NEUROLOGIX INC/DE
Form 10QSB
November 14, 2006

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

FORM 10-QSB

(Mark One)

|X| QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended September 30, 2006

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER: 000-13347

NEUROLOGIX, INC.
(Exact name of Small Business Issuer in its charter)

DELAWARE	06-1582875
(State or other jurisdiction of Incorporation or organization)	I.R.S. Employer Identification No.)

ONE BRIDGE PLAZA, FORT LEE, NEW JERSEY 07024
(Address of principal executive offices)

(201) 592-6451
(Issuer's telephone number)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes |X| No |_|.

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes |_| No |X|.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

At November 10, 2006 there were outstanding 26,542,924 shares of the Registrant's Common Stock, $.001 par value.

Transitional Small Business Disclosure Format: Yes |_| No |X|.

PART I. FINANCIAL INFORMATION

Item 1 - Financial Statements

NEUROLOGIX, INC.
(A Development Stage Company)
CONDENSED BALANCE SHEET
(UNAUDITED)
(Amounts in thousands, except share and per share data)

ASSETS
Current assets:

Cash and cash equivalents
Investments in marketable securities held to maturity
Prepaid expenses and other current assets

Total current assets
Equipment, less accumulated depreciation of $310
Intangible assets, less accumulated amortization of $116
Other assets

Total Assets

LIABILITIES AND STOCKHOLDERS' EQUITY
Current liabilities:
Accounts payable and accrued expenses
Capital lease obligations

Total liabilities

Commitments and contingencies
Stockholders' equity:
  Preferred stock; 5,000,000 shares authorized:
      Series A - Convertible, $.10 par value; 300,000 shares designated, 645 shares issued and outstanding with an aggregate liquidation preference of $645
      Series B - $.10 par value; 4,000,000 shares designated, no shares issued and outstanding
      Series C - Convertible, $.10 par value; 700,000 shares designated, 353,980 shares issued an outstanding with an aggregate liquidation preference of $12,426,471
  Common stock:
      $.001 par value; 60,000,000 shares authorized, 26,542,924 issued and outstanding
Additional paid-in capital
Deficit accumulated during the development stage

   Total stockholders' equity

   Total Liabilities and Stockholders' Equity

See accompanying notes to the unaudited condensed financial statements

NEUROLOGIX, INC.
(A Development Stage Company)
CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)
(Amounts in thousands, except share and per share data)

	Nine Months Ended September 30,		Three Months Ended September 3	
	2006	2005	2006	2
Operating expenses:				
Research and development	$2,792	$1,659	$1,263	
General and administrative expenses	3,141	1,947	1,395	
Loss from operations	(5,933)	(3,606)	(2,658)	(1
Other income (expense):				
Dividend, interest and other income	292	122	164	
Interest expense-related parties	(2)	(3)	-	
Other income, net	290	119	164	
Net loss	(5,643)	(3,487)	(2,494)	
Charge for accretion of beneficial				

conversion rights	(2,621)	-	-	
Preferred stock dividends	(427)	-	(277)	
Net loss applicable to common stock	$(8,691)	$(3,487)	$(2,771)	$
Net loss applicable to common stock per share, basic and diluted	$ (0.33)	$ (0.14)	$ (0.10)	$
Weighted average common shares outstanding, basic and diluted	26,542,924	25,409,082	26,542,924	26,53

NEUROLOGIX, INC.
(A Development Stage Company)
CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIENCY)
FOR THE PERIOD FROM FEBRUARY 12, 1999 (DATE OF INCEPTION) THROUGH SEPTEMBER
(UNAUDITED)
(Amounts in thousands, except share data)

	Series C Preferred Stock		Common Stock		Additional Paid-in	Un
	Shares	Amount	Shares	Amount	Capital	Comp
Sale of common stock to founders	-	$0	6,004,146	$0	$4	$-
Net loss	-	-	-	-	-	-
Balance, December 31, 1999	-	0	6,004,146	0	4	-
Net loss	-	-	-	-	-	-
Balance, December 31, 2000	-	0	6,004,146	0	4	-
Stock options granted for services	-	-	-	-	9	-
Common stock issued for intangible assets at $0.09 per share	-	-	259,491	-	24	-
Net loss	-	-	-	-	-	-
Balance, December 31, 2001	-	0	6,263,637	0	37	-
Retirement of founder shares	-	-	(33,126)	-	-	-

Common Stock issued pursuant to license agreement at $1.56 per share	-	-	368,761	-	577	(577
Private placement of Series B convertible preferred stock	-	-	-	-	2,613	-
Amortization of unearned compensation	-	-	-	-	-	24
Net loss	-	-	-	-	-	-
Balance, December 31, 2002	-	0	6,599,272	0	3,227	(553
Sale of Common Stock	-	-	276,054	0	90	(89
Amortization of unearned compensation	-	-	-	-	-	164
Net loss	-	-	-	-	-	-
Balance, December 31, 2003	-	0	6,875,326	0	3,317	(478
Conversion of note payable to Common Stock at $2.17 per share	-	-	1,091,321	1	2,371	-
Conversion of mandatory redeemable preferred stock to Common Stock	-	-	6,086,991	6	494	-
Conversion of Series B convertible preferred stock to Common Stock	-	-	1,354,746	1	(1)	-

