



## | QUARTERLY CEO MESSAGE |

February 8, 2002

Having been on board now for four months, the steps necessary to make Micrologix a success are quite clear. Yes, being part of shaping a company's direction is very exciting. Right now, it is critical that the right team, a sound strategy, and an effective ability to execute are established as a means to achieving outstanding results and increasing the company's value. In general, success depends partially on an ability to lead and manage in the face of uncertainty. So at this stage, some of our immediate priorities are focused toward reducing the uncertainties that exist today at Micrologix and developing a company with a broad, deep pipeline, which ultimately produces a steady stream of clinical candidates.

One immediate short-term priority, for example, is to resolve the cost-of-goods issue with our acne product candidate, MBI 594AN. We are confronting this with an aggressive multi-pronged approach. First, we are analyzing the components of the drug itself, looking for ways to potentially reduce the amount of peptide used, while retaining its effectiveness. Second, we are working with experts in the area of formulation and delivery to assess alternative formulations that might provide a better cost profile. And third, we are investigating manufacturing methods that could allow us to produce the peptide less expensively. This must all be coordinated with constant attention to the complex regulatory implications inherent in any development process. We are extremely focused on this issue and look forward to being able to provide some clarity on the acne development program as soon as we have the answers needed to proceed.

Second, regarding MBI 226, our product candidate for the prevention of central venous catheter-related bloodstream infections, we are approaching the 1000 patient mark in the currently ongoing Phase III trial and finalizing our evaluation of the enrollment target. As we mentioned last quarter, the original protocol included 1000 patients as the target enrollment. This was based on various assumptions during protocol design, both clinical and statistical. It has always been assumed, however, that there could be an increase in the size of the study (up to as many as 1500 patients) if deemed necessary, and acceptable to the FDA. A determination of the final enrollment number (which will be somewhere between the originally planned 1000 patients and the projected 1500 patients) is being made based on several factors, including a review of the statistical assumptions, strategic resource allocation, market research data, and potential partnering opportunities. By the end of February, for example, we expect to have completed a thorough market research study for the MBI 226 indication. This, along with the other factors mentioned above, will allow us to make a decision soon thereafter.

### **Strategy**

As stated in our Letter to Shareholders in mid-December, two of our principal objectives have been to establish a clear strategic direction and optimize our ability to execute. As promised, we are in the process of completing the draft of our internal Strategic Plan (to be finalized by April), providing the entire organization a clear understanding of where we are headed and how we plan to achieve some aggressive, but essential, objectives for the short, medium, and long terms.

Parts of the plan will include:

- The process of shaping Micrologix into a multi-product development company
- A growth plan based on a focused internal development process and an aggressive licensing, acquisition, and alliance strategy
- Goals and objectives for the next three fiscal years, which include building a broad, deep pipeline, with a steady stream of viable clinical candidates

We understand that credibility is “lost in miles and gained in inches”. But, we are in this for the long-term and believe this type of strategic thinking, along with an irrefutable ability to execute, will begin creating a company with a sustainable business model that builds shareholder value. And we are determined to build that credibility steadily as we begin to achieve the milestones we set. These milestones will be clarified over the next several months and quarters as we complete our strategic plan and confirm our objectives for the next year and beyond.

## Research & Development Programs

Now, in following through with our new commitment to communicate more effectively, it is important that we convey progress regularly on many other things occurring at Micrologix, outside of the two clinical candidates. So, I would like to take this opportunity to bring you up to date on some of the other research programs you may have heard about in the past. Before I go on, however, it is important to understand that these are research programs. Therefore, by definition, they are very early stage, and in the biotech industry, only a fraction of all research programs ultimately make it to market.

*New peptide analogs:* Over the past two years, the Micrologix research team has been working diligently on identifying additional peptide analogs, with the goal of increasing antimicrobial effectiveness and optimizing pharmacological properties. So far, this effort has been very successful, adding over 100 new peptides to our library. This is an important part of building a pipeline through internal growth, since many new product candidates can be derived from the constant search for new, more effective compounds. This is an important strategic issue as well, since leveraging our current technology platform to its maximum potential is a key component of our strategy. In fact, as has been mentioned in the past, many of these peptides possess some anti-inflammatory activity, another important characteristic being studied by our research team.

