees under these agreements. These costs are charged to research and development expense as incurred. (8) 401(K) Plan The Company has a defined contribution plan, entitled the Hemispherx BioPharma Employees 401(K) Plan and Trust Agreement (the 401(K) Plan). Full time employees of the Company are eligible to participate in the 401(K) Plan following one year of employment. Subject to certain limitations imposed by federal tax laws, participants are eligible to contribute up to 15% of their salary (including bonuses and/or commissions) per annum. Participants' contributions to the 401(K) Plan may be matched by the Company at a rate determined annually by the Board of Directors. Each participant immediately vests in his or her deferred salary contributions, while Company contributions will vest over one year. In 2000, 2001 and 2002 the Company provided matching contributions to each employee for up to 6% of annual pay aggregating $48,000, $48,000 and $38,000 respectively. (9) Royalties, License, and Employment Agreements The Company also has entered into a licensing agreement with a group of individuals and Hahnemann University relating to their contributions to the development of certain compounds, including Ampligen(R), and to obtain exclusive information and regulatory rights relating to these compounds. Under this agreement, the Company will pay 2% of net sales proceeds of Ampligen(R) not to exceed an aggregate amount of $6 million per year through 2005. In August 1988, the Company entered into a pharmaceutical use license agreement with Temple University (the Temple Agreement). In July, 1994, Temple terminated the Temple Agreement. In November 1994, the Company filed suit against Temple in the Superior Court of the State of Delaware seeking a declaratory judgment that the agreement was unlawfully terminated by Temple and therefore remained in full force and effect. Temple filed a separate suit against the Company seeking a declaratory judgment that its agreement with the Company was properly terminated. These legal actions have now been settled. Under the settlement, the parties have entered into a new pharmaceutical use license agreement (New Temple F-43 Agreement) that is equivalent in duration and scope to the previous license. Under the terms of the New Temple Agreement, Temple granted the Company an exclusive world-wide license for the term of the agreement for the commercial sale of Oragen products using patents and related technology held by Temple, which license is exclusive except to the extent Temple is required to grant a license to any governmental agency or non-profit organization as a condition of funding for research and development of the patents and technology licensed to the Company. The Company has contractual agreements with two of its officers. The aggregate annual base compensation under these contractual agreements for 2000, 2001 and 2002 was $686,000, $603,000 and $620,000 respectively. In addition, certain of these officers are entitled to receive performance bonuses of up to 25% of the annual base salary (in addition to the bonuses described below). In 2000, 2001 and 2002 no performance bonuses were granted. In 2001, Certain officers were granted warrants and options to purchase 426,650 shares of Common Stock at $4.01 per share. In 2002, certain officers were granted warrants and option to purchase 1,220,000 shares of common stock at $2.00 - $4.03 per share. One of the employment agreements provides for bonuses based on gross proceeds received by the Company from any joint venture or corporate partnering agreement. In October 1994, the Company entered into a licensing agreement with Bioclones (Propriety) Limited (SAB/Bioclones) with respect to co-development of various RNA drugs, including Ampligen(R), for a period ending three years from the expiration of the last licensed patents. The licensing agreement provides SAB/Bioclones with an exclusive manufacturing and marketing license for certain southern hemisphere countries (including certain countries in South America, Africa and Australia as well as the United Kingdom and Ireland (the licensed territory). In exchange for these marketing and manufacturing rights, the licensing agreement provides for: (a) a $3 million cash payment to the Company, all of which was received during the year ended December 31, 1995; (b) the formation and issuance to the Company of 24.9% of the capital stock of Ribotech, Ltd., a company which developed and operates a new manufacturing facility that produces raw material components of Ampligen(R) and (c) royalties of 6% to 8% of net sales of the licensed products in the licensed territories as defined, after the first $50 million of sales. SAB/Bioclones will be granted a right of first refusal to manufacture and supply to the Company licensed products for not less than one third of its world-wide sales of Ampligen(R), excluding SAB/Bioclones related sales. In addition, SAB/Bioclones will have the right of first refusal for oral vaccines in the licensed territory. In 2000, the Company paid to

Ribotech a total of $500,000 for the current and future purchases and delivery of polymers. Of the $500,000 advanced in 2000, a balance of $390,000 was included in other assets in 2000 and was used for purchases of polymers in 2001. In 2002, $262,000 was paid to Ribotech for delivery at Polymers. In October 1994, the Board of Directors granted a director of the Company the right to receive 3% of gross proceeds of any licensing fees received by the Company pursuant to the SAB/Bioclones licensing agreement, a fee of .75% of gross proceeds in the event that SAB Bioclones makes a tender offer for all or substantially all of the Company's assets, including a merger, acquisition or related transaction, and a fee of 1% on all products manufactured by SAB Bioclones. The Company may prepay in full its obligation to provide commissions within a ten year period. F-44 On March 20, 2002, our European subsidiary Hemispherx Biopharma Europe, S.A. ("Hemispherx S.A.") entered into a sales and Distribution agreement with Laboratories Del Dr. Esteve S.A. ("Esteve"). Pursuant to the terms of the agreement, Esteve was granted the exclusive right to market Ampligen(R) in Spain, Portugal and Andorra for the treatment of Myalgic/Chronic Fatigue Syndrome ("ME/CFS"). In addition to other terms and other projected payments, Esteve paid an initial and non-refundable fee of 625,000 Euros (approximately $563,000) to Hemispherx S.A. on April 24, 2002. Esteve is to pay a fee of 1,000,000 Euros after U.S. Food and Drug Administration approval of Ampligen(R) for the treatment of ME/CFS and a fee of 1,000,000 Euros upon Spain's approval of the final marketing authorization for using Ampligen(R) for the treatment of ME/CFS. In connection with the two agreements entered into with ISI (See Note 1), the Company is obligated to pay ISI a 6% royalty on the net sales of the Alferon N Injection product. (10) Leases The Company has several noncancelable operating leases for the space in which its principal offices are located and certain office equipment.\ Future minimum lease payments under noncancelable operating leases are as follows: (000's omitted) Year ending Operating December 31, leases ---------- --------- 2003. . . . . $ 279 2004. . . . . 286 2005. . . . . 240 2006. . . . . 193 2007. . . . . 65 ------- Total minimum lease payments. . . . . $ 1,063 ======= Rent expense charged to operations for the years ended December 31, 2000, 2001 and 2002 amounted to approximately $347,000, $294,000 and $307,000 respectively. The term of the lease for the Rockville, Maryland facility is through June, 2005 with an average rent of $8,000 per month, plus applicable taxes and charges. The term of the lease for the Philadelphia, Pennsylvania offices is through April, 2007 with an average rent of $15,000 per month, plus applicable taxes and charges. (11) Income Taxes As of December 31, 2002, the Company has approximately $66,000,000 of federal net operating loss carryforwards (expiring in the years 2004 through 2022) available to offset future federal taxable income. The Company also has approximately $15,000,000 of state net operating loss carryforwards (expiring in F-45 the years 2003 through 2007) available to offset future state taxable income. The utilization of certain state net operating loss carryforwards may be subject to annual limitations. Under the Tax Reform Act of 1986, the utilization of a corporation's net operating loss carryforward is limited following a greater than 50% change in ownership. Due to the Company's prior and current equity transactions, the Company's net operating loss carryforwards may be subject to an annual limitation generally determined by multiplying the value of the Company on the date of the ownership change by the federal long-term tax exempt rate. Any unused annual limitation may be carried forward to future years for the balance of the net operating loss carryforward period. Deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the carrying amounts used for income tax purposes. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences representing net future deductible amounts become deductible. Due to the uncertainty of the Company's ability to realize the benefit of the deferred tax asset, the deferred tax assets are fully offset by a valuation allowance at December 31, 2001 and 2002. The components of the net deferred tax asset of December 31, 2001 and 2002 consists of the following: (000,s omitted) Deferred tax assets: 2001 2002 ------- ------- Net operating losses $20,790 $22,440 Accrued Expenses and Other 21 (16) Capitalized Research and development costs 4,634 3,763 ------- ------- 25,445 26,187 Less: Valuation Allowance 25,445 26,187 ------- ------- Balance $ -0- $ -0- ======= ======= (12) Contingencies On September 30, 1998, we filed a multi-count complaint against Manuel P. Asensio, Asensio & Company, Inc. ("Asensio"). The action included claims of defamation, disparagement, tortuous interference with existing and prospective business relations and conspiracy, arising out of the Asensio's false and defamatory statements. The complaint further alleged that Asensio defamed and disparaged us in furtherance of a manipulative, deceptive and unlawful short-selling scheme in August and September, 1998. In 1999, Asensio filed an answer and counterclaim alleging that in response to Asensio's strong sell recommendation and other press releases, we made defamatory statements about F-46 Asensio. We denied the material