Effects of reverse acquisition	-	-	7,103,020	14	5,886	-
Amortization of unearned compensation	-	-	-	-	-	202
Stock options granted for services	-	-	-	-	42	(42
Exercise of stock options	-	-	10,000	-	15	-
Net loss	-	-	-	-	-	-
Balance, December 31, 2004	-	0	22,521,404	22	12,124	(318
Sale of Common Stock through private placement at an average price of $1.30 per share	-	-	2,473,914	4	3,062	-
Sale of Common Stock at an average price of $1.752 per share and warrants to Medtronic	-	-	1,141,552	1	2,794	-
Amortization of unearned compensation	-	-	-	-	-	825

Stock options granted for services	-	-	-	-	1,305	(1,305
Exercise of stock options	-	-	406,054	-	127	-
Net loss	-	-	-	-	-	-
Balance, December 31, 2005	-	0	26,542,924	27	19,412	(798
Sale of Preferred Stock through private placement at an average price of $35.00 per share	342,857	34	-	-	11,578	-
Fair value of beneficial conversion rights issued in connection with issuance of Series C Preferred Stock	-	-	-	-	2,621	-
Preferred Dividend and accretion of fair value of beneficial conversion charge	11,123	1	-	-	(1)	-
Share-based compensation expense	-	-	-	-	1,041	-
Effects of adoption of SFAS 123R	-	-	-	-	(311)	798
Net loss	-	-	-	-	-	-
Balance, September 30, 2006	353,980	$35	26,542,924	$27	$34,340	$ -

NEUROLOGIX, INC.
(A Development Stage Company)
CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(Amounts in thousands)

	Nine Months Ended September 3	
	2006	200
Operating activities:		
Net loss	$(5,643)	$(3,
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	48	
Amortization	34	
Stock options granted for services	-	
Impairment of intangible assets	-	
Amortization of non-employee share-based compensation	360	

Share-based employee compensation	940	
Non-cash interest expense	-	
Changes in operating assets and liabilities		
Decrease in prepaid expenses and other current assets	444	
Increase (decrease) in accounts payable and accrued expenses	59	
Net cash used in operating activities	(3,758)	(2,
Investing activities:		
Security deposits paid	-	
Purchases of equipment	(75)	
Additions to intangible assets	(162)	(
Purchases of marketable securities	(4,974)	(3,
Proceeds from maturities of marketable securities	2,800	2,
Net cash used in investing activities	(2,411)	(1,
Financing activities:		
Proceeds from note payable	-	
Borrowings from related party	-	
Cash acquired in Merger	-	
Merger-related costs	-	
Payments of capital lease obligations	(11)	
Proceeds from exercise of stock options	-	
Proceeds from issuance of common stock and warrants	-	5,
Proceeds from issuance of preferred stock	11,612	
Net cash provided by financing activities	11,601	5,
Net increase in cash and cash equivalents	5,432	1,
Cash and cash equivalents, beginning of period	1,255	1,
Cash and cash equivalents, end of period	$6,687	$2,
Supplemental disclosures of cash flow information:		
Non-cash investing and financing activities		
Dividends on Series C Preferred Stock paid in preferred shares	336	
Accrued dividends on Series C Preferred Stock	91	
Accretion of fair value of beneficial conversion on preferred stock	2,621	

See accompanying notes to the unaudited condensed financial statements.

NEUROLOGIX, INC.
(A Development Stage Company)
Notes to Unaudited Condensed Financial Statements
(In thousands, except for share and per share amounts)

(1) Description of Business

Neurologix, Inc. ("Neurologix" or the "Company"), is engaged in the research and development of proprietary treatments for disorders of the brain and central nervous system primarily utilizing gene therapies. These treatments are designed as alternatives to conventional surgical and pharmacological

treatments. The Company is a developmental stage company and has not generated any operating revenues.

The Company incurred net losses of $5,643, $3,487 and $19,762 and negative cash flows from operating activities of $3,758, $2,630 and $15,118 for the nine months ended September 30, 2006 and 2005 and for the period from February 12, 1999 (inception) to September 30, 2006, respectively. The Company expects that it will continue to incur net losses and cash flow deficiencies from operating activities for the foreseeable future.

As of September 30, 2006, the Company had cash and cash equivalents and short-term investments in marketable securities of $11,656. On May 10, 2006, the Company completed a private placement of a new series of preferred stock, resulting in gross proceeds to the Company of $12,000 (see Note 4). Management believes that, as a result of this offering, the Company's current resources will enable it to continue as a going concern through at least December 31, 2007. Although the Company believes that its resources are sufficient to complete one follow-on trial for Parkinson's disease and to complete a Phase I clinical trial for epilepsy, the Company's resources are not sufficient to allow it to perform all of the clinical trials required for drug approval and marketing. Accordingly, it will, from time to time, continue to seek additional funds through public or private equity offerings, debt financings or corporate collaboration and licensing arrangements. The Company does not know whether additional financing will be available when needed, or if available, will be on acceptable or favorable terms to it or its stockholders.

