

OPEXA THERAPEUTICS, INC.

FORM 10KSB (Annual Report (Small Business Issuers))

Filed 03/31/06 for the Period Ending 12/31/05

Address	2635 TECHNOLOGY FOREST BLVD. THE WOODLANDS, TX 77381
Telephone	(281) 272-9331
CIK	0001069308
Symbol	OPXA
SIC Code	2834 - Pharmaceutical Preparations
Fiscal Year	12/31

PHARMAFRONTIERS CORP.

FORM 10KSB

(Annual Report (Small Business Issuers))

Filed 3/31/2006 For Period Ending 12/31/2005

Address	2635 N. CRESCENT RIDGE DRIVE THE WOODLANDS, Texas 77381
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Fiscal Year	12/31

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

FORM 10-KSB

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

For the fiscal year ended December 31, 2005

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

Commission file number: 0-25513

PharmaFrontiers Corp.

(Exact name of small business issuer as specified in its charter)

Texas

76-0333165

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

2635 N Crescent Ridge Drive, The Woodlands, Texas

77381

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (281) 272-9331

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

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

Check whether the Issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. ☐

Check whether the Issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Issuer's revenues for the fiscal year ended December 31, 2005: \$0.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Issuer as of March 28, 2006 based upon the average bid and asked price as of such date, was \$11,824,916.

The Registrant's common stock outstanding as of March 28, 2006, was 20,967,035 [include financing] shares

DOCUMENTS INCORPORATED BY REFERENCE:

The Registrant is incorporating by reference in Part III of this Form 10-KSB certain information contained in the Registrant's proxy statement for its annual meeting of shareholders, which proxy statement will be filed by the Registrant on or before April 28, 2006.

Transitional Small Business Disclosure Format (Check One): Yes ☐ No ☒

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Forward Looking Statement

The statements contained in this report, other than statements of historical fact, constitute forward-looking statements. Such statements include, without limitation, all statements as to expectation, belief, estimation, intent, anticipation, development, trial, contingency and statements as to our future results of operations, the progress of our research and product development programs, the need for, and timing of, additional capital and capital expenditures, partnering prospects, the need for additional intellectual property rights, effects of regulations, and the potential market opportunities. These statements relate to events and/or future financial performance and involve known and unknown risks, uncertainties and other factors that may cause the actual results, levels of activity, performance or achievements of the Company or the industry in which it operates to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. These risks and other factors include those listed under "Risk Factors" and those described elsewhere in this report.

In some cases, you can identify forward-looking statements by the Company's use of terms such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," or the negative of these terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider various factors, including the risks outlined under "Risk Factors." These factors may cause the Company's actual results to differ materially from any forward-looking statement.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance, or achievements. Moreover, neither the Company nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements. The Company does not intend to update any of the forward-looking statements after the date of this report to conform prior statements to actual results.

Stock Split

In April 2004, the Company's shareholders approved a one for fifty reverse common stock split. All share, par share and par value amounts (except authorized shares) have been retroactively adjusted to reflect the split.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Overview

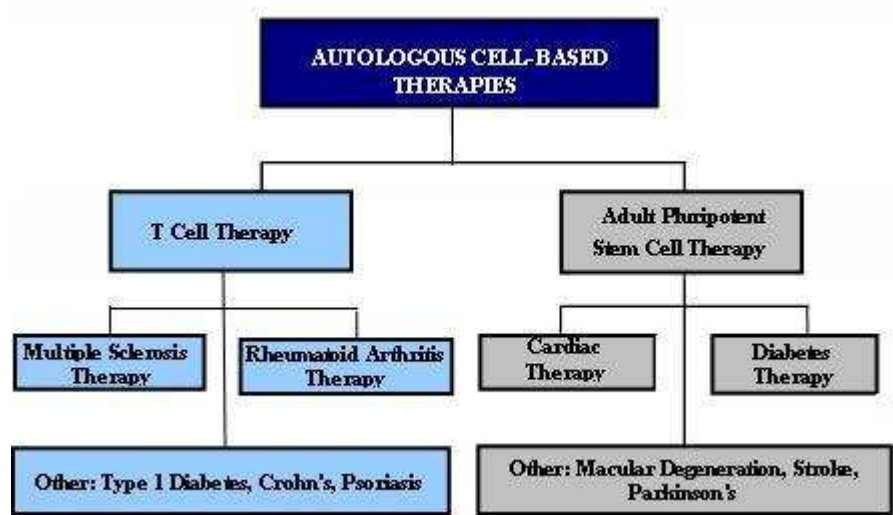
PharmaFrontiers Corp. (the "Company" or "PharmaFrontiers") is a biopharmaceutical company developing autologous cellular therapies to treat several major illnesses, including multiple sclerosis (MS), rheumatoid arthritis, diabetes, and cardiovascular disease. These therapies are based on the Company's proprietary T-cell and stem cell technologies.

PharmaFrontiers' lead product, Tovaxin™, is a T-cell-based therapeutic vaccine for MS, which offers a unique and personalized approach to treating the disease by inducing an immune response against the autoimmune myelin-reactive T-cells (MRTCs), which are believed to be responsible for the initiation of the disease process. Tovaxin is currently in Phase I/II clinical trials and is cleared by the U.S. Food and Drug Administration's (FDA) Center for Biologics Evaluation and Research (CBER) to enter a Phase IIb trial. Initial Phase I/II human trials show that T-cell vaccination (TCV) appear to safely induce immune responses that deplete and regulate myelin-peptide reactive T-cells. In two open-label Phase I/II clinical trials, the relapse rates were reduced by an average of 93%. Some patients appear to experience an improvement of their EDSS (a scoring method to measure the disability of MS patients). We do not believe that this EDSS improvement is normally seen with current therapies. Although the data from these trials appears to be promising, it must be noted that these trials were not placebo controlled. In the first half of 2006, we plan to enroll the first patient in Phase IIb placebo controlled trial. PharmaFrontiers believes that Tovaxin could be ready for commercialization as early as 2010. Moreover, the Company is evaluating a T-cell assay technology that can be used to monitor T-cell therapy and possibly develop a product for early diagnosis of MS.

We have an exclusive worldwide license for the intellectual property rights and research results of an autologous T cell vaccine for rheumatoid arthritis from the Shanghai Institutes for Biological Sciences (SIBS), Chinese Academy of Sciences of the People's Republic of China. The license agreement permits the SIBS' scientists to publish their research results to date after PharmaFrontiers has filed a patent application covering the rheumatoid arthritis T cell vaccine with the U.S. Patent and Trademark Office.

PharmaFrontiers also holds the exclusive worldwide license to adult pluripotent stem cells derived from peripheral blood monocytes that allow for the isolation, propagation, and differentiation into cells and tissues for patient-specific cell-based therapies. PharmaFrontiers is currently pursuing indications for congestive heart failure (CHF) and Type 1 diabetes with its stem cell technology. The Company also expects to conduct basic research to determine the potential use of its stem cells in other indications, such as macular degeneration, stroke, and Parkinson's disease. An overview of PharmaFrontiers' technologies and programs underway is provided in the following chart.

Overview of PharmaFrontiers Corp Technologies and Programs



T-Cell Therapy

PharmaFrontiers has the exclusive license to an individualized T-cell therapeutic vaccine, Tovaxin, which is in U.S. FDA Phase I/II human dose ranging and extension clinical trials to evaluate its safety and effectiveness in treating MS. The Company has been developing its T-cell technology platform following the acquisition of Opexa Pharmaceuticals, which was formed around an exclusive license granted by Baylor College of Medicine for the T-cell-based therapeutic vaccination technology developed by Dr. Jingwu Zang.

Tovaxin consists of a trivalent formulation (MBP, proteolipid protein [PLP], and myelin oligodendrocyte glycoprotein [MOG]) of attenuated autoreactive T-cells. MS is the result of a person's own T-cells attacking the myelin sheath that coats the nerve cells of the central nervous system (CNS). PharmaFrontiers' unique T-cell technology takes these autoreactive T-cells from the patient and expands them ex vivo (in a cell-culture environment outside the body), attenuates them by gamma irradiation, and then returns them to the patient as a subcutaneous injection. Although further testing is necessary, indications from our initial human trials appear to show that these attenuated T-cells cause an immune response directed at the autoreactive T-cells in the patient's body, stimulating a reduction in the level of harmful T-cells.

We believe that our initial human trials show that Tovaxin safely induces the depletion and regulation of myelin-peptide reactive T-cells, possibly stabilizing the disease, reducing the annualized relapse rate, and potentially improving the disability scores of patients. In October 2005, the FDA approved the Company's protocol for our Phase IIb clinical trial of Tovaxin. We intend to enroll the first patient in this pivotal Phase IIb in the first half of 2006. In addition, PharmaFrontiers is evaluating whether its T-cell assay technology can be used to monitor T-cell therapy, be developed as an assay for T-cell therapy, and be used to diagnose MS through an analysis of the autoreactive T-cells in a patient's blood.

Our Rheumatoid Arthritis (RA) T-cell vaccination (TCV) technology is conceptually similar to Tovaxin. RA is an autoimmune T-cell-mediated disease in which pathogenic T-cells trigger an inflammatory autoimmune response of the synovial joints of the wrists, shoulders, knees, ankles and feet which causes pain, stiffness, and swelling around the joints. Our RA TCV technology allows the isolation of these pathogenic T-cells from synovial fluid drawn from a patient. We will expand and modify these T-cells in our laboratory. The modified T-cells will be injected subcutaneously into patients with the goal of inducing an immune response directed at the Pathogenic T-cells in the patient's body. We believe this immune response could reduce the level of Pathogenic T-cells and potentially allow the reduction of joint swelling in RA patients.