allegations of the counterclaim. In July 2000, following dismissal in federal court for lack of subject matter jurisdiction, we transferred the action to the Pennsylvania State Court. In March 2001, the defendants responded to the complaints as amended and a trial commenced on January 30, 2002. A jury verdict disallowed the claims against the defendants for defamation and disparagement and the court granted us a directed verdict on the counterclaim. On July 2, 2002 the Court entered an order granting us a new trial against Asensio for defamation and disparagement. Thereafter, Asensio appealed the granting of a new trial. This appeal is now pending in the Superior Court of Pennsylvania. In June 2002, a former ME/CFS clinical trial patient and her husband filed a claim in the Superior Court of New Jersey, Middlesex County, against us, one of our clinical trial investigators and others alleging that she was harmed in the ME/CFS clinical trial as a result of negligence and breach of warranties. We believe the claim is without merit and we are defending the claim against us through our product liability insurance carrier. In June 2002, a former ME/CFS clinical trial patient in Belgium filed a claim in Belgium, against Hemispherx Biopharma Europe, NV/SA, our Belgian subsidiary, and one of our clinical trial investigators alleging that she was harmed in the Belgium ME/CFS clinical trial as a result of negligence and breach of warranties. We believe the claim is without merit and we are defending the claim against us through our product liability insurance carrier. In July 2002, we filed suit in the United States District Court for the Eastern District of Pennsylvania against our insurance company seeking (1) a judicial order declaring our rights and the obligations of our insurance carrier under the insurance policy our insurance carrier sold to us (2) monetary damage for breach of contract resulting from our insurance carrier refusal to fully defend us in connection with the Asensio litigation (3) monetary damages to compensate us for our insurance carrier breach of its fiduciary duty faith and dealing and (4) monetary damages, interest, cost, and attorneys fees to compensate us for violation of the Pennsylvania Bad Faith Statute. On March 31, 2003 we settled our outstanding claim with our insurance carrier for $1,500,000 relating to reimbursement of expenses in connection with our Asensio law suits. We expect to realize approximately $1,050,000 of this amount after payment of expenses related to the settlement. Such amount was recorded during the fourth quarter 2002 as a reduction in General and Administrative expenses in our statement of operations. In March 2003, one of our former law firms filed a complaint in the Court of Common Pleas of Philadelphia County against us for alleged legal fees in the sum of $65,051. We believe the claim is without merit and are defending the matter. (13) Related Party Transactions We have employment agreements with certain of our executive officers and have granted such officers and directors of the Company options and warrants to purchase common stock of the Company, as discussed in Notes 2(n) and 9. A director of the Company, is an attorney in private practice, who has rendered corporate legal services to us from time to time, for which he has received fees. A Director of the Company, lives in Paris, France and assists our European subsidiaries in their dealings with medical institutions and the F-47 European Medical Evaluation Authority. A Director of the Company, assists us in establishing clinical trail protocols as well as performs other scientific work for us from time to time. For these services, these Directors were paid an aggregate of $173,500, $144,955 and $170,150 for the years ending December 31, 2000, 2001 and 2002 respectively. William A. Carter, Chief Executive Officer of the Company, received an aggregate of $12,486 in short term advances which were repaid as of December 31, 2001. All advances bare interest at 6% per annum. The Company loaned $60,000 to, a Director of the Company in November, 2001 for the purpose of exercising 15,000 class A redeemable warrants. This loan bears interest at 6% per annum. We paid $42,775, $57,750 and $33,450 for the years ending December 31, 2000, 2001 and 2002, respectively to Carter Realty for the rent of property used at various times in 2002 by us. The property is owned by others and managed by Carter Realty. Carter Realty is owned by Robert Carter, the brother of William A. Carter. (14) Concentrations of credit risk Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash. The Company places its cash with high-quality financial institutions. At times, such amount may be in excess of Federal Deposit Insurance Corporation insurance limits of $100,000. F-48 (15) Quarterly Results of Operation (unaudited) (in thousand except per share data) 2001 ---------- First Second Third Fourth Quarter Quarter Quarter Quarter Total ------- -------- ------- -------- ------- Revenue 127 $ 101 $ 76 $ 86 $ 390 Costs and expenses 2,676 2,504 2,262 1,750 9,192 Net loss (2,480) (2,343) (2,145) (2,115) (9,083) ------ -------- ------- ------ ------ Basic and diluted loss per share $(.08) $(.08) $(.07) $(.07) $(.29) ------ -------- ------- ------ ------ 2002 (1) ---------- First Second Third Fourth Quarter Quarter Quarter Quarter Total ------- -------- ------- -------- ------- Revenues and license fee income $ 613 $ 134 $ 79 $ 78 $ 904 Costs and expenses 2,121 2,097 1,961 782 6,961 Net loss (1,488) (2,634) (1,891) (1,411) (7,424) ------ -------- ------- ------ ------ Basic and diluted loss per share $(.05) $(.08) $(.06) $(.04) $(.23) ------ -------- ------- ------ ------ (1) During the fourth quarter of 2002, the Company recorded write offs of certain investments in unconsolidated affiliates of approximately $688,000. (See note 2(c)). Additionally, during the fourth quarter of 2002, the Company

recorded as a reduction of general and administrative expenses, an amount of $1,050,000 representing the net settlement with its insurance carrier. (See Note 12) (16) Debenture Financing On March 12, 2003, We issued an aggregate of $5,426,000 in principal amount of 6% Senior Convertible Debentures due January 31, 2005 and an aggregate of 743,288 Warrants to two investors in a private placement for aggregate anticipated gross proceeds of $4,650,000. Pursuant to the terms of the Debentures, $1,550,000 of the proceeds from the sale of the Debentures have been held back and will be released to us if, and only if, we acquire ISI's facility with in a set timeframe. The Debentures mature on January 31, 2005 and bear interest at 6% per annum, payable quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest shall be valued at 95% of the average closing price of the common stock during the five consecutive F-49 business days ending on the third business day immediately preceding the applicable interest payment date. Pursuant to the terms and conditions of the Senior Convertible Debentures, we have pledged all of our assets as collateral and are subject to comply with certain financial and negative covenants, which include but are not limited to the repayment of principal balances upon achieving certain revenue milestone. The Debentures are convertible at the option of the investors at any time through January 31, 2005 into shares of our common stock. The conversion price under the Debentures is fixed at $1.46 per share, subject to adjustment for anti-dilution protection for issuance of common stock or securities convertible or exchangeable into common stock at a price less than the conversion price then in effect. The investors also received Warrants to acquire at any time through March 12, 2008 an aggregate of 743,288 shares of common stock at a price of $1.68 per share. On March 12, 2004, the exercise price of the Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between March 13, 2003 and March 11, 2004 (but in no event less than $1.176 per share). The exercise price (and the reset price) under the Warrants also is subject to similar adjustments for anti-dilution protection. We entered into a registration rights agreement with the investors in connection with the issuance of the Debentures and the Warrants. The registration rights agreement requires that we register the shares of common stock issuable upon conversion of the Debentures, as interest shares under the Debenture and upon exercise of the Warrants. In accordance with this agreement, we filed a registration statement on form S-3 with the Securities and Exchange Commission. If the registration statement is not declared effective within the time period required by the agreement or, after it is declared effective and subject to certain exceptions, sales of all shares required to be registered thereon cannot be made pursuant thereto, then we will be required to pay to the investors their pro rata share of $3,635 for each day any of the above conditions exist with respect to this registration statement. F-50 Interferon Sciences, Inc. INDEX TO CONSOLIDATED FINANCIAL STATEMENTS Page ---- Independent Auditors' Report F-52 Financial Statements: Consolidated Balance Sheets - December 31, 2002 and 2001 F-53 Consolidated Statements of Operations - Years ended December 31, 2002, 2001 and 2000 F-55 Consolidated Statements of Changes in Stockholders' Equity Capital Deficiency - Years ended December 31, 2002, 2001 and 2000 F-56 Consolidated Statements of Cash Flows - Years ended December 31, 2002, 2001 and 2000 F-58 Notes to Consolidated Financial Statements F-59 F-51 INDEPENDENT AUDITOR'S REPORT The Board of Directors and Stockholders Interferon Sciences, Inc. We have audited the accompanying consolidated balance sheets of Interferon Sciences, Inc. and subsidiary as of December 31, 2002 and 2001 and the related consolidated statements of operations, changes in stockholders' equity capital deficiency and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Interferon Sciences, Inc. and subsidiary as of December 31, 2002 and 2001 and the consolidated results of their operations and their consolidated cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has experienced a significant net losses in each of the years in the three-year period ended December 31, 2002 and at December 31, 2002, has a capital deficiency and a negative

working capital position. These factors raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. In connection with our audit of the financial statements referred to above, we audited Schedule II - Valuation and Qualifying Accounts for 2002. In our opinion, this schedule, when considered in relation to the financial statements taken as a whole, presents fairly, in all material respects, the information stated therein. Eisner LLP New York, New York June 10, 2003 F-52 INTERFERON SCIENCES, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS December 31, ---------- 2002 2001 ---- ---- As Restated (See Note 4) ASSETS Current assets Cash and cash equivalents $ 378,663 $ 1,184,889 Accounts and other receivables 42,739 123,389 Inventories, net of reserves of $4,678,659 and $5,538,413, respectively 28,489 109,913 Prepaid expenses and other current assets 12,179 17,608 ---------- ---------- Total current assets 462,070 1,435,799 ---------- ---------- Property, plant and equipment, at cost Land 140,650 140,650 Buildings and improvements 7,793,242 7,793,242 Equipment 4,920,942 4,920,942 ---------- ---------- 12,854,834 12,854,834 Less accumulated depreciation (11,173,264) (10,776,342) ---------- ---------- 1,681,570 2,078,492 ---------- ---------- Patent costs, net of accumulated amortization of $388,974 and $360,819 132,187 160,342 Other assets 100 10,100 ---------- ---------- $ 2,275,927 3,684,733 ========== ========== The accompanying notes are an integral part of these consolidated financial statements. F-53 INTERFERON SCIENCES, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS (continued) LIABILITIES AND CAPITAL DEFICIENCY Current liabilities Accounts payable $ 1,387,462 963,323 Accrued expenses 414,262 350,548 Due to American Red Cross 1,402,870 1,339,338 ISI stock subject to resale agreement and in-kind services due Metacine 1,700,000 1,700,000 Note payable and amount due GP Strategies 413,745 495,745 Convertible Notes payable, net of debt discount 281,863 ---------- ---------- Total current liabilities 5,600,202 4,848,954 ---------- ---------- Commitments Capital deficiency Preferred stock, par value $.01 per share; authorized - 5,000,000 shares; none issued and outstanding Common stock, par value $.01 per share; authorized - 55,000,000 shares; issued and outstanding- 21,030,405 and 20,308,031 shares, respectively 210,304 203,080 Capital in excess of par value 136,810,618 136,239,499 Accumulated deficit (140,345,197) (137,606,800) ---------- ---------- Total capital deficiency (3,324,275) (1,164,221) ---------- ---------- $ 2,275,927 3,684,733 ========== ========== The accompanying notes are an integral part of these consolidated financial statements. F-54 INTERFERON SCIENCES, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2002 2001 2000 -------- -------- -------- As Restated As Restated (See Note 4) (See Note 4) Revenues ALFERON N Injection $ 1,926,466 $ 1,498,603 $ 1,067,471 Research products and other revenues 1,442 ---------- ---------- ---------- Total revenues 1,926,466 1,498,603 1,068,913 ---------- ---------- ---------- Costs and expenses Cost of goods sold and excess/idle production costs 1,482,006 1,485,962 1,455,929 Research and development 1,514,286 2,286,300 1,533,324 General and administrative 1,818,194 2,646,734 2,306,146 Acquisition of in-process technology 2,341,418 ---------- ---------- ---------- Total costs and expenses 4,814,486 8,760,414 5,295,399 ---------- ---------- ---------- Loss from operations (2,888,020) (7,261,811) (4,226,486) Interest income 7,122 108,351 161,835 Interest expense (385,775) (91,469) (87,873) Equity in loss of Metacine (158,582) ---------- ---------- ---------- Loss before income tax benefit (3,266,673) (7,403,511) (4,152,524) Income tax benefit: Gain on sale of state net operating loss carryovers 528,276 968,553 1,483,861 ---------- ---------- ---------- Net loss $ (2,738,397) $(6,434,958) $(2,668,663) ========== ========== ========== Basic and diluted net loss per share $ (.13) $ (.33) $ (.22) ========== ========== ========== Weighted average number of shares outstanding 20,575,948 19,576,312 12,097,252 ========== ========== ========== The accompanying notes are an integral part of these consolidated financial statements. F-55 INTERFERON SCIENCES, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY CAPITAL DEFICIENCY Total Capital in stockholders' Common stock excess of Accumulated Settlement equity Shares Amount par value deficit Shares (deficiency) ---------- ---------- ---------- ---------- ---------- Balance at January 1, 2000, previously stated 5,327,473 $ 53,275 $129,397,259 $(128,812,179) $ (81,000) $ 557,355 Cumulative effect of restating inventory reserves, and effect of correcting cost of sales, see Note 4 (1,156,000) 309,000 81,000 (766,000) ---------- ---------- ---------- ---------- ---------- Balance at January 1, 2000, as restated 5,327,473 $ 53,275 $128,241,259 $(128,503,179) $ 0 $ (208,645) Net proceeds from sale of common stock 11,635,451 116,354 6,980,595 7,096,949 Common stock issued as compensation 20,000 200 23,550 23,750 Common stock issued under Company 401(k) plan 78,914 789 79,409 80,198 Common stock issued as payment against accounts payable 870,000 8,700 (8,700) Employee stock option compensation 2,050 2,050 Compensation paid in cash in settlement of obligation to