(2) Basis of presentation

The accompanying unaudited condensed financial statements of the Company should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2005 (the "10-KSB") filed with the Securities and Exchange Commission (the "SEC") on March 31, 2006. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and in accordance with the instructions to Form 10-QSB and the rules and regulations of the SEC. Accordingly, since they are interim statements, the accompanying financial statements do not include all of the information and notes required by GAAP for complete financial statement presentation. In the opinion of management, the interim financial statements reflect all adjustments consisting of normal, recurring adjustments that are

necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

Certain prior period amounts have been reclassified to conform to the current period presentation.

(3) Summary of Significant Accounting Policies

(a) Stock-Based Compensation:

At September 30, 2006, the Company had one active share-based employee compensation plan. Stock option awards granted from this plan are granted at the fair market value on the date of grant, and vest over a period determined at the time the options are granted, ranging from one to five years, and generally have a maximum term of ten years. Certain options provide for

accelerated vesting if there is a change in control (as defined in the plans). When options are exercised, new shares of the Company's common stock (the "Common Stock") are issued.

At the Company's Annual Meeting of Stockholders held on May 9, 2006, the Company's 2000 Stock Option Plan was amended to increase the number of shares that may be issued pursuant thereto from 1,300,000 to 3,800,000 shares.

Prior to January 1, 2006, the Company accounted for share-based employee compensation, including employee stock options, using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations ("APB Opinion No. 25"). Under APB Opinion No. 25, no compensation cost was recognized for stock options granted with an exercise price equal to or greater than the market price and disclosure was made regarding the pro forma effect on net earnings assuming compensation cost had been recognized using a fair-value method in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123").

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R "Share-based Payment" ("SFAS No. 123R") for employee stock options and other share based compensation using the modified prospective method. No share-based employee compensation cost had been reflected in net loss prior to the adoption of SFAS No. 123R. Results for prior periods have not been restated.

Under SFAS 123R, the total value of the stock option awards is expensed ratably over the service period of the employees receiving the awards. As of September 30, 2006, total unrecognized compensation cost related to stock option awards was approximately $559 and the related weighted-average period over which it is expected to be recognized is approximately 1.5 years.

A summary of option activity as of September 30, 2006 and changes during the nine months then ended is presented below:

Options	Shares Subject to Option (000)	Weighted-Average Exercise Price	Weighed-Average Remaining Contractual Term (years)	Ag Intri
Outstanding at January 1, 2006	2,225	$1.25		
Granted	1,135	1.54		
Exercised	-	-		
Forfeited or expired	-	-		
Outstanding at September 30, 2006	3,360	$1.35	6.61	
Exercisable at September 30, 2006	2,592	$1.27	5.74	

	=====	=====	====

The weighted-average grant-date fair value of options granted during the nine months ended September 30, 2006 was $1.54.

The fair value of each stock option award is estimated under SFAS No. 123R and was estimated under SFAS No. 123 on the date of the grant using the Black-Scholes option pricing model based on the assumptions noted in the following table. Expected volatility is based on historical volatility of the Common Stock. The Company does not currently anticipate any exercises or terminations for valuation purposes. The risk-free rate is based on the five year U.S. Treasury security rate. The expected term of the options is based on historical data and judgment regarding market trends and factors.

	Nine Months Ended September 30,	
	2006	2005
Expected option term (years)	5	5
Risk-free interest rate (%)	5.01%	3.94%
Expected volatility (%)	87%	99%
Dividend yield (%)	0%	0%

The following table illustrates the pro-forma effect on net loss and net loss applicable to common stock per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to all outstanding stock option awards for the periods presented prior to the Company's adoption of SFAS No. 123R:

	Nine Months Ended September 30, 2005	Th Se
Net loss applicable to common stock, as reported	$(3,487)	
Add: Total stock-based employee compensation expense included in reported net loss	330	
Deduct: Total stock-based employee compensation expense determined under fair value based method	(912)	
Pro-forma net loss applicable to common stock	$(4,069)	
Net loss applicable to common stock per share:		
Basic and diluted as reported	$(0.14)	
Basic and diluted pro-forma	$(0.16)	

(b) Basic and Diluted Net Loss Per Common Share:

Basic net loss per common share excludes the effects of potentially dilutive securities and is computed by dividing net loss applicable to common stock by the weighted average number of common shares outstanding for the period. Net loss applicable to common stock includes the value of dividends on preferred stock whether or not declared and the amortization of the fair value of any beneficial conversion rights issued with preferred stock. Diluted net income or loss per common share is adjusted for the effects of assuming the conversion or exercise of convertible securities, options, warrants and other potentially dilutive financial instruments only in the periods in which such effects would have been dilutive.