Stem Cell Therapy

PharmaFrontiers holds the exclusive worldwide license from the University of Chicago (through its prime contractor relationship with the U.S. Department of Energy's Argonne National Laboratory) for technology that allows a patient's donated blood to be laboratory processed in order to obtain mononuclear cells. These monocytes can be differentiated to form pluripotent stem cells in the presence of certain growth factors, yielding approximately 100 million stem cells per blood draw. The resulting monocyte-derived stem cells (MDSC) can be expanded and differentiated into other cell types when cultured in the presence of the appropriate growth factors. The Company is initially conducting pre-clinical research to develop stem cell therapies to treat congestive heart failure and Type 1 diabetes.

We believe the importance of these MDSC is that they can be prepared relatively easily and inexpensively from a patient's monocytes, expanded ex vivo (if necessary), and then administered back to the same patient. Because this is an autologous therapy, there should be no rejection issues and no need for the use of debilitating anti-rejection drugs.

Other Opportunities

The Company intends to conduct basic research to determine the potential use of its stem cells in other indications, such as macular degeneration, stroke, myocardial infarction, and Parkinson's disease. PharmaFrontiers intends to partner or sublicense some of these indications if they are not pursued for internal development. For those indications where the Company feels it can participate commercially, PharmaFrontiers desires to partner in key commercial markets outside of the United States.

Organizational History

The Company was incorporated in Texas in 1986 and originally engaged in businesses other than the biopharmaceutical business. These other business operations were terminated in February 2002. In May 2004, we entered the biopharmaceutical business by acquiring an entity that held rights to treatments using adult pluripotent stem cells derived from adult human peripheral blood, and in connection therewith we changed our name to our current corporate name. From an accounting standpoint, the subsidiary is deemed the acquirer in a reverse merger whereby the parent is deemed the survivor of the reorganization/reverse merger. As such, our financial statements are those of the subsidiary. In November 2004, we acquired Opexa Pharmaceuticals, Inc. ("Opexa"), which holds rights to technology to diagnose and treat multiple sclerosis through modified autoreactive T cells.

The Company's Products and Services

Our T cell Platform

Multiple Sclerosis - Background

In the United States, approximately 400,000 people suffer from multiple sclerosis, a chronic progressive autoimmune disease of the central nervous system (CNS) that is caused by myelin autoreactive T-cells progressively eroding the myelin that surrounds and insulates nerve fibers of the brain and spinal cord. Globally, there are approximately 2.5 million MS patients representing a drug market believed to be in excess of \$4 billion. The US markets accounted for 50 per cent of global MS sales in 2004, approximately \$2.3 billion. MS remains a challenging autoimmune disease to study because the pathophysiologic mechanisms are diverse, and the chronic, unpredictable course of the disease makes it difficult to determine whether the favorable effects of short-term treatment will be sustained. Therapies that can prevent or stop the progression of disease and allow reversal of the neurological damage and disability caused by the disease represent the greatest unmet need in MS.

In recent years, the understanding of MS pathogenesis has evolved to comprise an initial, T-cell-mediated inflammatory activity followed by selective demyelination (erosion of the myelin coating of the nerve fibers) and then neurodegeneration. The discovery of disease-relevant immune responses has accelerated the development of targeted therapeutic products for the treatment of the early stages of MS. Healthy individuals have been found to have autoreactive T-cells, which recognize a variety of self-antigens (e.g., myelin basic protein [MBP], proteolipid protein [PLP], and myelin oligodendrocyte glycoprotein [MOG]) as part of the normal T-cell repertoire and circulate naturally in the periphery without causing an autoimmune disease.

Some subjects unfortunately who have the appropriate genetic background have increased susceptibility for the in vivo activation and clonal expansion of myelin autoreactive T-cells. These myelin autoreactive T-cells may remain dormant, but at some point they are activated in the periphery, possibly by molecular mimicry (i.e., recognition of epitopes that are common to autoantigens and microbial antigens as exogenous triggers), thus enabling them to cross the blood-brain barrier (BBB) and infiltrate the healthy tissue of the brain and spinal cord. The cascade of pathogenic events leads to demyelination of axons, which causes nerve impulse transmissions to diffuse into the tissue.

Current Therapy for Multiple Sclerosis

Current MS disease modifying drugs on the market are only palliative and generally work through a mechanism of immunomodulation or immunosuppression. These therapies for MS are dominated by three forms of interferon that require frequent subcutaneous or intramuscular injections. Copaxone is an immunomodulator composed of a random copolymer of amino acids that is administered daily. Novantrone (mitoxanthrone) is an immunosuppressive drug that can only be given four times per year with a life time limit of 8 to 12 doses. All of the current therapies only slow the progression of MS and they have significant patient compliance challenges because of the dosing schedule, limited decrease in relapse rate, side effects profile (e.g., the interferon formulations produce severe flu-like symptoms, injection site reactions, infection and neutralizing antibodies (range from 5% to 45%) are developed that limits the efficacy of treatment; copaxone causes significant injection site reactions; while novantrone causes infections, bone marrow suppression, nausea, hair thinning, bladder infections, and mouth sores). These drugs must be administered daily to weekly.

TYSABRI®, a selective adhesion molecule inhibitor (an alpha 4 integrin antagonist), represents another class of MS drugs which works by preventing immune system cells (all leukocytes carrying the alpha 4 integrin glycoprotein on their surface) from crossing the BBB and move into the CNS. On February 28, 2005, Biogen Idec and Elan Corporation announced a voluntary suspension of the marketing of TYSABRI. On March 8, 2006 Biogen Idec and Elan Corporation announced that the Peripheral and Central Nervous System Drugs Advisory Committee of the FDA voted unanimously to recommend reintroduction of TYSABRI as a treatment for relapsing forms of MS. The Committee's recommendation is advisory to the FDA, and the agency is not bound by this recommendation. The FDA is expected to announce their decision by March 29, 2006.

Tovaxin for Multiple Sclerosis

The Company believes that Tovaxin works selectively on the myelin autoreactive T-cells by harnessing the body's natural immune defense system and feedback mechanisms to deplete these T-cells and induce favorable immune regulatory responses by rebalancing the immune system. Tovaxin is manufactured by taking the MRTCs from the blood, expanding them to a therapeutic dose ex-vivo, and attenuating them with gamma irradiation to prevent DNA replication. These attenuated MRTCs are then injected subcutaneously into the body in large quantities. The body recognizes specific T-cell receptor molecules of these MRTCs as foreign and mounts an immune response reaction against them, not only destroying the injected attenuated MRTCs, but also the circulating, myelin autoreactive T-cells carrying the peptide-specific T-cell receptor molecules. In addition, T-cell activation molecules on the surface of the activated MRTCs used as vaccine induce favorable immune regulatory responses, which promote anti-inflammatory responses. Because the therapy uses an individual's own cells, the only directly identifiable side effect is injection site reaction in a small percentage of the patients. These reactions clear within 24 hours.

We believe that this technology platform will have application in other T-cell mediated diseases such as Crohn's disease, psoriasis, rheumatoid arthritis and type 1 diabetes.

Tovaxin Intellectual Property

The technology was discovered by Dr. Jingwu Zang of Baylor College of Medicine in Houston. The Company has an exclusive, worldwide license from the Baylor College of Medicine to develop and commercialize three technology areas for MS, namely T-cell vaccination, peptides, and diagnostics. Under the License Agreement with the Baylor College of Medicine, the Company has rights to a total of 7 patents (2 U.S. and 5 foreign) and 69 patent applications (6 U.S., 62 foreign, and 1 Patent Cooperation Treaty [PCT]).

Tovaxin Manufacturing

PharmaFrontiers' manufactures its TCV therapy in its own Good Manufacturing Practice ("GMP") facility. The TCV technology is similar to that of traditional microbial vaccine technology, where the pathogen (or the attenuated derivative) is used to derive the protective antigens necessary to induce protective immune responses. In preparing a TCV therapy, the myelin autoreactive T-cells causing the disease are taken from the blood, specifically identified, and expanded ex vivo by incubating these T-cells with MBP, PLP, and MOG-selected peptides in the presence of antigen-presenting cells and growth factors. Myelin-peptide reactive T-cells are grown to therapeutic levels and cryopreserved. Prior to use, the MRTCs are expanded, formulated, and attenuated (by irradiation) to render them incompetent to replicate but viable for therapy. These attenuated T-cells are administered subcutaneously through a series of injections. We expect that a single draw of a 500 ml bag of blood is sufficient to provide a full year's therapeutic regime of Tovaxin.

Clinical Development of Tovaxin

Tovaxin is currently in Phase I/II Clinical trials. Patients treated in PharmaFrontiers Phase I/II open-label studies with trivalent (MBP, MOG, and PLP) formulations have experienced minimal side effects and a 93% average reduction in annual relapse rate.

Tovaxin Phase IIb

The Phase IIb trial, entitled "A Multicenter, Randomized, Double-Blind, Placebo-Controlled Study of Subcutaneous Tovaxin in Subjects with Clinically Isolated Syndrome or Relapsing Remitting Multiple Sclerosis", that the Company plans to initiate in the first half of 2006, is expected to be a multi-site double-blind, randomized, placebo-controlled 150 (100 treated, 50 placebo) patient trial. The primary endpoint will be lesion evaluation (the total number of gadolinium-enhancing lesions) via MRI with a secondary endpoint being annual relapse rate. This planned trial is designed to demonstrate the safety and efficacy of Tovaxin.