issue common stock cash in settlement of obligation 282,506 282,506 Forgiveness of amount due GP Strategies 129,886 129,886 Settlement shares sold 382,515 382,515 Net loss, as restated (2,668,663) (2,668,663) ---------- Balance at December 31, 2000 17,931,838 179,318 136,113,070 (131,171,842) 0 5,120,546 The accompanying notes are an integral part of these consolidated financial statements. F-56 INTERFERON SCIENCES, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY CAPITAL DEFICIENCY (continued) Common stock issued to Metacine 2,000,000 20,000 (20,000) Common stock issued as compensation 50,000 500 12,780 13,280 Common stock issued under Company 401(k) plan 323,949 3,239 106,095 109,334 Proceeds from exercise of common stock options 2,244 23 538 561 Employee stock option compensation 5,553 5,553 Settlement shares sold 21,463 21,463 Net loss, as restated (6,434,958) (6,434,958) ---------- Balance at December 31, 2001 20,308,031 203,080 136,239,499 (137,606,800) 0 (1,164,221) Common stock issued under Company 401(k) plan 722,374 7,224 71,119 78,343 Fair value of warrants issued with convertible notes and value of beneficial conversion feature 500,000 500,000 Net loss (2,738,397) (2,738,397) ---------- Balance at December 31, 2002 21,030,405 $210,304 $136,810,618 $(140,345,197) $ 0 $(3,324,275) The accompanying notes are an integral part of these consolidated financial statements. F-57 INTERFERON SCIENCES, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, ---------- 2002 2001 2000 -------- -------- -------- As Restated As Restated (See Note 4) (See Note 4) Cash flows from operating activities: Net loss $(2,738,397) $(6,434,958) $(2,668,663) Adjustments to reconcile net loss to net cash used for operating activities: Depreciation and amortization 425,077 507,507 502,157 Acquisition of in-process research and development 2,341,418 Equity in loss of Metacine 158,582 Gain on settlements of research-related liabilities (456,998) Provision for notes receivable 87,500 70,000 Non-cash compensation expense 78,343 128,167 388,504 Debt discount 281,863 Change in operating assets and liabilities: Accounts and other receivables 80,650 1,551,409 (1,639,237) Inventories 81,424 (4,439) (105,474) Prepaid expenses and other current assets 5,429 (120) 9,530 Accounts payable and accrued expenses 551,385 95,845 (1,497,126) Amount due to GP Strategies 18,000 29,106 (87,112) ---------- ---------- ---------- Net cash used for operating activities (1,216,226) (1,539,983) (5,484,419) ---------- ---------- ---------- Cash flows from investing activities: Additions to property, plant and equipment (46,994) (56,967) Investments in Metacine and other assets (787,500) (170,000) Reduction of other assets 10,000 ---------- ---------- ---------- Net cash provided by (used for) investing activities 10,000 (834,494) (226,967) ---------- ---------- ---------- Cash flows from financing activities: Proceeds from convertible notes payable 500,000 Net proceeds from sale of common stock 7,096,949 Repayment of note payable to GP Strategies (100,000) (100,000) Proceeds from exercise of common stock options 561 ---------- ---------- ---------- Net cash provided by (used for) financing activities 400,000 (99,439) 7,096,949 ---------- ---------- ---------- Net increase (decrease) in cash and cash equivalents (806,226) (2,473,916) 1,385,563 Cash and cash equivalents at beginning of year 1,184,889 3,658,805 2,273,242 ---------- ---------- ---------- Cash and cash equivalents at end of year $ 378,663 $ 1,184,889 $ 3,658,805 ========== ========== ========== The accompanying notes are an integral part of these consolidated financial statements. F-58 INTERFERON SCIENCES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Note 1. Organization and Business Interferon Sciences, Inc. (the "Company") is a biopharmaceutical company that operates in a single segment and is engaged in the study, manufacture, and sale of pharmaceutical products based on its highly purified, multispecies, natural source alpha interferon ("Natural Alpha Interferon"). The Company's ALFERON(R) N Injection (Interferon Alfa-n3) product has been approved by the United States Food and Drug Administration ("FDA") for the treatment of certain types of genital warts and the Company has studied its potential use in the treatment of HIV, hepatitis C, and other indications. Alferon N Injection is sold principally in the United States, however, a portion is sold in foreign countries. For the years ended December 31, 2002, 2001 and 2000, domestic sales totaled $1,926,466, $1,488,897, and $1,046,470, respectively, and foreign sales totaled zero, $9,706, and $21,001, respectively. All identifiable assets are located in the United States. Subsequent to December 31, 2002, the Company sold its inventory and granted a license to its products to Hemispherx Biopharma, Inc. See Note 20. Integrated Commercialization Solutions, Inc. ("ICS"), a subsidiary of AmerisourceBergen Corporation, is the sole United States distributor of ALFERON N Injection. ICS distributes ALFERON N Injection to a limited number of wholesalers throughout the United States. Note 2. Summary of Significant Accounting Policies Principles of consolidation -- The consolidated financial statements include the operations of the Company and Interferon Sciences Development Corporation ("ISD"), its wholly owned subsidiary. All significant intercompany transactions and balances

have been eliminated. The transactions and balances of Metacine, Inc. are being accounted for under the equity method (see Note 7). The losses of Metacine from April 9, 2001, the date of the Company's acquisition of an 82% equity interest in Metacine through December 31, 2001, have been reflected in the accompanying statement of operations as equity in loss of Metacine to the extent of the Company's carrying value of the investment in Metacine. At December 31, 2001, the carrying value was written down to $-0-. Cash and cash equivalents -- The Company considers all highly liquid instruments with maturities of three months or less from purchase date to be cash equivalents. Property, plant and equipment -- Property, plant and equipment are carried at cost. Major additions and improvements are capitalized while maintenance and repairs, which do not extend the lives of the assets, are expensed. Depreciation -- The Company provides for depreciation and amortization of plant and equipment following the straight-line method over the estimated useful lives of such assets as follows: Class of Assets Estimated Useful Lives ---------- ---------- Buildings and Improvements 15 to 30 years Equipment 5 to 10 years Depreciation expense for the years ended December 31, 2002, 2001 and 2000 was $396,922, $478,082 and $472,101, respectively. Patent costs -- The Company capitalizes costs to obtain patents and licenses. Patent costs are amortized over 17 years on a straight-line basis. To the extent a patent is determined to be worthless, the related net capitalized cost is immediately expensed. F-59 Revenue recognition -- Title passes to the customer at the shipping point and revenue is therefore recognized when the product is shipped. The Company's product is also tested by its quality control department prior to shipment. The Company has no other obligation associated with its products once shipment has occurred. Research and Development Costs - Research and development are expensed when incurred. The types of costs included in research and development are: salaries, supplies, clinical costs, facility costs and depreciation. All of these expenditures were for Company sponsored research and development programs. During 2000, the Company settled amounts owed by the Company on various research related liabilities at a savings to the Company of approximately $457,000. The amount was credited against research and development expenses in 2000. Inventories -- Inventories, consisting of raw materials, work in process and finished goods, are stated at the lower of cost or market on a FIFO basis. Inventory in excess of the Company's estimated usage requirements is written down to its estimated net realizable value. Inherent in the estimates of net realizable value is management estimates related to the Company's future manufacturing schedules, customer demand, possible alternative uses and ultimate realization of potentially excess inventory. Long-Lived Assets -- The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or estimated fair value less costs to sell. Stock option plan - The Company accounts for its stock-based compensation to employees and members of the Board of Directors in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation is recorded on the date of issuance or grant as the excess of the current market value of the underlying stock over the purchase or exercise price. Any deferred compensation is amortized over the respective vesting periods of the equity instruments, if any. The Company has adopted the disclosure provisions of Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation," and Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," which was released in December 2002 as an amendment of SFAS 123. The following table illustrates the effect on net loss and loss per share if the fair value based method had been applied to all awards. Year Ended December 31, 2002 2001 2000 Reported net loss $(2,738,397) $(6,434,958) $(2,668,663) Stock-based employee compensation expense included in reported net loss, net of related tax effects -- -- -- Stock based employee compensation determined under the fair value based method, net of related tax effects (94,165) (730,284) (481,151) Pro forma net loss (2,832,562) (7,165,242) (3,149,814) Loss per share (basic and diluted) As reported $ (.13) $ (.33) $ (.22) Pro forma $ (.14) $ (.37) $ (.26) F-60 During 2002 and 2001, the Company did not grant any stock options. The per share weighted-average fair value of stock options granted during 2000 was $.88 on the date of grant using the Black Scholes option-pricing model with the following weighted-average assumptions: expected dividend yield of 0.0%, risk-free interest rate of 6.1%, expected volatility of 142.4% and an expected life of 3.0 years. Loss per share -- Basic loss per share (EPS) are based upon the weighted average number of common shares outstanding during the period. Diluted EPS are based upon the weighted average number of common shares outstanding during the period assuming the issuance of common shares for

all dilutive potential common shares outstanding. At December 31, 2002, 2001 and 2000, the Company's options and warrants outstanding are anti-dilutive and therefore basic and diluted EPS are the same. Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Income taxes - Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. At December 31, 2002 and 2001, the Company has recorded a full valuation allowance for the net deferred tax asset. Recently Issued Accounting Standards In June 2001, the FASB issued SFAS No. 141, Business Combinations, ("SFAS No. 141") and SFAS No. 142, Goodwill and Other Intangible Assets ("SFAS No. 142"). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations. SFAS No. 141 specifies criteria that intangible assets acquired in a business combination must meet to be recognized and reported separately from goodwill. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121 and subsequently, SFAS No. 144 after its adoption. The Company adopted the provisions of SFAS No. 141 as of July 1, 2001, and SFAS No. 142 as of January 1, 2002. Upon adoption of SFAS No. 142, the Company was required to reassess the useful lives and residual values of all intangible assets acquired, and make any necessary amortization period adjustments by the end of the first interim period after adoption. If an intangible asset was identified as having an indefinite useful life, the Company would be required to test the intangible asset for impairment in accordance with the provisions of SFAS No. 142 within the first interim period. Impairment is measured as the excess of carrying value over the fair value of an intangible asset with an indefinite life. Any impairment loss would be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period. As of the date of adoption of SFAS No. 142, the Company does not have any goodwill and has unamortized identifiable intangible assets of approximately $160,000, all of which is subject to the transition provisions of SFAS No. 142. F-61 In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS No. 144"). SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. SFAS No. 144 requires companies to separately report discontinued operations and extends that reporting to a component of an entity that either has been disposed of (by sale, abandonment, or in a distribution to owners) or is classified as held for sale. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. The Company adopted SFAS No. 144 on January 1, 2002. In April 2002, the FASB issued SFAS No. 145, "Rescission of FAS Statements 4, 44 and 64, Amendment of FAS Statement 13 and Technical Corrections." SFAS No. 145 eliminates Statement 4 (and Statement 64, as it amends Statement 4), which required gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, and thus, also the exception to applying Opinion 30 is eliminated as well. This statement is effective for fiscal years beginning after May 2002 for the provisions related to the rescission of Statements 4 and 64 and for all transactions entered into beginning May 2002 for the provision related to the amendment of Statement 13. The Company does not expect that the adoption of SFAS No. 145 will have a material impact on its results of operations or financial position. In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs associated with Exit or Disposal Activities." SFAS No. 146 requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to