The following securities were not included in the computation of diluted net loss per share because to do so would have had an anti-dilutive effect for the periods presented:

	September 30,	
	2006	2005
Stock options	3,360,220	2,235,220
Warrants	3,131,985	1,519,056
Common Stock issuable upon conversion of Series A Convertible Preferred Stock	645	645
Common Stock issuable upon conversion of Series C Convertible Preferred Stock	6,960,273	-

(4) Private Placements

On May 10, 2006, the Company issued and sold 342,857 shares of a newly created series of preferred stock, par value $.10 per share (the "Series C Preferred Stock"), at a price of $35.00 per share, or a total of approximately $12,000, to General Electric Pension Trust, DaimlerChrysler Corporation Master Retirement Trust and certain funds managed by ProMed Management, LLC in a private placement transaction. The shares of Series C Preferred Stock, including all dividends paid to date, are currently convertible into 19.66 shares of Common Stock per share, or 6,960,273 shares of Common Stock in the aggregate. The Series C Preferred Stock is not redeemable by the Company. Upon a liquidation event (such as a liquidation, a merger or a sale of substantially

all of the Company's assets), the holders of Series C Stock will be entitled to receive a per share amount equal to the greater of: (i) $35 plus unpaid dividends or (ii) the amount payable upon conversion to Common Stock.

The Series C Preferred Stock will accrue cumulative dividends at a rate of 9% per annum, payable in quarterly installments in shares of Series C Preferred Stock. As of September 30, 2006, the Company paid dividends by issuing approximately 11,123 shares of Series C Preferred Stock with a fair value of $336.

The Series C Preferred Stock will automatically be converted into shares of Common Stock upon the first public offering of the Company's securities that results in gross proceeds of at least $50,000,000 or upon the written consent of holders of at least 70% of the outstanding shares of Series C Preferred Stock.

Each share of Series C Preferred Stock will be entitled to a number of votes per share equal to the number of shares of underlying Common Stock. As long as the Series C Preferred Stock comprises at least 5% of the Company's outstanding securities, the Company may not create any new class of stock that is pari passu with or senior to the Series C Preferred Stock without the consent of the holders of at least 70% of the Series C Preferred Stock.

The Series C Preferred Stock's conversion rate will be adjusted if the Company issues Common Stock (or convertible securities) at a price per share that is less than $1.55. There is no termination date for this anti-dilution protection. The Series C Preferred Stock is also subject to customary adjustment for stock splits and reverse splits, and corporate transactions such as mergers and reorganizations.

In connection with sale of the Series C Preferred Stock, the Company also issued warrants to purchase approximately 2,224,719 shares of Common Stock at an exercise price of $2.05 per share that expire on May 10, 2013. The Company initially computed the fair value of the warrants using the Black-Scholes option pricing model and then used the relative fair value method to allocate the proceeds from the offering to the warrants and the Series C Preferred Stock. As a result of that allocation, the value of the common shares issuable upon the conversion of the Series C Preferred Stock as of the date of issuance (the amount for which the shares could have been sold) exceeded the proceeds from the offering allocable to the Series C Preferred Stock by $2,621. This amount represented the value of beneficial conversion rights which was immediately accreted. The related charge is reflected in the accompanying condensed statements of operations for the three and nine months ended September 30, 2006 as an increase in the net loss for the purposes of determining the net loss applicable to common stock in each of those periods.

The purchasers of the Series C Preferred Stock, among other things, have certain demand and piggyback registration rights with respect to the Common Stock underlying the Series C Preferred Stock and warrants.

(5) Management Changes

Effective July 10, 2006, Dr. Christine V. Sapan was appointed as Senior Vice President, Chief Development Officer of the Company. Dr. Sapan's initial base annual salary is $225 and she is eligible to receive a

discretionary annual bonus, with a target bonus of 40% of her annual salary. On July 10, 2006, Dr. Sapan received options to purchase 250,000 shares of Common Stock at an exercise price of $1.20 per share, which vest over three years. The Company will recognize an annual non-cash compensation charge of $75 as a result of this option grant.

Effective July 17, 2006, Dr. Michael Sorell resigned as the President and Chief Executive Officer. In connection with such resignation, the Company and Dr. Sorell have entered into a Separation Agreement. This agreement provided for such resignation effective July 17, 2006. Dr. Sorell will continue as a director of the Company, without further compensation.

The Company will pay Dr. Sorell severance of $185, payable in equal semi-monthly installments through September 30, 2007. The Company recognized this amount as compensation expense in the third quarter of 2006.

The agreement provides for the immediate vesting of Dr. Sorell's stock

options. Such options will terminate upon the later of (i) the 15th day following the date on which Dr. Sorell ceases to be a director of the Company or (ii) December 31st of the calendar year during which Dr. Sorell ceases to be a director of the Company. The Company recognized a non-cash compensation charge of $219 in the third quarter of 2006 as a result of the accelerated vesting of and the extension of the exercise period for Dr. Sorell's stock options.

Effective July 17, 2006, John E. Mordock, a director of the Company, was appointed as the President and Chief Executive Officer. Mr. Mordock is paid an annual base salary of $200. He is eligible to receive a bonus based upon his performance and the Company's achievement of its goals, with a target bonus of 25%. On July 19, 2006, Mr. Mordock received options to purchase 250,000 shares of Common Stock, with an exercise price of $1.30 per share, all of which vested on the grant date. The Company recognized a non-cash compensation charge of $230 in the third quarter of 2006.