Our Stem Cell Platform

Stem Cells - Background

Stem cells are undifferentiated primary cells that have the potential to become any tissues and organs of the body. They hold therapeutic promise for the development of effective treatments and possibly cure various diseases. Hematopoietic stem cells (HSC's), present in the bone marrow and precursors to all blood cells, are currently the only type of stem cells commonly used for therapy. Doctors have been transferring HSC's in bone marrow transplants for more than 40 years. Advanced techniques for collecting or "harvesting" HSC's are now used to treat leukemia, lymphoma and several inherited blood disorders.

The clinical potential of stem cells has also been demonstrated in the treatment of other human diseases, including diabetes and advanced kidney cancer. However, these new therapies have been offered only to a very limited number of patients using adult stem cells.

New clinical applications for stem cells are currently being tested therapeutically for the treatment of liver diseases, coronary diseases, autoimmune and metabolic disorders (amyloidosis), chronic inflammatory diseases (lupus) and other advanced cancers.

Unfortunately stem cell therapies have technical, ethical and legal hurdles to overcome before they will be able to be used to possibly effect tissue and organ repair in disease states that heretofore have only treated the symptoms. A significant hurdle to most uses of stem cells is that scientists do not yet fully understand the signals that turn specific genes on and off to influence the differentiation of the stem cell. Therefore, scientists will have to be able to precisely control the differentiation of stem cells into the specific cell type to be used in therapy and drug testing. Current knowledge of the signals controlling differentiation fall well short of being able to mimic these conditions precisely to consistently have identical differentiated cells for each specified use.

To realize the promise of novel cell-based therapies for such pervasive and debilitating diseases, scientists must be able to easily and reproducibly manipulate stem cells so that they possess the necessary characteristics for successful differentiation, transplantation and engraftment. The following is a list of requisite steps in cell-based treatments that scientists will have to learn to precisely control prior to bringing such treatments to clinical trial. To be useful for transplant purposes, stem cells must be reproducibly made to: proliferate extensively and generate sufficient quantities of tissue, differentiate into the desired cell type(s), survive in the recipient after transplant, integrate into the surrounding tissue after transplant, function appropriately for the duration of the recipient's life, avoid harming the recipient in any way, and avoid the problem of immune rejection. There is no assurance that any commercialized cell-based therapies will ever be developed.

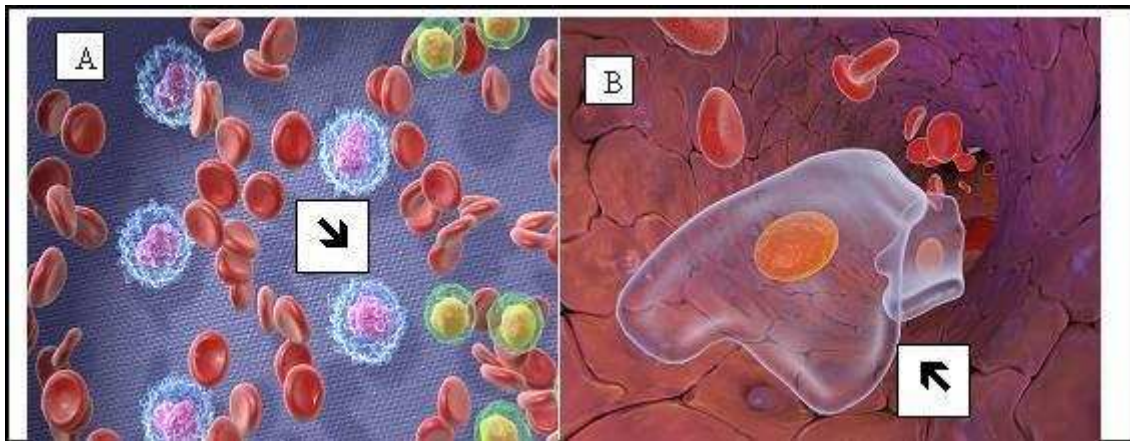
Although there are many ways to access stem cells, the Company believes that its autologous blood monocyte-derived stem cells offer distinct advantages.

Therapies utilizing Our Stem Cell Platform

Adult stem cells are unspecialized cells that have potential to develop into many different cell types in the body. Adult stem cells are believed to be a potential autologous renewable replacement source which might be used to treat various diseases, such as heart disease, type 1 diabetes, stroke, heart attack, burn injuries, spinal cord injuries, Parkinson's and Alzheimer's diseases, and many others. Adult stem cells are in clinical trials globally and are currently being used therapeutically in Thailand where hematopoietic stem cells (HSCs) are being used to treat cardiac disease (severe angina pectoris). In addition, adult stem cells are in clinical trials in the U.S. (mesenchymal stem cells), Brazil, Uruguay and Europe (bone marrow derived stem cells).

PharmaFrontiers' stem cell technology involves a proprietary process to produce monocyte-derived stem cells (MDSC) from blood. The Company believes that these MDSC can be derived from a patient's monocytes, expanded ex vivo, and then administered to the same patient. The Company believes that because this is an autologous therapy, there should be no rejection issues and no need for the use of anti-rejection drugs.

PharmaFrontiers, working either by itself or in conjunction with strategic partners, expects to utilize these MDSC from the same patient to develop a therapy which may cause autologous tissue or organ repair. The initial internal therapeutic targets are late stage heart failure and type 1 diabetes. Other therapeutic targets would be pursued through early-stage licensing or strategic alliances. This program is currently in pre-clinical development.



Panel A: Blood monocytes are collected () and (Panel B) de-differentiated to yield monocyte-derived stem cells (MDSCs) ().

Stem Cell Pre-Clinical and Clinical Development

PharmaFrontiers plans to conduct pre-clinical animal studies on these MDSC in the first half of 2006 before filing an IND. The plan is to leverage off of extensive international research and clinical trials and develop these cells internally for late stage heart failure and type 1 diabetes. All other potential applications will be out-licensed to generate upfront cash, milestone payments, and royalties.

Type 1 diabetes and heart failure were chosen for internal development because they are large markets (over 1 million patients in the U.S.) and the Company has a proprietary method of creating islet cells. Stem cell research using more expensive processes has shown encouraging clinical results for the use of cellular therapy in these indications.

Licenses, Patents and Proprietary Rights

We believe that proprietary protection of our technologies is critical to the development of our business. We intend to continue to protect our proprietary intellectual property through patents and other appropriate means. We rely upon trade-secret protection for some confidential and proprietary information and take active measures to control access to that information. We currently have non-disclosure agreements with all of our employees, consultants, vendors, advisory board members, contract research organizations and certain prospective investors.

The Company's intellectual property strategy includes developing proprietary technology for the sourcing, scale up, manufacturing, and storage of T cells and pluripotent adult stem cells and the use of these cells in multiple therapeutic applications. This strategy will include expanding on technologies in-licensed to us as well as in-licensing additional technologies through collaborations with universities and biotech companies.

We have licenses to certain patents that relate to our T cell technology and our pluripotent adult stem cell technology.

T Cell Therapy IP

We have an exclusive, worldwide license from the Baylor College of Medicine to patent applications claiming rights to the treatment of multiple sclerosis using modified T cells and to the use of the T cell technology as a diagnostic. The license was granted to the Company by Baylor in exchange for common stock in Opexa which was acquired by the Company in November 2004. The key terms of the agreement are: exclusive, worldwide, and a 2% royalty on net sales of licensed products. The royalty decreases after the aggregate net sales exceed \$500 million. There are no other performance or payment terms in the license. The Company also has a separate consulting agreement with the inventor, Dr. Jingwu Zang, which grants the Company the right of first refusal on all future discoveries made by Dr. Zang.

Rheumatoid Arthritis Therapy IP

We have an exclusive worldwide license for the intellectual property rights and research results of an autologous T cell vaccine for rheumatoid arthritis from the Shanghai Institutes for Biological Sciences (SIBS), Chinese Academy of Sciences of the People's Republic of China. The key terms of the agreement are: exclusive, worldwide, \$125,000 license payment and a 0.5% royalty on net sales of licensed products. The license agreement permits the SIBS' scientists to publish their research results to date after PharmaFrontiers has filed a patent application covering the rheumatoid arthritis T cell vaccine with the U.S. Patent and Trademark Office.

Stem Cell Therapy IP

We have an exclusive, worldwide license from the University of Chicago, through its prime contractor relationship with Argonne National Laboratory, to a patent application claiming rights to the development of adult pluripotent stem cells from monocytes isolated from adult human peripheral blood. The technology was discovered and developed at the Argonne National Laboratory, a U.S. Department of Energy Laboratory.

Pursuant to the license we have issued a total of 534,624 shares of our common stock to the University of Chicago. We have also agreed to pay the University of Chicago \$1.5 million upon our receiving \$10 million or more in any financing. At the same time as making such payment, we are obligated to issue to the University of Chicago sufficient additional shares of common stock so that the University holds a total of 2.6% of our outstanding stock after consummation of the financing. On October 31, 2005, the Company and The University of Chicago acting as the prime contractor for the Department of Energy's Argonne National Labs executed the First Amendment to Amended and Restated License Agreement. Both parties agreed to extend the \$1.5 million milestone payment date from October 31, 2005 to April 30, 2006. We have agreed to pay a percentage of royalties on sales of products subject to the licensed patents, as well as sublicense fees. In addition, the University of Chicago license requires us to expend on research and development at least \$2,000,000 within two (2) years of the execution of the license and at least an additional \$4,000,000 within four (4) years of the execution of the license. Research and development expenditures by sublicensees may account for half of each amount. The license also requires us to sell a product or method based on the licensed technology by February 2011.

Our Product Pipeline

Multiple Sclerosis T Cell Therapy, Tovaxin

Tovaxin is a vaccine approach to treating multiple sclerosis in that it induces the body's immune system to attack the myelin reactive T-cells (MRTCs) that we believe are responsible for destroying the myelin sheath coating of the axons in the central nervous system. We believe that the depletion of the MRTCs may stop progression of multiple sclerosis. Tovaxin is currently in Phase I/II Clinical Trials and is expected to enter a Phase IIb Clinical Trial in 2006.