an exit plan. The Company is required to adopt SFAS No. 146 on January 1, 2003. The Company does not expect the adoption of SFAS No. 146 will have a material impact on its results of operations or financial position. In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," an amendment to SFAS No. 123, "Accounting for Stock-Based Compensation." Provisions of this statement provide two additional alternative transition methods: modified prospective method and retroactive restatement method, for an entity that voluntary changes to the fair value based method of accounting for stock-based employee compensation. The statement eliminates the use of the original SFAS No. 123 prospective method of transition alternative for those entities that change to the fair value based method in fiscal years beginning after December 15, 2003. It also amends the disclosure provisions of SFAS No. 123 to require prominent annual disclosure about the effects on reported net income in the Summary of Significant Accounting Policies and also requires disclosure about these effects in interim financial statements. These provisions are effective for financial statements for fiscal years ending after December 15, 2002. Accordingly, the Company adopted the applicable disclosure requirements of this statement for year-end reporting. The transition provisions of this statement apply upon the adoption of the SFAS No. 123 fair value based method. The Company did not change its method of accounting for employee stock-based compensation from the intrinsic method to the fair value based alternative. Note 3. Operations The Company has experienced significant operating losses since its inception in 1980. As of December 31, 2002, the Company had an accumulated deficit of approximately $140 million. For the years ended December 31, 2002, 2001 and 2000, the Company had losses from operations of approximately $2.9 million, $7.3 million, and $4.2 million, respectively. Also, the Company has limited liquid resources. These factors raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Although the Company received FDA approval in 1989 to market ALFERON N Injection in the United States for the treatment of certain genital warts, the Company has had limited success in generating revenue from the sale of ALFERON N Injection to date. During the year ended December 31, 2002, the Company generated $1,926,466 in revenue from the sale of ALFERON N Injection and received $528,276 from the sale of the Company's New Jersey net operating tax loss carryovers. In addition, the Company completed a private placement of $500,000 of convertible notes to accredited investors. At F-62 December 31, 2002, the Company had approximately $379,000 of cash and cash equivalents, with which to support future operating activities and to satisfy its financial obligations as they become payable. On March 11, 2003, the Company sold all its inventory related to its ALFERON N Injection product and granted a three-year license to sell the product to Hemispherx Biopharma, Inc. ("HEB"). In exchange for the inventory and license, the Company received HEB common stock with a guaranteed value of $675,000, an additional 62,500 shares of HEB common stock without a guaranteed value, and a royalty equal to 6% of the net sales of ALFERON N Injection. The HEB common stock will be subject to selling restrictions. In addition, HEB assumed approximately $400,000 of the Company's payables and various other commitments. The Company and HEB also entered into another agreement pursuant to which the Company will sell to HEB, subject to regulatory approval, the Company's real estate property, plant, equipment, furniture and fixtures, rights to ALFERON N Injection and all of its patents, trademarks and other intellectual property related to its natural alpha interferon business. In exchange, the Company will receive $675,000 of HEB common stock with a guaranteed value, an additional 62,500 shares of HEB common stock without a guaranteed value and a royalty equal to 6% of the net sales of all products sold containing natural alpha interferon. HEB will assume approximately $2.3 million of the Company's indebtedness that currently encumbers its assets. In addition, HEB will fund the operating costs of the Company's facility pending the completion of this transaction. In the event the Company does not obtain regulatory approval prior to September 12, 2003, either the Company or HEB may terminate the agreement and not complete the transaction. Based on the Company's sale to HEB, estimates of revenue, expenses, and the timing of repayment of creditors, management believes that the Company has sufficient resources to enable the Company to continue operations until the third quarter of 2003. However, actual results, may differ materially from such estimate, and no assurance can be given that additional funding will not be required sooner than anticipated or that such additional funding, whether from financial markets or from other sources, will be available when needed or on terms acceptable to the Company. Insufficient funds will require the Company to terminate operations. Note 4. Restatement At December 31, 1999, the balance of the inventory reserves has been increased to eliminate the effect of the $766,000 reversal of inventory previously written down. This retroactive adjustment results in increasing the Accumulated Deficit at December 31, 1999 by $766,000 and decreasing inventory and total assets by the same amount. In addition, a restatement was required to correct cost of sales and equity in loss of Metacine. The Net Loss and loss per share for the years ended December 31, 2000 and 2001 have also been similarly

revised as follows: Year Ended December 31, 2000 2001 ---- ---- Net Loss as previously reported $(2,981,672) $(7,249,576) Effect of reversing inventory write (up) down(1) (71,300) 584,898 Effect of adjusting carrying value of inventory(2) 105,474 4,439 Elimination of adjustments for common stock held by Red Cross(3) 278,835 (65,713) Effect of correcting equity in loss of Metacine(4) -- 290,994 ---------- ---------- Net Loss as restated $(2,668,663) $(6,434,958) ---------- ---------- F-63 Basic and diluted Net Loss per share as previously stated $ (.25) $ (.37) Effect of reversing inventory write down -- .03 Effect of adjusting carrying value of inventory .01 -- Elimination of adjustments for common stock held by Red Cross .02 -- Effect of correcting equity in loss of Metacine -- .01 ---------- ---------- Basic and diluted Net Loss per share as restated $ (.22) $ (.33) ========== ========== (1) To adjust for reversal of inventory write (up) down. (2) To adjust the carrying value of inventory for production costs not capitalized. (3) To adjust cost of sales for the change in market value of common stock held by American Red Cross. (4) To adjust for the equity in the loss of Metacine in excess of the carrying basis. Note 5. Agreements with Hoffmann-LaRoche F. Hoffmann-La Roche Ltd. and Hoffmann-LaRoche, Inc. (collectively, "Hoffmann") have been issued patents covering human alpha interferon in many countries throughout the world. In 1995, the Company obtained a non-exclusive perpetual license from Hoffmann (the "Hoffmann Agreement") that grants the Company the worldwide rights to make, use, and sell, without a potential patent infringement claim from Hoffmann, any formulation of Natural Alpha Interferon. The Hoffmann Agreement permits the Company to grant marketing rights with respect to Natural Alpha Interferon products to third parties, except that the Company cannot grant marketing rights with respect to injectable products in any country in which Hoffmann has patent rights covered by the Hoffmann Agreement (the "Hoffmann Territory") to any third party not listed on a schedule of approximately 50 potential marketing partners without the consent of Hoffmann, which consent cannot be unreasonably withheld. Under the terms of the Hoffmann Agreement, the Company is obligated to pay Hoffmann an aggregate royalty on net sales (as defined) of Natural Alpha Interferon products by the Company in an amount equal to (i) 8% of net sales in the Hoffmann Territory, and 2% of net sales outside the Hoffmann Territory of products manufactured in the Hoffmann Territory, up to $75,000,000 of net sales in any calendar year and (ii) 9.5% of net sales in the Hoffmann Territory, and 2% of net sales outside the Hoffmann Territory of products manufactured in the Hoffmann Territory, in excess of $75,000,000 of net sales in any calendar year, provided that the total royalty payable in any calendar year shall not exceed $8,000,000. For the years ended December 31, 2002, 2001 and 2000, the Company recorded approximately $31,000, $60,000, and $42,000, in royalty expenses to Hoffmann, respectively. The Hoffmann Agreement can be terminated by the Company on 30 days notice with respect to the United States patent, any individual foreign patent, or all patents owned by Hoffmann. If the Hoffmann Agreement is terminated with respect to the patents owned by Hoffmann in a specified country, such country is no longer included in the Hoffmann Territory. Accordingly, the Company would not be permitted to market any formulation of alpha interferon in such country. Note 6. Research and Development Agreement with Interferon Sciences Research Partners, Ltd. In 1984, the Company organized ISD to act as the sole general partner of Interferon Sciences Research Partners, Ltd., a New Jersey limited partnership (the "Partnership"). The Company and the Partnership entered into a development contract whereby the Company received substantially all of the net proceeds ($4,414,475) of the Partnership's public offering of limited partnership interests. The Company used the proceeds to perform research, development and clinical testing on behalf of the Partnership for the development of ALFERON Gel containing recombinant interferon. F-64 In connection with the formation of the Partnership, ISD agreed to make additional cash contributions for purposes of continuing development of ALFERON Gel if the Partnership exhausted its funds prior to development of such product. ISD is wholly dependent upon the Company for capital to fund such commitment. The Partnership exhausted its funds during 1986, and the Company contributed a total of $1,997,000 during the period from 1986 to 1990, for the continued development of ALFERON Gel. In 1987, the Company filed a Product License Application with the FDA for approval to market ALFERON Gel. In February 1990, the FDA indicated that additional process development and clinical trials would be necessary prior to approval of ALFERON Gel. The Company believed, at that time, that the costs to complete the required process development and clinical trials would be substantial, and there could be no assurance that the clinical trials would be successful. As a result of the above events, in 1992, the Company withdrew its FDA Product License Application for ALFERON Gel containing recombinant interferon. In place of single species recombinant interferon, previously ALFERON Gel's active ingredient, the Company commenced, in 1992, further development of ALFERON Gel using the Company's natural source multi-species alpha interferon ("ALFERON N Gel"). However, at the present time, the Company is not actively pursuing development of ALFERON N Gel and the Company does not have an obligation to provide additional funding to the Partnership. Assuming successful development and commercial exploitation of ALFERON N Gel, which to date has not