(6) Other Agreements

Sublicense Agreement

The Company entered into a Sublicense Agreement (the "Sublicense Agreement"), effective as of August 4, 2006, with Diamyd Therapeutics AB, a subsidiary of Diamyd Medical, AB ("Diamyd"), a company organized under the laws of Sweden. Pursuant to the Sublicense Agreement, Diamyd granted to the Company a non-exclusive worldwide license to certain patent rights and technical information for the use of a gene version of glutamic acid decarboxylase (GAD) 65 in connection with the gene therapy treatment of Parkinson's disease as conducted by the Company during its Phase I clinical trial. Diamyd is the exclusive licensee of such patent rights owned by the Regents of the University of California, Los Angeles, which has approved the Sublicense Agreement. Pursuant to the Sublicense Agreement, the Company paid Diamyd an initial fee of $500, an amount that was expensed as research and development expense on the effective date of the Sublicense Agreement. Additionally, the Company will pay annual license maintenance fees of $75 beginning on January 1, 2008 through the term of the agreement and will make certain milestone and royalty payments to Diamyd as provided for in the Sublicense Agreement. The Sublicense Agreement is

terminable at any time by the Company upon 90 days' notice. Further information regarding the Sublicense is included in the Company's Current Report on Form 8-K filed on August 7, 2006.

Agreements with Ohio State University

Effective May 10, 2006, the Company entered into a Sponsored Research Agreement with The Ohio State University Research Foundation ("OSURF") which provides for research covering the development of gene therapy approaches to neurodegenerative disorders, including Parkinson's disease, epilepsy, Huntington's disease, Alzheimer's disease, as well as gene therapy approaches to pain, stroke, neurovascular diseases and other research (the "Research Project").

This sponsored research is funded by the Company and will be conducted under the direction of Dr. Matthew J. During, one of the Company's co-founders and a member of its Scientific Advisory Board. The initial term of this agreement is 18 months, and may be mutually extended for additional 18-month periods. The Company will be required to pay OSURF a fee of $250 over the initial 18-month term. As of September 30, 2006, the Company had paid OSURF a

total of $83. The Company has first right to negotiate with OSURF, on reasonably commercial terms, for an exclusive, worldwide right and license for commercial products embodying inventions conceived under the Research Project with the assistance of employees of OSURF.

In connection with the Research Agreement, the Company, on April 18, 2006, entered into a Facility Use Agreement as well as Visiting Scientist Agreements with The Ohio State University ("OSU"), all of which allow the Company's scientists to access and use OSU's laboratory facilities and certain equipment to perform their research. The term of the Facility Use Agreement is four years, subject to earlier termination under certain circumstances. The Company paid OSU an initial amount of $23, representing prepaid rent for the first year of such Agreement. Unless sooner terminated, the Company will pay an additional $70 over the remaining three years of such Agreement.

(7) Subsequent Event

On November 3, 2006, the Company entered into a lease with Bridge Plaza Realty Associates, LLC ("BPRA") for an additional 703 square feet of office space at One Bridge Plaza, Fort Lee, New Jersey 07024. This lease will commence upon the substantial completion of build out work to be performed by BPRA and will expire three years thereafter. The lease provides for a base annual rent of approximately $21 or $2 per month.

Item 2 - Management's Discussion and Analysis or Plan of Operation
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The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Company's unaudited financial statements and related notes included in this quarterly report on Form 10-QSB (this "Quarterly Report") and the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2005 filed with the SEC on March 31, 2006. Operating results are not necessarily indicative of results that may occur in future periods. All amounts in this Item 2 are in thousands.

Business Overview

The Company is a development stage company that is engaged in the research and development of proprietary treatments for disorders of the brain and central nervous system using gene therapy and other innovative therapies. These treatments are designed as alternatives to conventional surgical and pharmacological treatments.

To date, the Company has not generated any operating revenues and has incurred annual net losses. From inception through September 30, 2006 the Company had an accumulated deficit of $22,383, and it expects to incur additional losses in the foreseeable future. The Company recognized net losses of $5,643 for the nine months ended September 30, 2006, and $3,487 for the nine months ended September 30, 2005. The increase in net loss is primarily due to increased expenditures related to the progress of the Company's research and development programs in Parkinson's disease and epilepsy, and the expanded administrative infrastructure needed to support that progress.

Since its inception, the Company has financed its operations primarily through sales of its equity and debt securities. From inception through September 30, 2006, the Company received net offering proceeds from private sales of equity and debt securities, proceeds from a reverse merger in February

2004 (the "Merger") and proceeds from certain other financing activities totaling approximately $27,974 in the aggregate. This aggregate amount includes the net proceeds of $11,612 received by the Company, on May 10, 2006, from a private placement of its Series C Preferred Stock (see Note 4 to the financial statements). Although its costs of administration and public company compliance have increased this year, the Company has devoted a significant portion of its capital resources to the research and development of its products.

The Company's primary efforts are directed to develop therapeutic products (i) to meet the needs of patients suffering from Parkinson's disease and (ii) the needs of patients suffering from a type of human epilepsy known as temporal lobe epilepsy or "TLE."

Parkinson's Disease

In October 2006, the Company announced that it had completed its Phase I clinical trial of gene therapy for Parkinson's disease and presented its results for the 12 treated subjects at the Annual Meeting of the Society of Neuroscience in Atlanta. The results indicated that the treatment appears to be safe and well-tolerated in patients with advanced Parkinson's disease, with no evidence of adverse effects or immunologic reaction related to the study treatment. The trial also yielded statistically significant clinical efficacy and neuro-imaging results.