Rheumatoid Arthritis Therapy

Our Rheumatoid Arthritis (RA) T-cell vaccination (TCV) technology is conceptually similar to Tovaxin. RA is an autoimmune T-cell-mediated disease in which Pathogenic T-cells trigger an inflammatory autoimmune response of the synovial joints of the wrists, shoulders, knees, ankles and feet which causes pain, stiffness, and swelling around the joints. We are currently transferring the technology to our laboratory and plan to file patent applications and present data to the FDA in the first half of 2006 with the hope of filing an IND and initiating a Phase I clinical trial by the end of 2006.

Cardiac Stem Cell Therapy

Stem cell treatment of congestive heart failure could revolutionize treatment of the disease because it may treat the source of the problem by replacing diseased cardiac muscle tissue with stem cells that grow into new healthy cardiac tissue. Elsewhere multiple Phase I clinical studies encompassing more than 70 patients have been run with autologous bone marrow stem cells that report improved cardiac perfusion. A recent (2003-2004) trial reported that injected autologous bone marrow mononuclear cells, using electromechanical mapping into areas of ischemic myocardium in patients with endstage ischemic cardiomyopathy and heart failure, showed a therapeutic effect with improved myocardial perfusion and exercise capacity, at 6 and 12 months, as well as increased global left ventricular function. Using the experience of these Phase I trials we expect to move through pre-clinical development and, if successful, initiate human testing as soon as practicable.

Diabetes Stem Cell Therapy

Type 1 diabetes is a chronic disease for which there is no treatment. Frequent testing of glucose levels coupled with insulin injections are used to control the disease. The Company holds a license to produce cells that generate insulin using the core stem cell technology and will hold a license for the use of some unique growth factors, which have overcome the major scientific challenge of differentiating an adult stem cell to produce insulin. Our goal is to schedule human trials as soon as practicable.

Other Opportunities

The Company intends to conduct basic research to determine the potential use of the Company's stem cells in other indications such as macular degeneration, heart attack, and Parkinson's disease. Liver cells (hepatocytes) derived from our stem cells may be valuable across the biopharmaceutical industry to test for drug toxicity or to help cure liver diseases. The Company intends to partner or sublicense some of these indications if they are not pursued for internal development. For those indications where the Company feels it can participate commercially, the Company will possibly take partners in key commercial markets outside of the United States.

Research Collaborations

We anticipate that from time to time in the future we will enter into collaborative research agreements with other academic and research institutions. We will use such agreements to enhance our research capabilities. Typically, in the industry, such agreements provide the industry partner with rights to license the intellectual property created through the collaboration. We may also enter into collaborative research agreements with other pharmaceutical companies when we believe such collaboration will support the development and commercialization of our technology.

Commercialization Through Third Parties

We anticipate that we will possibly grant sublicenses for certain applications of our technologies. We believe that by sublicensing some of the rights to our technology to pharmaceutical companies and other third parties, we will be able to develop more efficiently some applications of our technologies. We currently do not have any sublicenses.

Competition

The development of therapeutic and diagnostic agents for human disease is intensely competitive. Major pharmaceutical companies currently offer a number of pharmaceutical products to treat heart attack, stroke, Parkinson's disease, diabetes, liver diseases, arthritis and other diseases for which our technologies may be applicable. Many pharmaceutical and biotechnology companies are investigating new drugs and therapeutic approaches for the same purposes, which may achieve new efficacy profiles, extend the therapeutic window for such products, alter the prognosis of these diseases, or prevent their onset. We believe that our products, when and if successfully developed, will compete with these products principally on the basis of improved and extended efficacy and safety and their overall economic benefit to the health care system. We expect competition to increase. We believe that our most significant competitors will be fully integrated pharmaceutical companies and more established biotechnology companies. Smaller companies may also be significant competitors, particularly through collaborative arrangements with large pharmaceutical or biotechnology companies. Some of our primary competitors in the current treatment of and in the development of treatments for multiple sclerosis include Biogen, Elan, Serono, Aventis, Teva, and Schering AG. Some of our primary competitors in the development of stem cell therapies include Aastrom Biosciences, Geron, Gamida-Cell Ltd, Stem Cells Inc., Cellerant Therapeutics, Viacell, and Osiris Therapeutics. Many of these competitors have significant products in development that could be competitive with our potential products.

Sales and Marketing

We intend to develop a sales force to market our multiple sclerosis cell therapy products in the U.S. Given the concentration of multiple sclerosis among a relatively small number of specialized neurologists, we believe that a modest size sales force would be sufficient to market the multiple sclerosis products. Our plan is to start building the sales force with the launch of the multiple sclerosis diagnostic products.

We expect to partner with large biotech and pharmaceutical companies for the marketing and sales of our stem cell therapy products.

Government Regulation

Our research and development activities and the future manufacturing and marketing of our potential products are, and will be, subject to regulation for safety and efficacy by a number of governmental authorities in the United States and other countries.

In the United States, pharmaceuticals, biologicals and medical devices are subject to FDA regulation. The Federal Food, Drug and Cosmetic Act, as amended, and the Public Health Service Act, as amended, the regulations promulgated thereunder, and other Federal and state statutes and regulations govern, among other things, the testing, manufacture, safety, efficacy, labeling, storage, export, record keeping, approval, marketing, advertising and promotion of our potential products. Product development and approval within this regulatory framework takes a number of years and involves significant uncertainty combined with the expenditure of substantial resources.

FDA Approval

We will need to obtain FDA approval of any therapeutic product we plan to market and sell. The steps required before our potential products may be marketed in the United States include:

1. *Preclinical Laboratory and Animal Tests* . Preclinical tests include laboratory evaluation of the product and animal studies in specific disease models to assess the potential safety and efficacy of the product and our formulation as well as the quality and consistency of the manufacturing process.
2. *Submission to the FDA of an Application for an Investigational New Drug Exemption, or IND, Which Must Become Effective Before U.S. Human Clinical Trials May Commence* . The results of the preclinical tests are submitted to the FDA as part of an IND, and the IND becomes effective 30 days following its receipt by the FDA, as long as there are no questions, requests for delay or objections from the FDA.
3. *Adequate and Well-Controlled Human Clinical Trials to Establish the Safety and Efficacy of the Product*. Clinical trials involve the evaluation of the product in healthy volunteers or, as may be the case with our potential products, in a small number of patients under the supervision of a qualified physician. Clinical trials are conducted in accordance with protocols that detail the objectives of the study, the parameters to be used to monitor safety and the efficacy criteria to be evaluated. Any product administered in a U.S. clinical trial must be manufactured in accordance with GMP. Each protocol is submitted to the FDA as part of the IND.

The protocol for each clinical study must be approved by an independent Institutional Review Board, or IRB, at the institution at which the study is conducted and the informed consent of all participants must be obtained. The IRB will consider, among other things, the existing information on the product, ethical factors, the safety of human subjects, the potential benefits of the therapy and the possible liability of the institution.

Clinical development is traditionally conducted in three sequential phases, which may overlap:

- In Phase I, products are typically introduced into healthy human subjects or into selected patient populations to test for adverse reactions, dosage tolerance, absorption and distribution, metabolism, excretion and clinical pharmacology.
- Phase II involves studies in a limited patient population to (i) determine the efficacy of the product for specific targeted indications and populations, (ii) determine optimal dosage and dosage tolerance and (iii) identify possible adverse effects and safety risks. When a dose is chosen and a candidate product is found to be effective and to have an acceptable safety profile in Phase II evaluations, Phase III trials begin.
- Phase III trials are undertaken to conclusively demonstrate clinical efficacy and to test further for safety within an expanded patient population, generally at multiple study sites.

The FDA continually reviews the clinical trial plans and results and may suggest changes or may require discontinuance of the trials at any time if significant safety issues arise.

1. *Submission to the FDA of Marketing Authorization Applications* . The results of the preclinical studies and clinical studies are submitted to the FDA in the form of marketing approval authorization applications.

2. *FDA Approval of the Application(S) Prior to Any Commercial Sale or Shipment of the Drug Biologic Product Manufacturing Establishments Located in Certain States Also May be Subject to Separate Regulatory and Licensing Requirement* . The testing and approval process will require substantial time, effort and expense. The time for approval is affected by a number of factors, including relative risks and benefits demonstrated in clinical trials, the availability of alternative treatments and the severity of the disease. Additional animal studies or clinical trials may be requested during the FDA review period, which might add to that time.

After FDA approval for the product, the manufacturing and the initial indications, further clinical trials may be required to gain approval for the use of the product for additional indications. The FDA may also require unusual or restrictive post-marketing testing and surveillance to monitor for adverse effects, which could involve significant expense, or may elect to grant only conditional approvals.

FDA Manufacturing Requirements

Among the conditions for product licensure is the requirement that the prospective manufacturer's quality control and manufacturing procedures conform to the FDA's GMP requirements. Even after product licensure approval, the manufacturer must comply with GMP on a continuing basis, and what constitutes GMP may change as the state of the art of manufacturing changes. Domestic manufacturing facilities are subject to regular FDA inspections for GMP compliance, which are normally held at least every two years. Foreign manufacturing facilities are subject to periodic FDA inspections or inspections by the foreign regulatory authorities with reciprocal inspection agreements with the FDA. Domestic manufacturing facilities may also be subject to inspection by foreign authorities.

Fast Track, Priority Review and Accelerated Approval

Fast Track refers to a process for interacting with the FDA during drug development. Priority Review applies to the time frame the FDA targets for reviewing a completed application. Accelerated Approval (Subpart H) applies to the design and content of the studies used to support a marketing claim.