occurred, the Company may be obligated to pay the Partnership royalties equal to 4% of the Company's net sales of ALFERON N Gel and 15% of revenues received from sublicensing ALFERON N Gel. Note 7. Agreement with Metacine, Inc. On July 28, 2000, the Company acquired for $100,000 an option to purchase certain securities of Metacine, Inc. ("Metacine"), a company engaged in research using dendritic cell technology, on the terms set forth below. On April 9, 2001, the Company exercised its option to acquire an 82% equity interest in Metacine. Pursuant to the agreement, as amended, the Company received 700,000 shares of Metacine common stock and a five-year warrant to purchase, at a price of $12.48 per share, 282,794 shares of Metacine common stock in exchange for $300,000 in cash, an obligation to pay Metacine $ 1,850,000 and $250,000 of services to be rendered by the Company by June 30, 2002. In addition, the Company issued Metacine 2,000,000 shares of the Company's common stock. The agreement contains certain restrictions on the ability of Metacine to sell the Company's shares and provides for the Company to make cash payments ("Deficiency Payments") to Metacine to the extent Metacine has not received from the sale of the Company's common stock, cumulative net proceeds of $1,850,000 by September 30, 2002 or $400,000 of net proceeds per quarter beginning with the period ending September 30, 2001 and $250,000 for the quarter ending September 30, 2002. On October 4, 2001, the Company made a Deficiency Payment to Metacine in the amount of $400,000 for the quarter ending September 30, 2001. The Company has not made the remainder of the Deficiency Payments in the aggregate amount of $1,450,000. If Metacine sells all of the 2,000,000 shares received and the cumulative proceeds from the sales and any Deficiency Payments are less than $1,850,000, the Company may issue to Metacine additional shares of common stock at the Company's full discretion. These additional shares would be treated in the same manner as the original 2,000,000 shares. In the event that cumulative net proceeds to Metacine from the sale of the Company's common stock exceed $1,850,000, any Deficiency Payments previously made by the Company ($400,000 through December 31, 2002) would be repaid to the Company to the extent these proceeds exceed $1,850,000. All additional proceeds beyond the $1,850,000 and repayment of Deficiency Payments, if any, would be for the benefit of Metacine. The Company was required to put in escrow 100,000 Metacine shares to secure its obligations to render $250,000 of services to Metacine and 462,500 Metacine shares to secure its potential obligations to make Deficiency Payments. Since the Company has not made $1,450,000 in Deficiency Payments and has not rendered $250,000 of services to Metcine, Metacine could request 462,500 Metacine shares currently held in escrow to satisfy the Company's past due obligations. Although the Company is the majority owner of Metacine, the Company must, on many matters, vote its shares of Metacine common stock in the same proportion as votes cast by the minority stockholders of Metacine, except for certain matters with respect for which the Company has protective rights. In accordance with EITF Issue No. 96-16, Investor's Accounting for an Investee When the Investor has a Majority of the Voting Interest but the Minority Shareholder or Shareholders have Certain Approval or Veto Rights, the minority holders have substantive participating rights which include controlling the selection, termination and setting of compensation for Metacine management who are responsible for implementing policies and procedures, making operating and capital decisions (including establishing budgets) for Metacine and most other F-65 ordinary operating matters, and therefore, the Company does not control Metacine. In addition, the Company only has one representative on a board of directors consisting of three directors. Accordingly, the acquisition is being accounted for under the equity method. Of the $2.5 million consideration paid for Metacine, $2,341,418 was recorded as a charge for the acquisition of in-process research and development ("IPR&D") in 2001. The charge was recorded as the acquisition of IPR&D as Metacine's primary asset is technology that has not reached technological feasibility and has no alternative uses. The in-process research and development expenses relate to a patent portfolio consisting of six issued patents, eight pending patents and four invention disclosures related to the use of dendritic cells for the treatment of various diseases. While the patent portfolio, when viewed as a whole, represented a new approach to the treatment of various diseases utilizing cell therapy, the six issued patents had no independent commercial value. While the Company did not engage the services of an independent appraiser to assess the fair value of the purchased in process research and development, it considered the following factors: (i) any product or process utilizing dendritic cells as a treatment for any disease would regulated by the FDA and therefore would require extensive clinical testing prior to the time any revenue would be generate from the sale of a product or process, (ii) the cost of such clinical trials would be in excess of $ 50,000,000, (iii) it would take between seven to ten years to complete such clinical trials, (iv) there could be no assurance that even if Metacine could obtain the funding required to complete the clinical trials (which was well beyond Metacine's capability at the time Metacine acquired rights to the patent portfolio), that the clinical trials would have shown the product or process tested to be safe and effective. The Company's $1,850,000 obligation to Metacine, less the $400,000 Deficiency Payment made in October 2001, has been recorded as a current liability at December 31, 2002 and 2001. The

$250,000 of services to be provided has also been recorded as a current liability. Services rendered to Metacine to date were immaterial and as such, the liability remained unchanged at December 31, 2002 and 2001. The investment has been further reduced to zero at December 31, 2001, by the Company's equity in the loss of Metacine of $158,582 for the period from April 9, 2001 through December 31, 2001. On April 1, 2003, the license granted by the University of Pittsburgh to Metacine covering Metacine's technology was terminated due to non-payment by Metacine. Accordingly, the Company's has not reflected its share of its equity in the losses in Metacine for the years ended December 31, 2002 and 2001 in the amounts of $274,846 and $290,994, respectively. The Company is currently in discussions with Metacine with respect to a full settlement of the Company's obligations to Metacine. Note 8. Inventories Inventories, consisting of material, labor and overhead, are classified as follows: December 31, 2002 2001 ---------- As Restated (See Note 4) Finished goods $ 322,518 $ 1,263,696 Work in process 3,052,070 3,052,070 Raw materials 1,332,560 1,332,560 Less reserve for excess inventory (4,678,659) (5,538,413) ---------- ---------- $ 28,489 $ 109,913 ========== ========== Finished goods inventory consists of vials of ALFERON N Injection, available for commercial and clinical use either immediately or upon final release by quality assurance. In light of the results of the Company's Phase 3 studies of ALFERON N Injection in HIV and HCV-infected patients, the Company has recorded a reserve against its inventory of ALFERON N Injection to reflect its estimated net realizable F-66 value. The reserve was a result of the Company's assessment of anticipated near-term projections of product to be sold or utilized in clinical trials, giving consideration to historical sales levels. As a result, inventories at December 31, 2002 and 2001, reflect a reserve for excess inventory of $4,678,659 and $5,538,413, respectively. Note 9. Convertible Notes Payable In August 2002, the Company completed a private placement of $500,000 of convertible notes to accredited investors. Each note is convertible into the Company's common stock at a price of $.05 per share (subject to adjustment to 70% of the market price of the Company's common stock under certain circumstances) and bears interest at the rate of 10% per annum. $250,000 of the convertible notes is due January 31, 2003 and the other $250,000 of the convertible notes is due December 31, 2003. For each $100,000 principal amount of notes issued, the investors received warrants to purchase an additional 10.2 million shares of the Company's common stock exercisable at $.01 per share. The warrants were valued at $400,000 and are amortized as interest expense over the terms of the respective notes. The transaction is subject to approval by the shareholders of the Company. In the event that shareholder approval is not obtained, the convertible noteholders could exercise their rights and call a default making the convertible notes immediately due and payable. In addition, these notes are convertible into common stock at a beneficial rate. The beneficial conversion feature is valued at $100,000 and accounted for as debt discount and is being amortized over the term of the notes. Note 10. Income Taxes As a result of the loss allocation rules contained in the Federal income tax consolidated return regulations, approximately $5,900,000 of net federal operating loss carryforwards, which expire from 2003 to 2006, are available to the Company upon ceasing to be a member of GP Strategies's consolidated return group in 1991. In addition, the Company has net federal operating loss carryforwards for periods subsequent to May 31, 1991, and through December 31, 2002 of approximately $104,000,000 that expire from 2006 to 2022. In addition, the Company had state net operating loss carryforwards of approximately $32,000,000 that expire from 2005 to 2009. The Company believes that the events culminating with the closing of its Common Stock Private Offering on November 6, 2000 may result in an "ownership change" under Internal Revenue Code, Section 382, with respect to its stock. The Company believes that as a result of the ownership change, the future utility of its pre-change net operating losses may be significantly limited. Further, the issuance of 51,000,000 warrants in August 2002 could also result in an ownership change and further limit use of the net operating losses carried forward. The tax effects of temporary differences that give rise to deferred tax assets and liabilities consist of the following as of December 31, 2002 and 2001: Deferred tax assets 2002 2001 ---------- ---------- Net operating loss carry-forwards $ 39,530,000 34,551,000 Tax credit carry-forwards -- 150,000 Inventory reserve 1,872,000 2,114,000 Property and equipment, principally due to differences in basis and depreciation 661,000 588,000 In-process technology costs -- 937,000 ---------- ---------- Gross deferred tax asset 42,063,000 38,340,000 Valuation allowance (42,063,000) (38,340,000) ---------- ---------- Net deferred taxes $ -- $ -- ========== ========== F-67 A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The Company has determined, based on the Company's history of annual net losses, that a full valuation allowance is appropriate. The change in the valuation allowance for 2002 and 2001 was $3,723,000 and $2,411,000, respectively. Based on the Company's net loss before income taxes in 2002, 2001 and 2000, the Company would have recorded a tax benefit. During each of these years, the Company recorded increases in the valuation allowance due to uncertainty regarding the realization of deferred taxes that reduced the Company's expected income tax benefit to zero in

these years. The Company participates in the State of New Jersey's corporation business tax benefit certificate transfer program (the "Program"), which allows certain high technology and biotechnology companies to transfer unused New Jersey net operating loss carryovers to other New Jersey corporation business taxpayers. During 1999, the Company submitted an application to the New Jersey Economic Development Authority (the "EDA") to participate in the Program and the application was approved. The EDA then issued a certificate certifying the Company's eligibility to participate in the Program and the amount of New Jersey net operating loss carryovers the Company has available to transfer. Since New Jersey law provides that net operating losses can be carried over for up to seven years, the Company may be able to transfer its New Jersey net operating losses from the last seven years. The Program requires that a purchaser pay at least 75% of the amount of the surrendered tax benefit. During 2002, 2001 and 2000, the Company completed the sale of approximately $6.5 million, $12 million, and $19 million of its New Jersey tax loss carryovers and received $0.53 million, $0.97 million, and $1.48 million, which were recorded as a tax benefit from gains on sale of state net operating loss carryovers on its Consolidated Statement of Operations in 2002, 2001 and 2000, respectively. Note 11. Common Stock, Stock Options, Warrants and Other Shares Reserved The Company has a stock option plan (the "Plan"), which authorizes a committee of the Board of Directors to grant options, to purchase shares of Common Stock, to officers, directors, employees and consultants of the Company. Pursuant to the terms of the Plan, no option may be exercised after 10 years from the date of grant. The Plan permits options to be granted at a price not less than 85% of the fair market value, however, the options granted to date have been at fair market value of the common stock at the date of the grant. Employee stock option activity for options under the Plan during the periods indicated is as follows: Number of Weighted-Average Shares Exercise Price ---------- ---------- Balance at December 31, 1999 1,887,260 $ .25 Granted 61,710 1.10 Forfeited (2,580) .25 --------- Balance at December 31, 2000 1,946,390 .28 Exercised (2,244) .25 Forfeited (13,525) .35 --------- Balance at December 31, 2001 1,930,621 .28 Forfeited (22,546) .41 --------- Balance at December 31, 2002 1,908,075 .27 F-68 At December 31, 2002, the exercise prices and weighted-average remaining contractual life of outstanding options were: Number of Options Life --------- ---- $ .25 - $1.00 1,854,475 1 year $1.01 - $1.25 53,600 1 year At December 31, 2002, the number of options exercisable was 1,908,075, and the weighted-average exercise price of those options was $.27. FASB Interpretation No. 44 provides guidance for applying APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("FIN 44"). It applies prospectively to new awards, exchanges of awards in a business combination, modifications to outstanding awards, and changes in grantee status on or after July 1, 2000, except for provisions related to repricings and the definition of an employee that apply to awards issued after December 15, 1998. The Company has evaluated the financial impact of FIN 44 and has determined that the repricing of employee stock options on October 27, 1999 falls within the guidance of FIN 44. On October 27, 1999, the Company repriced 429,475 stock options to $.25 per share. On July 1, 2000, the implementation date of FIN 44, 352,823 shares of the 429,475 shares were fully vested (exercisable) and the closing price of the Company's common stock on such date was $1.63 per share. Beginning on and after July 1, 2000, the Company is required to record compensation expense on the repriced vested options only when the market price exceeds $1.63 per share and only on the amount in excess of $1.63 per share. For the repriced unvested stock options, the intrinsic value measured at the July 1, 2000 effective date that is attributable to the remaining vesting period will be recognized over that future period. The unvested stock options at July 1, 2000 (76,652) were fully vested on January 1, 2001. On December 31, 2002, the closing price of the Company's common stock was $.05 per share and accordingly, under FIN 44, no compensation expense was recorded on the repriced fully vested stock options of July 1, 2000 and on the repriced unvested stock options of July 1, 2000. Information regarding all Options and Warrants Changes in options and warrants outstanding during the years ended December 31, 2002, 2001 and 2000, and options and warrants exercisable and shares reserved for issuance at December 31, 2002 are as follows: F-69 The following table includes all options and warrants including employee options (which are discussed above). Price Range Number of Per Share Shares ---------- --------- Outstanding at December 31, 1999 $ .25 - $77.90 2,567,032 Granted .56 - 1.50 14,631,279 Terminated .25 - 77.90 (90,975) ---------- ---------- Outstanding at December 31, 2000 .25 - 48.00 17,107,336 Exercised .25 (2,244) Terminated .25 - 48.00 (77,938) ---------- ---------- Outstanding at December 31, .25 - 36.00 17,027,154 Warrants Issued .01 - .01 51,000,000 Terminated .25 - 36.00 (49,510) ---------- ---------- Outstanding at December 31, 2002 .01 - 1.50 67,977,644 ========== Exercisable: December 31, 2002 .25 - 1.50 16,977,644 ========== Shares reserved for issuance: December 31, 2002 67,977,644 ========== Options and warrants outstanding and exercisable, and shares reserved for issuance at December 31, 2002, include 500,000 shares under a warrant agreement with GP Strategies. The warrants are priced at $1.00 per share and expire on March 25, 2004. Options and warrants outstanding and exercisable, and shares reserved for issuance at December 31, 2002, include