The Company has modified the timing of its Parkinson's disease clinical program as outlined below, because the Company has learned that the development of the catheter system to be used to infuse the treatment in future clinical trials and the transfer of the manufacturing process to a facility that is compliant with current Good Manufacturing Processes ("cGMP") will taken longer than previously expected.

Subject to concurrence by the FDA, the Company's ability to manufacture product on a timely basis, the availability of funding and other factors, the Company plans to commence one or more follow-on clinical trials in

preparation for a pivotal trial. The trials will be designed, among other things, to test the therapy bilaterally, determine the proper dosing and test the catheter system developed by Medtronic International Ltd. ("Medtronic") pursuant to its development agreement with the Company. The Company currently expects to commence its follow-on trials in the second quarter of 2007 (For further information, see "Plan of Operation" below).

Since February 2005, the Company has maintained the direct costs associated with its Parkinson's project, including research fees, license fees and pre-clinical and clinical study costs. For the nine months ended September 30, 2006 and 2005, the Company has incurred $414 and $405 of these costs, respectively. The increase is primarily due to a $307 increase in costs during the nine months ended September 30, 2006, associated with the manufacturing of product to be used in the Company's planned follow-on and pivotal trials. This increase was offset by a reduction in Phase I clinical trial costs of $312. The Phase I clinical trial was winding down and completed during the first nine months of 2006.

Epilepsy

In October 2004, motivated by encouraging rodent studies, the Company entered into an agreement with Universidad Federal de Sao Paolo to commence a non-human primate study for evaluating the toxicity of using its NLX technology

in the brain for the treatment of epilepsy. The Company's approach is based on the use of the non-pathogenic AAV vector, delivered using standard neurosurgical techniques. All studies were completed in November 2005. The non-human primate study showed that Neuropeptide Y (rAAV-NPY) did not affect the general health of the animals and did not cause any detectable alteration in normal brain pathology. The results of an additional rodent study were presented in December 2005. The analysis showed that the rAAV-NPY gene transfer reduces spontaneous seizures in an in vivo model of epilepsy and positively influences the fundamental biological process which leads to a chronically epileptic state. The Company currently plans to file an IND for a Phase I clinical trial for its epilepsy product in the first quarter of 2007.

Since the date of the Merger, the Company has maintained the direct costs associated with its epilepsy project, including research fees, license fees and pre-clinical and clinical study costs. For the nine months ended September 30, 2006 and 2005, the Company has incurred $36 and $41 of these costs, respectively.

Other Therapies

The Company will also continue its efforts in developing therapies to treat Huntington's disease and other neurodegenerative disorders under its research agreement with Cornell under the direction of Dr. Michael G. Kaplitt and one scientist currently on the Company's staff, as well as in the new laboratory facility that it has established in April 2006 at Ohio State University under the direction of Dr. Matthew J. During and three scientists currently on the Company's staff (see Note 6 - Other Agreements).

Plan of Operation

Parkinson's Disease

As discussed above under "Business Overview--Parkinson's Disease", in October 2006, the Company announced that it had completed its Phase I clinical trial of gene therapy for Parkinson's disease and presented its results for the 12 treated subjects at the Annual Meeting of the Society of Neuroscience in Atlanta. The results indicated that the treatment appears to be safe and well-tolerated in patients with advanced Parkinson's disease, with no evidence of adverse effects or immunologic reaction related to the study treatment. The trial also yielded statistically significant clinical efficacy and neuro-imaging results.

The Company has modified the timing of its Parkinson's disease clinical program as outlined below, because the Company has learned that the development of the catheter system to be used to infuse the treatment in future clinical trials and the transfer of the manufacturing process to a facility that is cGMP compliant will take longer than previously expected. The Company currently plans to conduct one or more follow-on trials prior to conducting a pivotal trial for its treatment of Parkinson's disease, commencing in the second quarter of 2007. The follow-on trials will be designed, among other things, to test the therapy bilaterally, determine the proper dosing and test the catheter system developed by Medtronic pursuant to its development agreement with the Company. The scope and timing of such trials will largely depend upon FDA concurrence, the ability to manufacture product on a timely basis, the availability of funding and other factors.

The Company will also take steps to move toward a pivotal trial for treatment of Parkinson's disease, and hopes to be in a position to file its

protocol with the FDA in 2009. The Company presently estimates that the pivotal trial could be completed in 2011 and the estimated costs to reach that milestone are expected to be between $20,000 and $30,000.

The cost and timing for further trials and FDA approval are subject to numerous risks, as further described under "Risk Factors" in the Company's 2005 Annual Report on Form 10-KSB filed with the SEC on March 31, 2006.

Epilepsy

The Company also intends to focus its efforts on advancing its product development for the treatment of epilepsy and currently expects to file an IND for a Phase I clinical trial in the fourth quarter of 2006. The Company expects the cost of such trial to amount to approximately $750. The scope and timing of such trial will, in large part, depend upon, FDA concurrence and the successful completion of certain license arrangements.

The Company currently expects that, if the project progresses and certain other conditions are met, it can file for FDA approval for its epilepsy product by 2011, and the estimated costs to reach that milestone are currently expected to be between $15,000 and $25,000.