Fast Track is a formal mechanism to interact with the FDA using approaches that are available to all applicants for marketing claims. The Fast Track mechanism is described in the Food and Drug Administration Modernization Act of 1997. The benefits of Fast Track include scheduled meetings to seek FDA input into development plans, the option of submitting a New Drug Application (NDA) in sections rather than all components simultaneously, and the option of requesting evaluation of studies using surrogate endpoints as discussed below. The Fast Track designation is intended for the combination of a product and a claim that addresses an unmet medical need, but is independent of Priority Review and Accelerated Approval. An applicant may use any or all of the components of Fast Track without the formal designation. Fast Track designation does not necessarily lead to a Priority Review or Accelerated Approval.

Priority Review is a designation for an application after it has been submitted to the FDA for review for approval of a marketing claim. Under the Food and Drug Administration Modernization Act of 1997, reviews for NDAs are designated as either Standard or Priority. A Standard designation sets the target date for completing all aspects of a review and the FDA taking an action on the application (approve or not approve) at 10 months after the date it was filed. A Priority designation sets the target date for the FDA action at 6 months. A Priority designation is intended for those products that address unmet medical needs.

Accelerated Approval or Subpart H Approval is a program described in the NDA regulations that is intended to make promising products for life threatening diseases available on the market on the basis of preliminary evidence prior to formal demonstration of patient benefit. The studies are designed to measure and the FDA evaluation is performed on the basis of a surrogate marker (a measurement intended to substitute for the clinical measurement of interest, usually prolongation of survival) that is considered likely to predict patient benefit. The approval that is granted may be considered a provisional approval with a written commitment to complete clinical studies that formally demonstrate patient benefit. The Federal Register published a discussion of Accelerated Approval with comments. Absent a formal demonstration of patient benefit, a risk benefit assessment cannot be made. Accelerated Approval designation does not necessarily lead to a Priority Review.

Special Protocol Assessment

The Special Protocol Assessment (SPA) process is a procedure by which the FDA provides official evaluation and guidance on proposed protocols for pivotal Phase III clinical trials. An SPA documents the FDA's agreement that the design and plan analysis of the Phase III study adequately addresses objectives in support of a regulatory submission such as a biologics license application (BLA).

Proposed FDA Regulations

The FDA is requiring human cell, tissue, and cellular and tissue-based product (HCT/P) establishments to follow current good tissue practice, which governs the methods used in, and the facilities and controls used for, the manufacture of HCT/Ps; recordkeeping; and the establishment of a quality program. The agency is also issuing new regulations pertaining to labeling, reporting, inspections, and enforcement that will apply to manufacturers of those HCT/Ps regulated solely under the authority of the Public Health Service Act, and not as drugs, devices, and/or biological products.

As part of this approach, the FDA has published final rules for registration of establishments that engage in the recovery, screening, testing, processing, storage or distribution of human cells, tissues, and cellular and tissue-based products, and for the listing of such products. These products specifically include stem cells that are progenitors of blood cells; however, the FDA makes no explicit statement regarding the inclusion of other types of stem cells. In addition, the FDA has published proposed rules for making suitability determinations for donors of cells and tissue and for current good tissue practice for manufacturers using them. We cannot now determine the full effects of this regulatory initiative, including precisely how it may affect the clarity of regulatory obligations and the extent of regulatory burdens associated with pluripotent adult stem cell research (for stem cells that give rise to various tissue types, including blood), and the manufacture and marketing of adult stem cell products.

Other Regulations

In addition to safety regulations enforced by the FDA, we are also subject to regulations under the Occupational Safety and Health Act, the Environmental Protection Act, the Toxic Substances Control Act and other present and potential future foreign, Federal, state and local regulations.

Outside the United States, we will be subject to regulations that govern the import of drug products from the United States or other manufacturing sites and foreign regulatory requirements governing human clinical trials and marketing approval for our products. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursements vary widely from country to country. In particular, the European Union is revising its regulatory approach to high tech products, and representatives from the United States, Japan and the European Union are in the process of harmonizing and making more uniform the regulations for the registration of pharmaceutical products in these three markets.

Research and Development

Research and development expenses for the year ended December 31, 2005 were approximately \$9.9 million, mainly reflecting the costs of the Phase I/II clinical trials for Tovaxin, pre-trial expenses for the Tovaxin Phase IIb Clinical Trial scheduled to begin in 2006 and research and development in support of pre-clinical cardiac and diabetes stem cell therapies. Research and development expenses for the year ended December 31, 2004, were approximately \$2.5 million.

Risk Factors

The following factors affect our business and the industry in which it operates. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known or that we currently consider immaterial may also have an adverse effect on our business. If any of the matters discussed in the following risk factors were to occur, our business, financial condition, results of operations, cash flows, or prospects could be materially adversely affected .

Risks Related to Our Business

Our business is at an early stage of development.

Our business is at an early stage of development. We do not have any products in late-stage clinical trials or on the market. We are still in the early stages of identifying and conducting research on potential products. Only one of our products has progressed to the stage of being studied in human clinical trials. Our potential products will require significant research and development and preclinical and clinical testing prior to regulatory approval in the United States and other countries. We may not be able to develop any products, to obtain regulatory approvals, to enter clinical trials for any of our product candidates, or to commercialize any products. Our product candidates may prove to have undesirable and unintended side effects or other characteristics adversely affecting their safety, efficacy or cost-effectiveness that could prevent or limit their use. Any product using any of our technology may fail to provide the intended therapeutic benefits, or achieve therapeutic benefits equal to or better than the standard of treatment at the time of testing or production.

We have a history of operating losses and do not expect to be profitable in the near future.

We have not generated any profits since our entry into the biotechnology business, have no source of revenues, and have incurred significant operating losses. We expect to incur additional operating losses for the foreseeable future and, as we increase our research and development activities, we expect our operating losses to increase significantly. We do not have any sources of revenues and may not have any in the foreseeable future.

We will need additional capital to conduct our operations and develop our products and our ability to obtain the necessary funding is uncertain.

We need to obtain significant additional capital resources from sources including equity and/or debt financings, license arrangements, grants and/or collaborative research arrangements in order to develop products and continue our business. As of December 31, 2005, we had cash and cash equivalents of approximately \$2.5 million. Our current burn rate is approximately \$400,000 per month excluding capital expenditures. Although our burn rate is expected to increase to \$800,000 per month once the Phase IIb clinical trials begin, we do not intend to start the Phase IIb until we have raised additional capital. We will need to raise additional capital to fund our working capital needs during the second quarter of 2006. We do not have any credit facilities available with financial institutions or any other third parties and as such we must rely upon best efforts third-party debt or equity funding and we can provide no assurance that we will be successful in any funding effort. The failure to raise such funds will necessitate the curtailment of operations and delay of the start of the clinical trials.

The timing and degree of any future capital requirements will depend on many factors, including:

- the accuracy of the assumptions underlying our estimates for capital needs in 2005 and beyond;
- scientific progress in our research and development programs;
- the magnitude and scope of our research and development programs;
- our ability to establish, enforce and maintain strategic arrangements for research, development, clinical testing, manufacturing and marketing;
- our progress with preclinical development and clinical trials;
- the time and costs involved in obtaining regulatory approvals;
- the costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing patent claims; and
- the number and type of product candidates that we pursue.

We do not have any committed sources of capital, although we have issued and outstanding warrants that, if exercised, would result in an equity capital raising transaction. Additional financing through strategic collaborations, public or private equity financings, capital lease transactions or other financing sources may not be available on acceptable terms, or at all. Additional equity financings could result in significant dilution to our stockholders. Further, if additional funds are obtained through arrangements with collaborative partners, these arrangements may require us to relinquish rights to some of our technologies, product candidates or products that we would otherwise seek to develop and commercialize ourselves. If sufficient capital is not available, we may be required to delay, reduce the scope of or eliminate one or more of our programs, any of which could have a material adverse effect on our financial condition or business prospects.

Approximately 88% of our total assets are comprised of intangible assets that are subject to review on a periodic basis to determine whether an impairment on these assets is required. An impairment would not only greatly diminish our assets, but would also require us to record a significant non-cash expense charge.

We are required under generally accepted accounting principles to review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. At December 31, 2005, our intangible assets, consisting of the University of Chicago license and acquired intangible assets from the Opexa acquisition that is an inseparable group of patents and licenses that can't function independently, were approximately \$26.1 million. If management determines that impairment exists, we will be required to record a significant charge to expense in our financial statements during the period in which any impairment of our goodwill is determined.

Clinical trials are subject to extensive regulatory requirements, very expensive, time-consuming and difficult to design and implement. Our products may fail to achieve necessary safety and efficacy endpoints during clinical trials.

Human clinical trials are very expensive and difficult to design and implement, in part because they are subject to rigorous regulatory requirements. The clinical trial process is also time consuming. We estimate that clinical trials of our product candidates will take at least several years to complete. Furthermore, failure can occur at any stage of the trials, and we could encounter problems that cause us to abandon or repeat clinical trials. The commencement and completion of clinical trials may be delayed by several factors, including:

- unforeseen safety issues;
- determination of dosing issues;
- lack of effectiveness during clinical trials;
- slower than expected rates of patient recruitment;
- inability to monitor patients adequately during or after treatment; and
- inability or unwillingness of medical investigators to follow our clinical protocols.

In addition, we or the FDA may suspend our clinical trials at any time if it appears that we are exposing participants to unacceptable health risks or if the FDA finds deficiencies in our IND submissions or the conduct of these trials.

We are dependent upon our management team and a small number of employees.