11,635,451 shares under warrant agreements with the purchasers of a 2000 private offering. The warrants are priced at $1.50 per share and expire on April 17, 2005. Options and warrants outstanding and exercisable, and shares reserved for issuance at December 31, 2002, include 2,934,118 shares under a warrant agreement to purchase 1,467,059 units. Each unit consists of a share of common stock and a warrant to purchase an additional share of common stock at a price of $1.50 per share, exercisable at a price of $.66 per unit. The units were issued as compensation for services rendered to the Company in the 2000 private offering and expire on April 17, 2005. Options and warrants outstanding and shares reserved for issuance, at December 31, 2002, include 51,000,000 shares under warrant agreements (subject to shareholder approval) with the purchasers of the convertible notes. The warrants are exercisable at $.01 per share upon shareholder approval and expire in 2007. Note 12. Savings Plan The ISI Savings Plan (the "Savings Plan") permits pre-tax contributions to the Savings Plan by participants pursuant to Section 401(k) of the Internal Revenue Code of up to 15% of base compensation. The Company will match up to the 6% level of the participants' eligible contributions. The Savings Plan matches 40% in cash and 60% in the Company's common stock up to the 6% level. For 2002, the Company's contribution to the Savings Plan, which was fully vested, was $131,000, consisting of $52,657 in cash and $78,343 in stock. For 2001, the Company's contribution to the Savings Plan was $176,000, F-70 consisting of $66,666 in cash and $109,334 in stock. For 2000, the Company's contribution to the Savings Plan was $124,000, consisting of $43,802 in cash and $80,198 in stock. Note 13. Common Stock Compensation and Profit Sharing Plan Common Stock Compensation Plan Effective October 1, 1997, the Company adopted the Common Stock Compensation Plan (the "Stock Compensation Plan"), providing key employees with the opportunity of receiving the Company's common stock as additional compensation. Pursuant to the terms of the Stock Compensation Plan, key employees were to receive, as additional compensation, a pre-determined amount of the Company's common stock in three equal installments on October 1, 1998, 1999 and 2000, provided that the key employees remain in the employ of the Company at each such installment date. As of October 1, 2000, 1999 and 1998, a deferred compensation liability of $289,920, $340,821 and $412,344, respectively, was accrued for these employees based on the common stock market price of October 1, 1997. On October 1, 2000, 1999 and 1998, the Company paid the compensation in cash in settlement of the Company's obligation to issue shares of common stock. Accordingly, cash of $7,414, $2,131, and $25,947, respectively, was paid in satisfaction of the accrued liability of $289,920, $340,821 and $412,344, respectively. The difference of $282,506, $338,690, and $386,397 was credited to additional paid in capital in 2000, 1999 and 1998, respectively. Profit Sharing Plan The Company has a Profit Sharing Plan (the "Profit Sharing Plan") providing key employees and consultants with an opportunity to share in the profits of the Company. The Profit Sharing Plan is administered by the Company's Compensation Committee. Pursuant to the terms of the Profit Sharing Plan, the Compensation Committee, in its sole discretion, based upon the significance of the employee's contributions to the operations of the Company, selects certain key employees and consultants of the Company who are entitled to participate in the Profit Sharing Plan and determines the extent of their participation. The amount of the Company's profits available for distribution to the participants (the "Distribution Pool") is the lesser of (a) 10% of the Company's income before taxes and profit sharing expense and (b) an amount equal to 100% of the base salary for such year of all the participants in the Profit Sharing Plan. The Compensation Committee may require as a condition to participation that a participant remain in the employ of the Company until the end of the fiscal year for which payment is to be made. Payments required to be made under the Profit Sharing Plan must be made within 10 days of the filing of the Company's tax return. To date, there have been no contributions by the Company under the Profit Sharing Plan. Note 14. Related Party Transactions GP Strategies owns less than 5% of the Company's common stock as of December 31, 2002. The Company was a party to a management agreement with GP Strategies, pursuant to which certain legal, financial and administrative services had been provided by employees of GP Strategies. The management agreement was terminated on March 27, 2000 (See Note 16). See Note 16 for information with respect to royalty obligations to GP Strategies. F-71 Note 15. Supplemental Statement of Cash Flow Information The Company paid no income taxes or interest during the three-year period ended December 31, 2002. During the years ended December 31, 2002, 2001 and 2000 the following non-cash financing and investing activities occurred: 2002: None 2001: The Company issued 2,000,000 shares, with a guaranteed value of $1,850,000, of common stock and committed to provide $250,000 of services to be rendered by the Company to Metacine (see Note 7). The Company reduced capital in excess of par value and the corresponding liability by $21,463 for settlement shares sold. 2000: The Company issued 870,000 shares of common stock as payment related to accounts payable (see Note 16). The Company credited capital in excess of par value for forgiveness of $129,886 of debt due GP Strategies. The Company reduced capital in excess of par value and the corresponding liability by $382,515 for settlement shares sold. Note 16. Commitments The Company obtained human

white blood cells used in the manufacture of ALFERON N Injection from several sources, including the Red Cross pursuant to a supply agreement dated April 1, 1997 (the "Supply Agreement"). The Company will not need to purchase more human white blood cells until such time as production of crude alpha interferon is resumed. Under the terms of the Supply Agreement, the Company was obligated to purchase a minimum amount of human white blood cells each month through March 1999 (the "Minimum Purchase Commitment"), with an aggregate Minimum Purchase Commitment during the period from April 1998 through March 1999 in excess of $3,000,000. As of November 23, 1998, the Company owed the Red Cross approximately $1.46 million plus interest at the rate of 6% per annum accruing from April 1, 1998 (the "Red Cross Liability") for white blood cells purchased pursuant to the Supply Agreement. Pursuant to an agreement dated November 23, 1998, the Company granted the Red Cross a security interest in certain assets to secure the Red Cross Liability, issued to the Red Cross 300,000 shares of common stock and agreed to issue additional shares at some future date as requested by the Red Cross to satisfy any remaining amount of the Red Cross Liability. The Red Cross agreed that any net proceeds received by it upon sale of such shares would be applied against the Red Cross Liability and that at such time as the Red Cross Liability was paid in full, the Minimum Purchase Commitment would be deleted effective April 1,1998 and any then existing breaches of the Minimum Purchase Commitment would be waived. In January 1999 the Company granted the Red Cross a security interest (the "Security Interest") in, among other things, the Company's real estate, equipment inventory, receivables, and New Jersey net operating loss carryovers to secure repayment of the Red Cross Liability, and the Red Cross agreed to forbear from exercising its rights under the Supply Agreement, including with respect to collecting the Red Cross Liability until June 30, 1999 (which was subsequently extended until December 31, 1999). On December 29, 1999, the Company, the Red Cross and GP Strategies entered in an agreement pursuant to which the Red Cross agreed that until September 30, 2000 it would forbear from exercising its rights under (i) the Supply Agreement, including with respect to collecting the Red Cross Liability, and (ii) the Security Interest. In connection with the Asset Sale Transactions, the Company, HEB and the Red Cross entered into a similar agreement pursuant to which the Red Cross agreed to forbear from exercising its rights until May 31, 2003 and the Red Cross agreed to accept HEB common stock with a guaranteed value of $500,000 in full settlement of all of the Company's obligations to the Red Cross. Under the terms of such agreement, if HEB does not make such payment, the Red Cross has the right to sell the Company's real estate. F-72 During 1999, the Red Cross sold 27,000 of the Settlement Shares and sold the balance of such shares (273,000 shares) during the first quarter of 2000. As a result, the net proceeds from the sales of the Settlement Shares, $33,000 in 1999 and $368,000 in 2000, were applied against the liability to the Red Cross. The remaining liability to the Red Cross included in accounts payable on the consolidated balance sheet at December 31, 2002 and 2001 was approximately $1,403,000 and $1,339,000, respectively. On October 30, 2000, the Company issued an additional 800,000 shares to the Red Cross. The net proceeds from the sale of such shares by the Red Cross will be applied against the remaining liability of $1,403,000 owed to the Red Cross. However, there can be no assurance that the net proceeds from the sale of such shares will be sufficient to extinguish the remaining liability owed the Red Cross. Pursuant to an agreement dated March 25, 1999, GP Strategies loaned the Company $500,000. In return, the Company granted GP Strategies (i) a first mortgage on the Company's real estate, (ii) a two-year option (which has expired) to purchase the Company's real estate, provided that the Company has terminated its operations and the Red Cross Liability has been repaid, and (iii) a two-year right of first refusal (which has expired) in the event the Company desires to sell its real estate. In addition, the Company issued GP Strategies 500,000 shares of Common Stock and a five-year warrant to purchase 500,000 shares of Common Stock at a price of $1 per share. The common stock and warrants issued to GP Strategies were valued at $500,000 and recorded as a financing cost and amortized over the original period of the GP Strategies Debt in 1999. Pursuant to the agreement, the Company has issued a note to GP Strategies representing the GP Strategies Debt, which note was originally due on September 30, 1999 (but extended to June 30, 2001) and bears interest, payable at maturity, at the rate of 6% per annum. In addition, at that time the Company negotiated a subordination agreement with the Red Cross pursuant to which the Red Cross agreed that its lien on the Company's real estate is subordinate to GP Strategies' lien. On March 27, 2000, the Company and GP Strategies entered into an agreement pursuant to which (i) the GP Strategies Debt was extended until June 30, 2001 and (ii) the Management Agreement between the Company and GP Strategies was terminated and all intercompany accounts between the Company and GP Strategies (other than the GP Strategies Debt) in the amount of approximately $130,000 were discharged which was recorded as a credit to capital in excess of par value. On August 23, 2001, the Company and GP Strategies entered into an agreement pursuant to which the GP Strategies Debt was extended to March 15, 2002. During 2001, the Company paid GP Strategies $100,000 to reduce the GP Strategies Debt. In addition, in January 2002,