- *Other indications and product candidates:* As part of our new philosophy at Micrologix, we are committed to helping patients. We, therefore, must become a market driven company, looking at possibilities, both internally and externally, that can be developed into commercially viable product candidates. Some of the opportunities you may remember hearing about if you have followed Micrologix in the past include:
  - Ophthalmic indications: This is an interesting market in the anti-infective category. Peptides are technically challenging in many ways, with certain areas more challenging than others. Ophthalmology is challenging since toxicity issues must be even more intensely addressed. We are continuing to work to identify peptide analogs with characteristics acceptable to this indication and will address our progress and intentions in this area in future communications.
  - Other topical indications: Based on the inherent capabilities of our peptides and preliminary market information, this project has become a higher priority than in the past. If further technical and market research efforts prove favorable, we may proceed with this program and could identify and optimize a lead candidate during the next fiscal year. Examples of indications in this area are skin and burn wound infections.
  - Systemic applications: Undoubtedly, a systemic application of our peptide technology would be a major market opportunity and a solid scientific innovation. Our relationship with UCLA is now in its second year, with no lead candidate identified as yet. Research studies are currently being completed that will help determine the direction of this program over the next several months. In addition, we are exploring several parallel paths outside the UCLA collaboration to explore alternative possibilities for a systemic antimicrobial peptide product candidate.
  - Topical enhancers: While the systemic enhancer program is on the “back burner” awaiting progress in the systemic program, we are continuing to investigate opportunities for topical enhancers. This is another area with a potential market opportunity for our peptide technology. As part of our strategy to leverage the peptide platform we are evaluating this product opportunity and will have more to report in the new fiscal year.

I must reiterate that all of these projects are still in the research stages. This is so important, it's worth repeating. We want to make sure everyone understands these are not yet considered viable clinical candidates, much less commercial opportunities. As with any biotech company, our job now is to execute on our R&D plan, providing us the information necessary to make go/no-go decisions quickly, effectively, and prudently. This means we will commit to and accelerate programs that are viable, and decisively cut programs that are not. You can count on further updates in these areas in the coming quarters, as we will continue to communicate progress and/or decisions as soon as feasible.

### **External Growth Opportunities**

Based on our strategic direction and corporate objectives, our peptide technology is only one platform for growth. Since an important value driver in the biotech industry is the strength of a company's pipeline, it is important that we also identify and evaluate external opportunities to build and expand our portfolio. We are currently in various stages of exploration on several product candidate and technology possibilities with various infectious disease targets. As part of our new strategy, therefore, we will continue to look at complementary and/or supplementary technologies and compounds that will expand our pipeline and broaden our spectrum of indications.

### **Strategic Alliances & Partnerships**

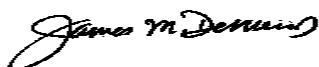
There are many components to building corporate value. Meeting objectives based on identifying the critical success factors facing a company is one component. In this regard, we have identified several of our specific critical success factors for the future. One of those critical success factors is securing solid strategic collaborations and alliances. We believe it would be advantageous for us to have partnerships or collaborations on one or more of our compounds. Among other things, a strong partner would both share some of the development expense and add some "goodwill value" in the form of implied technology validation. For these reasons, we are focused on partnering as part of our strategy and are committed to establishing a win-win philosophy in all discussions and negotiations with potential partners.

### **Augmenting the Team to Optimize our Ability to Execute**

As mentioned in the past, an essential component of our success will be having the right people, in the right positions, in the right environment. This is progressing very well as we concentrate on bringing in significant experience from the biotech and pharmaceutical industries. Simultaneously, the entire internal Micrologix culture is being transformed into one that is committed to results, accountability, and teamwork (among other things). I have always said that "success is achieved when you have a team of people who can deal with any circumstances and are willing to do whatever it takes to achieve outstanding results". With the solid base of our current team and the quality of expertise, experience, and management competence we anticipate adding in the near future, we are on track to live up to that concept.

So, as I hope you can appreciate, we are absolutely committed to systematically building a successful, valuable company here at Micrologix. As we mentioned in our most recent quarterly conference call, this will be a process, so no one event will make it all happen, and it will take time to unfold. Yes, there is uncertainty in the short-term, but as stated above, success depends partly on an ability to manage in the face of uncertainty. We have that ability, and so at this stage it is important that we have identified our critical success factors, begun developing a sound strategy for the future, established the required areas of expertise to augment our team for execution of our plan, and formed solid goals and objectives for the short, medium, and long term. We realize that currently, these are just words. Over the next several quarters, therefore, the results must speak for themselves. And, while uncertainty is a fact of life in our industry, we know we must strive to minimize the uncertainty. With the continued support of our shareholders and stakeholders, we believe we can achieve these objectives and build the best company achievable for the long-term.

Sincerely,



Jim DeMesa, MD  
President and CEO