Our business strategy is dependent upon the skills and knowledge of our management team. We believe that the special knowledge of these individuals gives us a competitive advantage. If any critical employee leaves, we may be unable on a timely basis to hire suitable replacements to effectively operate our business. We also operate with a very small number of employees and thus have little or no backup capability for their activities. The loss of the services of any member of our management team or the loss of a number of other employees could have a material adverse effect on our business.

We are dependent on contract research organizations and other contractors for clinical testing and for certain research and development activities, thus the timing and adequacy of our clinical trials and such research activities are, to a certain extent, beyond our control.

The nature of clinical trials and our business strategy requires us to rely on contract research organizations, independent clinical investigators and other third party service providers to assist us with clinical testing and certain research and development activities. As a result, our success is dependent upon the success of these outside parties in performing their responsibilities. Although we believe our contractors are economically motivated to perform on their contractual obligations, we cannot directly control the adequacy and timeliness of the resources and expertise applied to these activities by our contractors. If our contractors do not perform their activities in an adequate or timely manner, the development and commercialization of our drug candidates could be delayed.

Our current research and manufacturing facility is not large enough to manufacture future stem cell and T-cell therapies.

We conduct our research and development in a 10,000 square foot facility in The Woodlands, Texas, which includes a 1,200 square foot suite of three rooms for the future manufacture of stem cell and T-cell therapies through Phase III trials. Our current facility is not large enough to conduct commercial-scale manufacturing operations. We will need to expand further our manufacturing staff and facility, obtain a new facility or contract with corporate collaborators or other third parties to assist with future drug production.

In the event that we decide to establish a commercial-scale manufacturing facility, we will require substantial additional funds and will be required to hire and train significant numbers of employees and comply with applicable regulations, which are extensive. We do not have funds available for building a manufacturing facility, and we may not be able to build a manufacturing facility that both meets regulatory requirements and is sufficient for our commercial-scale manufacturing.

We may arrange with third parties for the manufacture of our future products. However, our third-party sourcing strategy may not result in a cost-effective means for manufacturing our future products. If we employ third-party manufacturers, we will not control many aspects of the manufacturing process, including compliance by these third parties with the FDA's current Good Manufacturing Practices and other regulatory requirements. We further may not be able to obtain adequate supplies from third-party manufacturers in a timely fashion for development or commercialization purposes, and commercial quantities of products may not be available from contract manufacturers at acceptable costs.

Patents obtained by other persons may result in infringement claims against us that are costly to defend and which may limit our ability to use the disputed technologies and prevent us from pursuing research and development or commercialization of potential products.

A number of pharmaceutical, biotechnology and other companies, universities and research institutions have filed patent applications or have been issued patents relating to cell therapy, stem cells, T-cells, and other technologies potentially relevant to or required by our expected products. We cannot predict which, if any, of such applications will issue as patents or the claims that might be allowed. We are aware that a number of companies have filed applications relating to stem cells. We are also aware of a number of patent applications and patents claiming use of stem cells and other modified cells to treat disease, disorder or injury.

If third party patents or patent applications contain claims infringed by either our licensed technology or other technology required to make and use our potential products and such claims are ultimately determined to be valid, there can be no assurance that we would be able to obtain licenses to these patents at a reasonable cost, if at all, or be able to develop or obtain alternative technology. If we are unable to obtain such licenses at a reasonable cost, we may not be able to develop some products commercially. There can be no assurance that we will not be obliged to defend ourselves in court against allegations of infringement of third party patents. Patent litigation is very expensive and could consume substantial resources and create significant uncertainties. An adverse outcome in such a suit could subject us to significant liabilities to third parties, require disputed rights to be licensed from third parties, or require us to cease using such technology.

If we are unable to obtain future patents and other proprietary rights our operations will be significantly harmed.

Our ability to compete effectively is dependent in part upon obtaining patent protection relating to our technologies. The patent positions of pharmaceutical and biotechnology companies, including ours, are uncertain and involve complex and evolving legal and factual questions. The coverage sought in a patent application can be denied or significantly reduced before or after the patent is issued. Consequently, we do not know whether the patent applications for our technology will result in the issuance of patents, or if any future patents will provide significant protection or commercial advantage or will be circumvented by others. Since patent applications are secret until the applications are published (usually eighteen months after the earliest effective filing date), and since publication of discoveries in the scientific or patent literature often lags behind actual discoveries, we cannot be certain that the inventors of our licensed patents were the first to make the inventions covered by the patent applications or that the licensed patent applications were the first to be filed for such inventions. There can be no assurance that patents will issue from the patent applications or, if issued, that such patents will be of commercial benefit to us, afford us adequate protection from competing products, or not be challenged or declared invalid.

Our competition includes fully integrated biopharmaceutical and pharmaceutical companies that have significant advantages over us.

The markets for therapeutic stem cell products, multiple sclerosis products, and rheumatoid arthritis products are highly competitive. We expect that our most significant competitors are fully integrated pharmaceutical companies and more established biotechnology companies. These companies are developing stem cell-based products and they have significantly greater capital resources and expertise in research and development, manufacturing, testing, obtaining regulatory approvals, and marketing than we currently do. Many of these potential competitors are further along in the process of product development and also operate large, company-funded research and development programs. As a result, our competitors may develop more competitive or affordable products, or achieve earlier patent protection or product commercialization than we are able to achieve. Competitive products may render any products or product candidates that we develop obsolete.

If we fail to meet our obligations under our license agreements, we may lose our rights to key technologies on which our business depends.

Our business depends on three licenses from third parties. Additionally, any business relating to a T cell vaccine for rheumatoid arthritis depends upon a license from the Shanghai Institute for Biological Science. These third party license agreements impose obligations on us, such as payment obligations and obligations to diligently pursue development of commercial products under the licensed patents. If a licensor believes that we have failed to meet our obligations under a license agreement, the licensor could seek to limit or terminate our license rights, which could lead to costly and time-consuming litigation and, potentially, a loss of the licensed rights. During the period of any such litigation, our ability to carry out the development and commercialization of potential products could be significantly and negatively affected. If our license rights were restricted or ultimately lost, our ability to continue our business based on the affected technology platform could be severely adversely affected.

Restrictive and extensive government regulation could slow or hinder our production of a cellular product.

The research and development of stem cell therapies is subject to and restricted by extensive regulation by governmental authorities in the United States and other countries. The process of obtaining U.S. Food and Drug Administration, or FDA, and other necessary regulatory approvals is lengthy, expensive and uncertain. We may fail to obtain the necessary approvals to continue our research and development, which would hinder our ability to manufacture or market any future product.

To be successful, our product candidates must be accepted by the health care community, which can be very slow to adopt or unreceptive to new technologies and products.

Our product candidates, if approved for marketing, may not achieve market acceptance since hospitals, physicians, patients or the medical community in general may decide to not accept and utilize these products. The product candidates that we are attempting to develop represent substantial departures from established treatment methods and will compete with a number of more conventional drugs and therapies manufactured and marketed by major pharmaceutical companies. The degree of market acceptance of any of our developed products will depend on a number of factors, including:

- our establishment and demonstration to the medical community of the clinical efficacy and safety of our product candidates;
- our ability to create products that are superior to alternatives currently on the market;
- our ability to establish in the medical community the potential advantage of our treatments over alternative treatment methods; and
- reimbursement policies of government and third-party payers.

If the health care community does not accept our products for any of the foregoing reasons, or for any other reason, our business would be materially harmed.

Risks Related to Our Common Stock

There is currently a limited market for our common stock, and any trading market that exists in our common stock may be highly illiquid and may not reflect the underlying value of the Company's net assets or business prospects.

Although our common stock is currently traded on the OTC Bulletin Board, there is currently a limited market for our common stock and there can be no assurance that an improved market will ever develop. Investors are cautioned not to rely on the possibility that an active trading market may develop.

As our share price is volatile, we may be or become the target of securities litigation, which is costly and time-consuming to defend.

In the past, following periods of market volatility in the price of a company's securities or the reporting of unfavorable news, security holders have often instituted class action litigation. If the market value of our common stock experiences adverse fluctuations and we become involved in this type of litigation, regardless of the outcome, we could incur substantial legal costs and our management's attention could be diverted from the operation of our business, causing our business to suffer.

Our "blank check" preferred stock could be issued to prevent a business combination not desired by management or our current majority shareholders.

Our articles of incorporation authorize the issuance of "blank check" preferred stock with such designations, rights and preferences as may be determined by our board of directors without shareholder approval. Our preferred stock could be utilized as a method of discouraging, delaying, or preventing a change in our control and as a method of preventing shareholders from receiving a premium for their shares in connection with a change of control.

Future sales of our common stock in the public market could lower our stock price.

We may sell additional shares of common stock in subsequent public or private offerings. We may also issue additional shares of common stock to finance future acquisitions. We cannot predict the size of future issuances of our common stock or the effect, if any, that future issuances and sales of shares of our common stock will have on the market price of our common stock. Sales of substantial amounts of our common stock (including shares issued in connection with an acquisition), or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock.

We presently do not intend to pay cash dividends on our common stock.

We currently anticipate that no cash dividends will be paid on the common stock in the foreseeable future. While our dividend policy will be based on the operating results and capital needs of the business, it is anticipated that all earnings, if any, will be retained to finance the future expansion of the our business. Therefore, prospective investors who anticipate the need for immediate income by way of cash dividends from their investment should not purchase the shares offered in this offering.

Employees

As of December 31, 2005, we had 18 full time employees. We believe that our relations with our employees are good. None of our employees is represented by a union or covered by a collective bargaining agreement.