The Company has also recently undertaken efforts to develop gene therapy for the treatment of Huntington's disease, with a goal of advancing towards an initial Phase I clinical trial within the next 3 years.

Over the next 12 months, in addition to its normal recurring expenditures, the Company expects to spend approximately: $1,400 in additional follow-on clinical trial expenses with regard to its Parkinson's treatment;

$600 in Phase I clinical trial expenses with regard to its epilepsy product; $650 in expenditures related to the scale up of its manufacturing capabilities for the supply of product for its projected Parkinson's clinical trials; $1,200 in research and licensing fees; and $1,100 in costs associated with operating as a publicly traded company, such as legal fees, accounting fees, insurance premiums, stock market listing fees and investor and public relations fees.

The Company has taken steps to improve and increase its technical and administrative staff. In January 2006, it hired a Chief Financial Officer ("CFO") and, in July 2006, it hired a Chief Development Officer.

Results of Operations

Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005

Revenues. The Company did not generate any operating revenues during the three months ended September 30, 2006 and 2005.

Costs and Expenses.

Research and Development. Research and development expenses increased by $963 during the three months ended September 30, 2006 to $1,263 as compared to $300 during the same period in 2005. The increase is due mainly to the $500 initial fee paid to Diamyd Medical for the license of their patent rights and technical information of a gene version of GAD 65 (see Note 6). In addition, the Company realized increases of $184 in costs for cash and non-cash compensation and travel of Company scientists and scientific consultants, $99

in costs associated with the development agreement and stock purchase agreement entered into with Medtronic, $65 in costs associated with the Sponsored Research Agreement entered into with OSURF (see Note 6) and $52 in connection with the manufacturing of products to be used in the Company's follow-on and pivotal Parkinson's trials.

General and Administrative. General and administrative expenses increased by $671 to $1,395 during the three months ended September 30, 2006, as compared to $724 during the comparable period in 2005. The increase in 2006 is primarily due to $634 in non-cash compensation charges related to (i) the accelerated vesting of and the extension of the exercise period for Michael Sorell's stock options in connection with his termination, and (ii) the option grant to John E. Mordock in connection with his hiring as the Company's President and CEO in July 2006 (see Note 5).

Other Income, Net. Other income, net increased by $136 during the three months ended September 30, 2006, over the comparable period of 2005. This increase is primarily attributable to an increase in interest income earned on funds received by the Company during the third quarter of 2006 from its private placement of its Series C Preferred Stock.

Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005

Revenues. The Company did not generate any operating revenues during the nine months ended September 30, 2006 and 2005.

Costs and Expenses.

Research and Development. Research and development expenses increased by $1,133 during the nine months ended September 30, 2006 to $2,792 as compared to $1,659 during the same period in 2005. The increase is, in part, due to the $500 initial fee paid to Diamyd Medical for the license of their patent rights and technical information of a gene version of GAD 65 (see Note 6). The increase is also due to $307 in costs incurred in 2006 associated with the manufacturing of product to be used in the Company's follow-on and pivotal trials, $450 in increased costs for the compensation and travel of Company scientists and scientific consultants, $298 in increased costs related to charges associated with a development agreement and stock purchase agreement entered into with Medtronic and $65 in costs associated with the Sponsored Research Agreement entered into with OSURF (see Note 6). These increases were offset by a reduction, from the prior comparable period of $326 due to the winding down of the treatment of patients as part of the Company's Phase I clinical trial for Parkinson's disease. The Company also benefited from the elimination of $94 in costs, incurred in the nine months ended September 30, 2005, under a research agreement with Auckland Uniservices, Ltd.

General and Administrative. General and administrative expenses increased by $1,194 to $3,141 during the nine months ended September 30, 2006, as compared to $1,947 during the comparable period in 2005, in part due to $634 in cash and non-cash compensation charges related to (i) the accelerated vesting of and the extension of the exercise period for Michael Sorell's stock options in connection with his termination, (ii) the severance payable to Dr. Sorell in connection with his termination and (iii) the option grant to John E. Mordock in connection with his hiring as the Company's President and CEO in July 2006 (see Note 5). The increase is also due to higher professional fees for the period, including legal fees, accounting fees, recruiting fees and investor relations fees of $318. This increase is due to increased recruiting

fees associated with the hiring of the Company's Chief Financial Officer and Chief Development Officer, as well as increased legal and accounting fees associated with the preparation of the Company's Annual Report on Form 10-KSB for the year ended December 31, 2005 and the preparation of the Company's annual meeting proxy statement.

In addition, G&A was higher due to increased cash and non-cash compensation expenses to employees, directors and consultants of $216 during the nine months ended September 30, 2006 as a result of stock option grants issued in May 2006, the hiring of the Company's Chief Financial Officer in January 2006, as well as additional administrative staff and consultants in the first nine months of 2005.

Other Income, (Net). Other income, net increased by $171 during the nine months ended September 30, 2006 over the comparable period of 2005. This increase is a result of increased interest income earned on funds received by the Company during the first nine months of 2006 from its private placement of its Series C Preferred Stock.

Liquidity and Capital Resources.