the Company paid GP Strategies $100,000 to further reduce the GP Strategies Debt. Interest expense accrued to GP Strategies was $18,000, $27,937 and $22,500 for the years ended December 31,2002, 2001 and 2000, respectively. In connection with the Asset Sale Transactions, the Company, HEB and GP Strategies entered into a similar agreement pursuant to which GP Strategies agreed to forbear from exercising its rights until May 31, 2003 and GP Strategies agreed to accept HEB common stock with a guaranteed value of $425,000 in full settlement of all the Company's obligations to GP Strategies. Under the terms of such agreement, if HEB does not make such payment, GP Strategies has the right to sell the Company's real estate. As consideration for the transfer to the Company of certain licenses, rights and assets upon the formation of the Company by GP Strategies, the Company agreed to pay GP Strategies royalties of $1,000,000, but such payments will be made only with respect to those years in which the Company has income before income taxes, and will be limited to 25% of such income. Through December 31, 2002, the Company has not generated income before taxes and therefore has not accrued or paid royalties to GP Strategies. See Notes 5 and 6 for information relating to royalties payable to Hoffmann and the Partnership, respectively. F-73 Note 17. Quarterly Financial Data (unaudited) The following summarizes the Company's unaudited quarterly results for 2002 and 2001. 2002 Quarters First Second Third Fourth ----- ------ ----- ------ As Restated(2) As Restated(2) As Restated(2) Thousands of dollars except per share data Revenues $ 784 $ 176 $ 687 $ 279 Gross profit (loss)(1) 369 (149) 254 (30) Net loss (693) (949) (639) (457) Basic and diluted net loss per share (.03) (.05) (.03) (.02) 2001 Quarters First Second Third Fourth ----- ------ ----- ------ As Restated(2) As Restated(2) As Restated(2) As Restated(2) Thousands of dollars except per share data Revenues $ 371 $ 344 $ 459 $ 325 Gross profit (loss)(1) (44) 22 98 (63) Net loss (1,272) (3,659) (1,060) (444) Basic and diluted net loss per share (.07) (.18) (.05) (.02) (1) Gross profit (loss) is calculated as revenue less cost of goods sold and excess/idle production costs. (2) Restatement 2002 Quarters First Second Third Gross profit (loss) as previously reported $ (35) $(245) $ 263 Effect of reversing inventory write(up) down(a) 252 -- -- Effect of adjusting carrying value of inventory(b) (32) (8) (49) Elimination of adjustments for common stock held by Red Cross(c) 184 104 40 ---------- Gross profit (loss) as restated $ 369 $(149) $ 254 ========== F-74 Net loss as previously stated $(1,289) $(1,429) $ (655) Net effect of gross profit adjustments from above 404 96 (9) Effect of correcting equity in loss of Metacine(d) 112 124 39 Elimination of adjustments for common stock held by Metacine(e) 80 260 100 Amortization of Debt Discount(f) -- -- (114) ---------- Net loss as restated $ (693) $ (949) $ (639) ========== Basic and diluted net loss per share as previously stated $ (0.06) $ (0.07) $ (0.03) Effect of gross profit adjustments 0.02 -- -- Effect of Metacine related adjustments 0.01 0.02 0.01 Effect of amortization of debt discount -- -- (0.01) ---------- Basic and diluted net loss per share as restated $ (0.03) $ (0.05) $ (0.03) ========== (a) To adjust for reversal of inventory write (up) down. (b) To adjust the carrying value of inventory for production costs not capitalized. (c) To adjust cost of sales for the change in market value of common stock held by the American Red Cross. (d) To adjust for the equity in the loss of Metacine in excess of the carrying basis. (e) To adjust other expenses for the change in market value of common stock held by Metacine. (f) To amortize debt discount on convertible notes issued during the year. 2001 Quarters First Second Third Fourth Gross profit (loss) as previously reported $ (270) $ (56) $ (267) $ 81 Effect of reversing inventory write(up) down(a) 159 116 192 118 Effect of adjusting carrying value of inventory(b) (15) 53 (19) (14) Elimination of adjustments for common stock held by Red Cross(c) 82 (91) 192 (248) ---------- Gross profit (loss) as restated $ (44) $ 22 $ 98 $ (63) ========== Net loss as previously stated $(1,498) $(3,737) $(1,665) $ (350) Net effect of gross profit adjustments from above 226 78 365 (144) F-75 Effect of correcting equity in loss of Metacine(d) -- -- -- 290 Elimination of adjustments for common stock held by Metacine(e) -- -- 240 (240) ---------- Net loss as restated $(1,272) $(3,659) $(1,060) $ (444) ========== Basic and diluted net loss per share as previously stated $ (0.08) $ (0.19) $ (0.08) $ (0.02) Effect of gross profit adjustments 0.01 -- 0.02 -- Effect of Metacine related adjustments -- -- 0.01 -- ---------- Basic and diluted net loss per share as restated $ (0.07) $ (0.19) $ (0.05) $ (0.02) ==========

(a) To adjust for reversal of inventory write (up) down. (b) To adjust the carrying value of inventory for production costs not capitalized. (c) To adjust cost of sales for the change in market value of common stock held by the American Red Cross. (d) To adjust for the equity in the loss of Metacine in excess of the carrying basis. (e) To adjust other expenses for the change in market value of common stock held by Metacine. Note 18. Fair Value of Financial Instruments The carrying values of financial instruments, assuming the Company continues as a going concern, including cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and note payable approximate fair values, because

of the short term nature or interest rates that approximate current rates. Note 19. Agreement with Mayo In April 2001, the Company entered into a technology license agreement with Mayo Foundation for Medical Education and Research ("Mayo") under which the Company obtained certain technology rights. The Company has committed to fund approximately $400,000 of costs related to a clinical trial beginning in December 2001 and which is currently expected to take at least two years from the date hereof to complete. The Company paid Mayo $100,000 related to this clinical trial in 2001, incurred $101,565 in 2002 and will owe other amounts upon the completion of certain parts of the trial, with the last payment due upon receipt of the final written report on the trial. The Company can terminate this agreement up to 60 days after receipt of this report. After expiration of this ability to terminate, the Company must issue 25,000 shares of the Company's common stock to Mayo and must pay milestone payments upon certain regulatory or other events and royalties on future sales, if any. In addition, the Company paid $60,000 to Mayo related to the agreement in 2001. Under the terms of the Asset Sales Transactions, the Company's right to continue this agreement and the obligation owed to Mayo was transferred to HEB. The Company did not generate any revenues from this agreement for each of the three years ended December 31, 2002. Note 20. Subsequent Event On March 11, 2003, the Company sold all its inventory related to its ALFERON N Injection product and granted a license to sell the product to Hemispherx Biopharma, Inc. ("HEB"). In exchange for the inventory and license, the Company received HEB common stock with a guaranteed value of $675,000, an additional 62,500 shares of HEB common stock without a guaranteed value, and a royalty equal to 6% of the net sales of ALFERON N Injection. The HEB common stock F-76 will be subject to selling restrictions. In addition, HEB assumed approximately $400,000 of the Company's payables and various other commitments. The Company and HEB also entered into another agreement pursuant to which the Company will sell to HEB, subject to regulatory approval, the Company's real estate property, plant, equipment, furniture and fixtures, rights to ALFERON N Injection and all of its patents, trademarks and other intellectual property related to its natural alpha interferon business. In exchange, the Company will receive $675,000 of HEB common stock with a guaranteed value, an additional 62,500 shares of HEB common stock without a guaranteed value and a royalty equal to 6% of the net sales of all products sold containing natural alpha interferon. HEB will assume approximately $1.5 million of the Company's indebtedness that currently encumbers its assets. In addition, HEB will fund the operating costs of the Company's facility pending the completion of this transaction. In the event the Company does not obtain regulatory approval prior to September 12, 2003, either the Company or HEB may terminate the agreement and not complete the transaction. In March 2003, the Company sold 15,000,000 shares of its common stock in a private placement transaction to an investor for $150,000. In connection with this private placement, the Company also sold, for $1,000, 15,000,000 warrants exercisable at $.01 per share and expiring in March 2008. F-77 INTERFERON SCIENCES, INC. AND SUBSIDIARY SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS Additions Balance at Charged to Balance at Beginning Costs, Provisions End of Description Of Period and Expenses Deductions(a) Period ---------- ---------- ---------- ---------- ---------- Year ended December 31, 2002 Valuation and qualifying accounts deducted from assets to which they apply: Reserve for excess inventory $5,538,413 $ $ 859,754 $4,678,659 Year ended December 31, 2001 Valuation and qualifying accounts deducted from assets to which they apply: Reserve for excess inventory $6,123,311 $ $ 584,898 $5,538,413 Year ended December 31, 2000 Valuation and qualifying accounts deducted from assets to which they apply: Reserve for excess inventory $6,991,185 $ $ 867,874 $6,123,311 Notes: Deductions are for the usage of a portion of the reserve for excess inventory. F-78 Hemispherx Biopharma, Inc. Unaudited Pro forma Financial Information. Consolidated Statements of Operations for the year ended December 31, 2002 and for the nine months ended September 30, 2003. Consolidated Balance Sheet as of September 30, 2003. The unaudited pro-forma adjustments give effect to the second agreement with ISI irrespective of the fact that the second acquisition remains unconsummated and is contingent on the Company receiving the appropriate governmental approval for the real estate to be acquired and ISI stockholders approving the transaction. Hemispherx Biopharma, Inc. and Subsidiaries Unaudited Pro Forma Consolidated Statement of Operations Year ended December 31, 2002 (in thousands, except per share data) (4) PRO FORMA (1) (2) (3) PRO FORMA AS FURTHER HEMISPHERX INTERFERON PRO FORMA PRO FORMA FURTHER ADJUSTED BIOPHARMA, INC. SCIENCES, INC. ADJUSTMENTS AS ADJUSTED ADJUSTMENTS FOR FOR SECOND AND SUBSIDIARIES AND SUBSIDIARY FOR FIRST FOR FIRST ASSET SECOND ASSET ASSET 2002 2002 ASSET ACQUISITION ACQUISITION ACQUISITION ACQUISITION ---------- ---------- ---------- ---------- ---------- ---------- Revenues: Sales of product $ -- $ 1,926 $ $ 1,926 $ $ 1,926 Clinical treatment programs 341 341 341 License fee income 563 563 563 -------- ---------- -------- --------- -------- --------- 904 1,926 -- 2,830 -- 2,830 -------- ---------- -------- --------- -------- --------- Costs and expenses: Costs of goods sold/idle Production costs -- 1,482 (37)(a)