ITEM 2. DESCRIPTION OF PROPERTY

Our 10,200 sq. ft. facility is located on 3 acres at 2635 N Crescent Ridge Drive in The Woodlands, TX. This location provides space for pipeline development through research and development; a specialized Flow Cytometry and Microscopy lab; support of clinical trials with GMP manufacturing Suites; Quality Systems management with Quality Control Laboratory, Regulatory Affairs, Quality Assurance; as well as administrative support space. There is 2,500 sq. ft. of space still available for future build-out. The facility including the property is leased for a term of ten years with two options for an additional five years each at the then prevailing market rate.

The recently completed 800 sq. ft. GMP (good manufacturing practice) manufacturing area has capacity to manufacture cellular therapy material for Phase I, II, and III clinical trials and renders services under the FDA (Food and Drug Administration) guidelines for GMP thus assuring the quality of the materials and components produced within the facility. The Class 10,000 (ISO Class 7) space is currently configured with a three phase changing area, common corridor for shared large equipment and centralized supply storage, and three tissue culture suites. Each culture suite contains biological safety cabinets which provide Class 100 (ISO Class 2) for direct manipulation of clinical material. The design allows for easy adaptation to a wide variety of manufacturing processes. Room pressurizations and flows of personnel, equipment and material provide PharmaFrontiers with an integrated GMP-compliant operation. The Quality Control lab and the Quality Assurance provide support the GMP manufacturing process.

ITEM 3. LEGAL PROCEEDINGS

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

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

(a) Special Meeting of Shareholders.

On November 11, 2005, the Company held a special meeting for shareholders of record at the close of business on October 5, 2005.

(b) Proposal Voted Upon and Shareholder Vote.

The shareholders voted to approve an amendment to the Company's Articles of Incorporation to increase the aggregate number of shares of common stock authorized for issuance from 50 million shares to 100 million shares. A total of 18,399,013 shares were voted representing approximately 91% of the outstanding shares, of which 12,187,777 shares voted for the amendment, 6,184,431 shares voted against the amendment, and 26,805 shares abstained.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDERS MATTERS

Shares of our common stock are traded on the National Association of Securities Dealers Inc. Over the Counter Bulletin Board under the symbol "PFTR.OB". Our common stock trades on a limited, sporadic and volatile basis.

The following table sets forth, for the periods indicated, the range of high and low bid information for our common stock. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

	Price Ranges	
	High	Low
Fiscal Year Ended December 31, 2004		
First Quarter	0.03	0.01
Second Quarter	14.25	0.01
Third Quarter	8.15	6.50
Fourth Quarter	9.50	5.90
Fiscal Year Ended December 31, 2005		
First Quarter	8.70	4.50
Second Quarter	5.50	2.46
Third Quarter	1.41	1.25
Fourth Quarter	0.63	0.59

No cash dividends have been declared on the Company common stock since the Company's inception and it is not anticipated that dividends will be declared on our common stock in the foreseeable future.

As of December 31, 2005, there were approximately 566 holders of record of our Common Stock.

Trades of our common stock may be subject to SEC Rule 15c-9, which imposes certain requirements on broker/dealers who sell securities subject to the rule to persons other than established customers and accredited investors. For transactions covered by the rule, brokers/dealers must make a special suitability determination for purchasers of the securities and receive the purchaser's written agreement to the transaction prior to sale. The SEC also has rules that regulate broker/dealer practices in connection with transactions in "penny stocks." Penny stocks generally are equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the Nasdaq system, provided that current price and volume information with respect to transactions in that security is provided by the exchange or system). The penny stock rules require a broker/ dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document prepared by the SEC that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker/dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker/dealer and its salesperson in the transaction, and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker/dealer and salesperson compensation information, must be given to the customer orally or in writing prior to effecting the transaction and must be given to the customer in writing before or with the customer's confirmation. These disclosure requirements have the effect of reducing the level of trading activity in the secondary market for our common stock. As a result of these rules, investors may find it difficult to sell their shares.

Recent Sales of Unregistered Securities

Set forth below is certain information concerning issuances of securities during the fourth quarter of 2005 by the Company that were not registered under the Securities Act.

In October 2005, 10,000 shares of common stock valued at their fair value of \$59,400 were issued to a consultant for his services.

In October 2005, options to purchase 147,500 shares of Common Stock were issued to four independent directors at an exercise price of \$1.15 per share. One third of the options vested immediately, one third of the options vest on the first anniversary date, and the remaining one third vests on the second anniversary date.

In October 2005, options to purchase 27,500 shares of Common Stock were issued to four independent directors at an exercise price of \$1.15 per share. The options vest on the first anniversary date.

In December 2005, options to purchase 376,000 shares of Common Stock were issued to fifteen Opexa employees at an exercise price of \$0.70 per share. One fourth of the options vest on the first anniversary date, one fourth of the options vests on the second anniversary date, one fourth of the options vests on the third anniversary date, and the remaining one fourth vests on the fourth anniversary date.

The above transactions were completed pursuant to Section 4(2) of the Securities Act and did not involve any public offering and were sold to a limited group of persons. Each recipient either received adequate information about the Company or had access, through employment or other relationships, to such information, and the Company determined that each recipient had such knowledge and experience in financial and business matters that they were able to evaluate the merits and risks of an investment in the Company.

Except as otherwise noted, all sales of the Company's securities were made by officers of the Company who received no commission or other remuneration for the solicitation of any person in connection with the respective sales of securities described above. The recipients of securities represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the share certificates and other instruments issued in such transactions.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion of our financial condition and results of operations should be read in conjunction with the accompanying financial statements and the related footnotes thereto.

Organizational History

PharmaFrontiers was incorporated in Texas in 1986 and originally engaged in businesses other than the biopharmaceutical business. These other business operations were terminated in February 2002. In May 2004, we entered the biopharmaceutical business by acquiring an entity that held rights to treatments using adult pluripotent stem cells derived from adult human peripheral blood, and in connection therewith we changed our name to our current corporate name. From an accounting standpoint, the subsidiary is deemed the acquirer in a reverse merger whereby the parent is deemed the survivor of the reorganization/reverse merger. As such, our financial statements are those of the subsidiary. In November 2004, we acquired Opexa which holds rights to technology to diagnose and treat multiple sclerosis through modified autoreactive T cells.

Critical Accounting Policies

General

The Consolidated Financial Statements and Notes to Consolidated Financial Statements contain information that is pertinent to this management's discussion and analysis. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of any contingent assets and liabilities. Management believes these accounting policies involve judgment due to the sensitivity of the methods, assumptions and estimates necessary in determining the related asset and liability amounts. Management believes it has exercised proper judgment in determining these estimates based on the facts and circumstances available to it at the time the estimates were made. The significant accounting policies are described in the Company's financial statements.

Principles of consolidation

The accompanying consolidated financial statements of the Company include the accounts of its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Long-lived assets

Long-lived assets (i.e., intangible assets) are reviewed for impairment whenever events or changes in circumstances indicate that the net book value of the asset may not be recoverable. An impairment loss is recognized if the sum of the expected future cash flows (undiscounted and before interest) from the use of the asset is less than the net book value of the asset. Generally, the amount of the impairment loss is measured as the difference between the net book value of the asset and the estimated fair value of the related asset. Management does not believe any assets have been impaired at December 31, 2005.

Revenue

We did not receive any revenue in 2005 and do not expect any revenue in 2006.

Intellectual Property

As of December 31, 2005, we had \$28,019,332 of intellectual property, \$23,991,128 of which resulted from the acquisition of Opexa and \$4,028,204 which pertained to the consideration paid to date to the University of Chicago for the worldwide license to technology developed at Argonne National Laboratory. Of the \$23,991,128 of acquired intangible assets, the full amount is assigned to an inseparable group of patents and licenses that cannot function independently by themselves. The weighted average useful life of the intangible group as of December 31, 2005 is approximately 16.5 years. The weighted average useful life of the University of Chicago license is 18 years. Accumulated amortization for the Intellectual Property as of December 31, 2005 is \$1,888,891. In April 2005 the Company obtained a fairness opinion from an independent investment banking firm with respect to the Opexa acquisition and there was no impairment at that time. In accordance with FAS 142, the Board authorized an update to this impairment analysis as of December 31, 2005 and it was determined that no impairment existed.

Results of Operations and Financial Condition

Net Sales.

We recorded no sales for the twelve months ended December 31, 2005 and 2004.

General and Administrative Expenses

Our general and administrative expenses during the twelve months ended December 31, 2005, was \$ 550,178 as compared to \$572,534 for the twelve months ended December 31, 2004. General and administrative expenses consist primarily of salaries and benefits, office expense, professional services fees, and other corporate overhead costs. We anticipate increases in general and administrative expenses as we continue to develop and prepare for commercialization of our technology

Research and Development Expense

Research and development expense was \$9,892,253 for the twelve months ended December 31, 2005, as compared to \$2,465,634 the twelve months ended December 31, 2004. The increase in expenses was primarily due the acquisition of Opexa and the assumption of its operations and research and development programs as well as our Phase I/II clinical trials for Tovaxin, stem cell development and pre-clinical costs, the hiring of personnel and other expenses associated with the increase in research and development efforts. We have made and expect to continue to make substantial investments in research and development in order to develop and market our technology. Research and development costs consist primarily of general and administrative and operating expenses related to research and development activities. We expense research and development costs as incurred. Property, plant and equipment for research and development that has an alternative future use is capitalized and the related depreciation is expensed as research and development costs. We expect our research and development expense to increase as we continue to invest in the development of our technology.

Interest Expense

Interest expense was \$7,323,851 for the twelve months ended December 31, 2005 compared to \$868,926 for the twelve months ended December 31, 2004. The increase is primarily related to the amortization of the remaining discount under the beneficial conversion feature of the 15% exchangeable convertible promissory notes (the "Notes"), the accrued interest on the Notes that was converted into shares of Common Stock.