The Company is still in the development stage and has not generated any operating revenues as of September 30, 2006. In addition, the Company will continue to incur net losses and cash flow deficits from operating activities for the foreseeable future. Cash, cash equivalents and short-term investments were $11,656 at September 30, 2006. Management believes that, including the additional funds raised in May 2006 through the sale of preferred stock and warrants (see Note 4) to the financial statements), the Company's current resources will enable it to continue as a going concern through at least December 31, 2007.

Although the Company believes that its resources are sufficient to begin one follow-on trial for Parkinson's disease and complete a Phase I clinical trial for epilepsy, the Company's resources are not sufficient to allow it to perform all of the clinical trials required for drug approval and marketing, including a pivotal trial for Parkinson's disease. Accordingly, it will continue to seek additional funds through public or private equity offerings, debt financings or corporate collaboration and licensing arrangements. The Company does not know whether additional financing will be available when needed or, if available, will be on acceptable or favorable terms to it or its stockholders.

Net cash used in operating activities was $3,758 for the nine months ended September 30, 2006 as compared to $2,630 during the same period in 2005. The $1,128 increase in net cash used in operations was primarily due to an increase in cash expenses of $1,578, related to the progress of the Company's research and development programs in Parkinson's disease and epilepsy and the expanded administrative infrastructure needed to support that progress, including the $500 initial fee paid to Diamyd Medical for the license of their patent rights and technical information of a gene version of GAD 65 (see Note 6), offset by a decrease in net operating assets of $452.

Net cash used in investing activities during the nine months ended September 30, 2006 was $2,411 as compared to net cash used of $1,379 during the nine months ended September 30, 2005. The difference is primarily due to an increase in net purchases of short-term investments in the amount of $974 during the nine months ended September 30, 2006.

Net cash provided by financing activities during the nine months ended September 30, 2006 was $11,601 as compared to $5,159 during the nine months ended September 30, 2005. During the nine months ended September 30, 2006, the Company completed a private placement of its Series C Preferred Stock to investors led by General Electric Pension Trust and Daimler Chrysler Corporation Master Retirement Trust that yielded $11,612 in net proceeds (see Note 4). During the nine months ended September 30, 2005, the Company completed a private placement of its Common Stock to a group of investors led by Merlin Biomed Group that yielded $5,066 in net proceeds.

Recent Accounting Pronouncements

Staff Accounting Bulletin No. 108

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 must be applied to annual financial statements for their first fiscal year ending after November 15, 2006. The Company is currently evaluating the impact that the adoption of SAB 108 will have, if any, on its consolidated financial statements and notes thereto.

FORWARD LOOKING STATEMENTS

This document includes certain statements of the Company that may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and which are made pursuant to the Private Securities Litigation Reform Act of 1995. These forward-looking statements and other information relating to the Company are based upon the beliefs of management and assumptions made by and information currently available to the Company. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events, or performance, as well as underlying assumptions and statements that are other than statements of historical fact. When used in this document, the words "expects," "anticipates," "estimates," "plans," "intends," "projects," "predicts," "believes," "may" or "should," and similar expressions, are intended to identify forward-looking statements. These statements reflect the current view of the Company's management with respect to future events and are subject to numerous risks, uncertainties, and assumptions. Many factors could cause the actual results, performance or achievements of the Company to be materially different from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements, including, among other things:

- the inability of the Company to raise additional funds, when needed, through public or private equity offerings, debt financings or additional corporate collaboration and licensing arrangements;
- the inability of the Company to successfully complete the follow-on trials for Parkinson's disease or to commence Phase I for temporal lobe epilepsy; and

- the inability of the Company to successfully obtain or defend the intellectual property of its product candidates and technologies.

Other factors and assumptions not identified above could also cause the actual results to differ materially from those set forth in the forward-looking statements. Additional information regarding factors which could cause results to differ materially from management's expectations is found in the section entitled "Risk Factors" contained in the Company's 2005 Annual Report on Form 10-KSB. Although the Company believes these assumptions are reasonable, no assurance can be given that they will prove correct. Accordingly, you should not rely upon forward-looking statements as a prediction of actual results. Further, the Company undertakes no obligation to update forward-looking statements after the date they are made or to conform the statements to actual results or changes in the Company's expectations.

Item 3 - Controls and Procedures

(a) Disclosure Controls and Procedures. The Company's management, with the participation of the Company's President and Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the most recent period covered by this report. Based on such evaluation, the Company's President and Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

(b) Changes in Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the third quarter of 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6 - Exhibits

See Exhibit Index

Signatures

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on

its behalf by the undersigned, thereunto duly authorized.

NEUROLOGIX, INC.

November 14, 2006 /s/ John E. Mordock

John E. Mordock
President and Chief Executive Officer
(as Principal Executive Officer)

November 14, 2006 /s/ Marc L. Panoff

Marc L. Panoff
Chief Financial Officer, Secretary and Treasurer
(as Principal Accounting Officer/ Principal Financial Officer)

EXHIBIT INDEX

Exhibit No.	Exhibit
31.1	Rule 13a-14(a)/15d-14(a) Certification of President and Chief Executive Officer (as Principal Executive Officer).**
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer, Secretary and Treasurer (as Principal Accounting Officer/Principal Financial Officer).**
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer, Secretary and Treasurer.**

** Filed herewith