1,445 60(e) 1,505 Research and development 4,946 1,514 (39)(a) 6,421 7(e) 6,428 General and administrative (34)(a) 2,015 1,818 116(c) 3,915 6(e) 3,921 -------- ---------- -------- --------- -------- --------- F-79 Total cost and expenses 6,961 4,814 6 11,781 73 11,854 -------- ---------- -------- --------- -------- --------- Interest and other income 103 7 (7)(a) 103 103 Interest and related expenses (386) 386(a) (1,551) (1,609)(d) (3,160) (1,551)(b) Investments in unconsolidated affiliates (1,470) (1,470) (1,470) Gain on sale of state net operating loss carryovers 528 (528)(a) -- -- -------- ---------- -------- --------- -------- --------- Net loss $(7,424) $ (2,739) $(1,706) $(11,869) $(1,682) $(13,551) -------- ---------- -------- --------- -------- --------- Basic and diluted loss per share $ (0.23) $ (0.36) $ (0.40) -------- --------- --------- Basic and diluted weighted Average common shares outstanding 32,086 487 32,573 1,069 33,642 -------- -------- --------- -------- --------- See accompanying notes to consolidated statement of operations F-80 NOTES TO UNAUDITED PROFORMA CONSOLIDATED STATEMENT OF OPERATIONS The following notes describe the column headings in the unaudited pro forma consolidated statement of operations and the pro forma adjustments that have been made to this statement: (1) Reflects the audited consolidated historical statement of operations of Hemispherx Biopharma, Inc. and subsidiaries for the year ended December 31, 2002. (2) Reflects the audited consolidated historical statement of operations for ISI for the year ended December 31, 2002. (3) Reflects pro forma adjustments relating to the first acquisition of certain assets of ISI and the related funding as follows: (a) Adjustments to reflect the recording of costs related to sales of product by ISI where values were reduced to zero in years prior to 2002, the elimination of ISI's net interest expense, the elimination of ISI's depreciation, and the elimination of a gain on the sale of a tax loss by ISI as follows: ---------- Inventory $(287) ---------- Interest expense-net 379 ---------- Depreciation 397 ---------- Sale of state net operating loss carryover (528) ---------- Total $ (39) ---
---------- (b) Increase in interest expense resulting from the issuance of $3.1 million of 6% senior convertible debentures. Interest expense is inclusive of deferred interest charges resulting from the Company recording debt discounts of $2.1 million in recognition of fair values of detachable warrants, contingent conversion features original issued discount and settlement costs recorded in connection with the debenture offering. (c) Increase in general and administrative costs of resulting from the recognition of 6% royalty charges on the net sales of the acquired ALFERON N injection product. (4) Reflects pro forma adjustments relating to the second acquisition of certain asset of ISI and the related funding as follows: (d) Increase in interest expense resulting from the issuance of an additional $1.6 million 6% senior convertible debentures and additional detachable warrants to purchase 1,000,000 shares of common stock at $2.40 per share. Interest expense is inclusive of deferred interest charges resulting from the Company recording of additional debt discounts of approximately $ 2.8 million in recognition of fair values of additional detachable warrants, contingent conversion features, original issued discount and additional settlement costs recorded in connection with the debenture offering. (e) Adjustments reflect depreciation expense relating to the acquired building as result of the second acquisition of certain assets of ISI. F-81 Hemispherx Biopharma, Inc. and Subsidiaries Unaudited Pro Forma Consolidated Statement of Operations Hemispherx Biopharma, Inc. and Subsidiaries Unaudited Pro Forma Consolidated Statement of Operations Nine Months ended September 30, 2003 (in thousands, except per share data) (4) (3) PRO FORMA (1) (2) PRO FORMA PRO FORMA FURTHER PRO FORMA HEMISPHERX INTERFERON ADJUSTMENTS AS ADJUSTED ADJUSTMENTS AS FURTHER BIOPHARMA, INC. SCIENCES, INC. FOR FIRST FOR FIRST FOR SECOND ADJUSTED FOR AND SUBSIDIARIES AND SUBSIDIARY ASSET ASSET ASSET SECOND ASSET 2003 2003 ACQUISITION ACQUISITION ACQUISITION ACQUISITION ---------- ---------- ---------- ---------- ---------- Revenues: Sales of product $ 236 $ 242 $ $ 478 $ $ 478 Clinical treatment programs 118 118 118 --------- ------ --------- --------- ------ --------- 354 242 596 596 --------- ------ --------- --------- ------ --------- Costs and expenses: Costs of goods sold/idle Production costs 224 267 47(a) 538 45(d) 583 Research and development 2,574 190 (7)(a) 2,757 6(d) 2,763 General and administrative 2,550 266 (7)(a) 2,838 6(d) 2,844 29(c) --------- ------ --------- --------- ------ --------- Total cost and expenses 5,348 723 62 6,133 57 6,190 --------- ------ --------- --------- ------ --------- Interest and other income 61 61 61 Interest and related expenses (5,795) (33) 33(a) (5,795) 847(c) (4,948) Service fee income 115 (115)(a) -- Other income 6 (6)(a) -- Bulk sale of Alferon inventory 1,164 (1,164)(a) -- --------- ------ --------- --------- ------ --------- Net loss $(10,728) $ 771 $ (1,314) $(11,271) $(790) $(10,481) --------- ------ --------- --------- ------ --------- Basic and diluted loss per share $ (.31) $ (.32) $ (.29) --------- --------- ------ --------- Basic and diluted weighted Average common shares outstanding 34,211 35,185 487 35,672 See accompanying notes to consolidated statement of operations F-82 NOTES TO UNAUDITED PROFORMA CONSOLIDATED STATEMENT OF OPERATIONS The following notes describe the column headings in the unaudited pro forma

consolidated statement of operations and the pro forma adjustments that have been made to this statement: (1) Reflects the unaudited consolidated historical statement of operations of Hemispherx Biopharma Inc. and subsidiaries for the nine months ended September 30, 2003. (2) Reflects the unaudited consolidated historical statement of operations for ISI for the period ended March 11, 2003. (3) Reflects pro forma adjustments relating to the first acquisition of certain assets of ISI and the related funding as follows: (a) Adjustments to reflect the recording of costs related to sales of product by ISI where values were reduced to zero in years prior to 2002, the elimination of ISI's net interest expense, the elimination of ISI's depreciation, and the elimination of a gain and service fee income in connection with the sale of the Alferon business as follows: ---------- Inventory $(109) ---------- Interest expense 33 ---------- Depreciation 76 ---------- Service fee income (115) ---------- Other income (6) ---------- Extraordinary gain on sale of Alferon business (1,164) ---------- Total $(1,285) ---------- (b) Increase in general and administrative costs resulting from the recognition of 6% royalty charges on the net sales of the acquired ALFERON N Injection product. (4) Reflects pro forma adjustments relating to the second acquisition of certain asset of ISI and the related funding as follows: (c) Decrease in interest expense for the effect of the conversion of $4.4 million of the 6% senior convertible debentures during the nine months ended September 30, 2003 as it relates to write offs of debt discounts recognized in connection with the debenture offering for which we have given effect to on pro forma basis as if it had occurred during the year ended December 31, 2002. (d) Adjustments reflect depreciation expense relating to the acquired building as result of the second acquisition of certain assets of ISI. F-83 Hemispherx Biopharma, Inc. and Subsidiaries Unaudited Pro Forma Consolidated Balance Sheet PRO FORMA (2) AS September 30, 2003 (1) PRO FORMA ADJUSTED (in thousands) HEMISPHERX ADJUSTMENTS FOR BIOPHARMA, FOR SECOND SECOND INC. AND ASSET ASSET SUBSIDIARIES ACQUISITION ACQUISITION ASSETS Current Assets: Cash and cash equivalents $ 5,061 $ 5,061 Other receivables 141 141 Inventories net of reserves 2,545 2,545 Prepaid and other current assets 309 309 ---------- --------- ---------- Total current assets 8,056 8,056 ---------- --------- ---------- Property, plant and equipment, net 112 2,269 2,381 Patent and trademark rights, net 1,076 1,076 Investments in unconsolidated affiliates 408 408 Deferred financing costs 270 270 Deferred acquisition costs 1,068 (1,068) -- Advance receivable 951 951 Other assets 51 51 ---------- --------- ---------- Total assets $ 11,992 $1,201 $ 13,193 ========== ========= ========== LIABILITIES Current liabilities: Accounts payable $857 $ 363 $ 1,220 Accrued expenses 857 857 Current portion of long term debt 349 349 ---------- -------- ---------- Total current liabilities 2,063 363 2,426 ---------- -------- ---------- Long term debt net of current portion 969 969 Redeemable common stock Stockholders' equity: 1,600 625 2,225 Common stock 38 38 Additional paid-in capital 117,145 213 117,358 Accumulated deficit (109,802) (109,802) Treasury stock (21) (21) ---------- -------- ---------- Total stockholders' equity 7,360 213 7,573 ---------- -------- ---------- Total liabilities and stockholders' equity $ 11,992 $ 1,201 $ 13,193 ========== ======== ========== See accompanying notes to consolidated balance sheet F-84 NOTES TO UNAUDITED PROFORMA CONSOLIDATED BALANCE SHEET The following notes describe the column headings in the unaudited pro-forma consolidated balance sheet and the pro forma adjustments that have been made to this balance sheet: (1) Reflects the unaudited consolidated historic balance sheet of Hemispherx Biopharma Inc. and subsidiaries as of September 30, 2003. (2) Reflects pro forma adjustments for the second acquisition of certain assets of ISI totaling $2.2 million and the assumption of certain obligations, including those settled via the issuance of shares of the Company's common stock. A portion of the common shares totaling $.6 million issued to ISI were redeemable and are reflected as such. As a result of the agreements, the following table summarizes the estimated fair values of the assets and liabilities assumed at the acquisition date. (AMOUNTS IN THOUSANDS) Second Acquisition ---------- Building $2,269 Fair Value of Liabilities Assumed (363) ------ Fair Value of Common Shares Issued $1,906 ====== F-85 ---------- No dealer, salesman or any other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell these securities and it is not a solicitation of an offer to buy these securities in any state where the offer or sale is not permitted. The information contained in this Prospectus is current only as of this date. TABLE OF CONTENTS Page Prospectus Summary ..... 2 Risk Factors ..... 6 Use of Proceeds ..... 17 Dividend Policy ..... 17 Price Range of Common Stock ..... 18 Selected Consolidated Financial Data ..... 18 Management's Discussion and Analysis of Financial Condition And Results of Operations ..... 20 Our

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---------- 10,879,501 SHARES OF COMMON STOCK HEMISPHERX BIOPHARMA, INC. ---------- PROSPECTUS ---------- December 18, 2003

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