Net loss

We had net loss for the year ended December 31, 2005, of \$19,414,197 or (\$1.24) per share (basic and diluted), compared with a net loss of \$4,620,664 or (\$.73) per share (basic and diluted), for the twelve months ended December 31, 2004. The primary reason for the increase in net loss is due primarily to the amortization of the remaining discount under the beneficial conversion feature of the Notes and the accrued interest on the Notes that was converted into shares of common stock, along with start-up of operations which included the hiring of new personnel including employees and directors and scientific advisory board members. These individuals have agreements with us that provide for salary payments. The increase in net loss is also attributable to the acquisition of Opexa Pharmaceuticals and the assumption of its operations and research and development programs. Also included are professional fees incurred from legal, accounting, and consulting services to secure and expand our license patent claims. Anticipated future expenses include research and development, professional and consulting fees, and expenses associated with the expansion of the office and laboratory/manufacturing facilities.

Liquidity and Capital Resources

Historically, the Company has financed its operations primarily from the sale of its debt and equity securities. As of December 31, 2005, the Company had cash of approximately \$2.5 million. Our current burn rate is approximately \$400,000 per month excluding capital expenditures. Although our burn rate is expected to increase to \$800,000 per month once the Phase IIb clinical trials begin, we do not intend to start the Phase IIb until we have raised additional capital. We will need to raise additional capital to fund our working capital needs during the second quarter of 2006. We do not have any credit facilities available with financial institutions or any other third parties and as such we must rely upon best efforts third-party debt or equity funding and we can provide no assurance that we will be successful in any funding effort. The failure to raise such funds will necessitate the curtailment of operations and delay of the start of the clinical trials.

Contractual Commitments

A tabular disclosure of contractual obligations at December 31, 2005, is as follows:

	Payments due by period				
	Total	Less than 1 year	1 - 3 Years	3 - 5 Years	More than 5 Years
Operating Leases	\$ 1,361,551	\$ 59,535	\$ 248,496	\$ 284,735	\$ 768,785
Employment and consulting contracts for officers and directors	245,000	126,500	\$ 119,000	-	-
Total	\$ 1,607,051	\$ 186,035	\$ 367,496	\$ 284,735	\$ 768,785

Off-Balance Sheet Arrangements

As of December 31, 2005, the Company had no off-balance sheet arrangements.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") enacted Statement of Financial Accounting Standards 123—revised 2004 ("SFAS 123R"), *Share-Based Payments*, which replaces Statement of Financial Accounting Standards No. 123 ("SFAS 123"), *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25 ("APB 25"), *Accounting for Stock Issued to Employees*. SFAS 123R requires the measurement of all employee share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in the consolidated statements of income.

The accounting provisions of SFAS 123R will be effective for the Company for reporting periods beginning after December 15, 2005. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. See Note 1 of the Notes to Consolidated Financial Statements for the pro forma net income and net income per share amounts, for Fiscal 2003 through Fiscal 2004, as if the Company had used a fair-value-based method similar to the methods required under SFAS 123R to measure compensation expense for employee stock incentive awards. The Company is evaluating the terms and structure of its current share based payments and does not expect the adoption to have a significant, adverse impact on the consolidated statements of income and net income per share as it relates to current granted options and warrants as of the date of the adoption.

In January 2003, the FASB issued Interpretation No. 46(R) ("FIN 46"), *Consolidation of Variable Interest Entities*. FIN 46 addresses consolidation by business enterprises of variable interest entities (formerly special purpose entities). In general, a variable interest entity is a corporation, partnership, trust or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. The objective of FIN 46 is not to restrict the use of variable interest entities, but to improve financial reporting by companies involved with variable interest entities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements are effective for the first period that ends after March 15, 2004; the Company elected to adopt the requirements effective for the reporting period ending December 31, 2004. The adoption of FIN 46 had no effect on the consolidated financial statements.

ITEM 7. FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
PharmaFrontiers Corp.
(a development stage company)
The Woodlands, Texas

We have audited the accompanying consolidated balance sheet of PharmaFrontiers Corp., (“Pharma”) (a development stage company), as of December 31, 2005 and the related consolidated statements of expenses, changes in stockholders’ equity and cash flows for the two years ended December 31, 2005 and the period from January 22, 2003 (Inception) through December 31, 2005. These consolidated financial statements are the responsibility of Pharma’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 standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 Pharma as of December 31, 2005 and the consolidated results of its operations and its cash flows for the periods described in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that Pharma will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, Pharma has suffered recurring losses from operations, which raises substantial doubt about its ability to continue as a going concern. Management’s plans regarding those matters are described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

MALONE & BAILEY, PC
www.malone-bailey.com
Houston, Texas

February 7, 2006

PHARMAFRONTIERS CORP.
(a development stage company)
CONSOLIDATED BALANCE SHEET
December 31, 2005

ASSETS

Current assets

Cash	\$ 2,560,666
Prepaid expenses	182,524
Total current assets	2,743,190
Intangible assets, net of \$1,888,891 of accumulated amortization	26,130,441
Property & equipment, net of \$256,082 of accumulated depreciation	479,996
Other assets	388,210
Total assets	\$ 29,741,837

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities

Accounts payable	\$ 689,467
Accrued expenses	240,309
Note payable	1,500,000
Total current liabilities	2,429,776

Commitments and contingencies

Stockholders' equity

Convertible preferred stock, no par value, 10,000,000 shares authorized, none issued and outstanding	-
Common stock, \$.05 par value, 100,000,000 shares authorized, 20,619,545 shares issued and outstanding	1,030,977
Additional paid in capital	50,441,948
	)
Deficit accumulated during the development stage	(24,160,864
Total stockholders' equity	27,312,061
Total liabilities and stockholders' equity	\$ 29,741,837

See accompanying summary of accounting policies
and notes to consolidated financial statements

PHARMAFRONTIERS CORP.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF EXPENSES
Years ended December 31, 2005 and 2004 and the
Period from January 22, 2003 (Inception) to December 31, 2005

	2005	2004	Inception through 2005
General and administrative	\$ 550,178	\$ 572,534	\$ 1,203,513
Depreciation and amortization	1,735,209	264,819	2,000,028
Research and development	9,892,253	2,465,634	12,357,887
Loss on disposal of assets	22,810	457,122	479,932
Operating loss	(12,200,450)	(3,760,109)	(16,041,360)
Interest income	81,930	5,992	87,922
Other income	28,174	2,379	30,553
Interest expense	(7,323,851)	(868,926)	(8,237,979)
NET LOSS	<u>\$ (19,414,197)</u>	<u>\$ (4,620,664)</u>	<u>\$ (24,160,864)</u>
Basic and diluted loss per share	\$ (1.24)	\$ (0.73)	N/A
Weighted average shares outstanding	15,648,365	6,309,145	N/A

See accompanying summary of accounting policies
and notes to consolidated financial statements

PHARMAFRONTIERS CORP.
(A Development Stage Company)
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
January 22, 2003 (Inception) through December 31, 2005

	Common Stock		Additional	Accumulated	
	Shares	Par	Paid in Capital	Deficit	Total
Shares issued for cash	5,250,000	\$ 262,500	\$ (261,500)	\$ --	\$ 1,000
Shares repurchased and cancelled	(1,706,250)	(85,313)	84,988	--	(325)
Discount relating to:					
- beneficial conversion feature	--	--	28,180	--	28,180
- warrants attached to debt	--	--	28,180	--	28,180
Net loss	--	--	--	(126,003)	(126,003)
Balances at December 31, 2003	3,543,750	177,187	(120,152)	(126,003)	(68,968)
Shares issued for:					
- cash	22,500	1,125	7,875	--	9,000
- services	2,065,000	103,250	745,750	--	849,000
- license	242,688	12,135	414,940	--	427,075
- reverse merger with Sportan	997,399	49,870	(197,603)	--	(147,733)
- acquisition of Opexa	2,500,000	125,000	23,625,000	--	23,750,000
- additional shares attached to convertible debt	161,000	8,050	280,316	--	288,366
- conversion of convertible notes	607,501	30,375	217,995	--	248,370
Shares cancelled	(80,000)	(4,000)	4,000	--	--
Discount relating to:		--			
- beneficial conversion feature	--	--	855,849	--	855,849
- warrants attached to debt	--	--	1,848,502	--	1,848,502
Option Expense	--	--	123,333	--	123,333
Net loss	--	--	--	(4,620,664)	(4,620,664)
Balances at December 31, 2004	10,059,838	502,992	27,805,805	(4,746,667)	23,562,130
Shares issued for:					
- cash	3,894,509	194,725	5,647,044	--	5,841,769
- convertible debt	6,110,263	305,513	7,343,933	--	7,649,446
- debt	23,000	1,150	159,850	--	161,000
- license	291,935	14,597	1,853,787	--	1,868,384
- services	240,000	12,000	1,000,400	--	1,012,400
Offering costs relating to					
- equity financing	--	--	(495,552)	--	(495,552)
Discount relating to:					
- beneficial conversion feature	--	--	831,944	--	831,944
- warrants attached to debt	--	--	1,433,108	--	1,433,108
Option expense	--	--	2,487,741	--	2,487,741
Warrant expense	--	--	2,373,888	--	2,373,888
Net loss	--	--	--	(19,414,197)	(19,414,197)
Balances at December 31, 2005	20,619,545	\$ 1,030,977	\$ 50,441,948	\$ (24,160,864)	\$ 27,312,061

See accompanying summary of accounting policies
and notes to consolidated financial statements

PHARMAFRONTIERS CORP.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
Year ended December 31, 2005 and the Period from January 22, 2003
(Inception) through December 31, 2004 and 2005

	2005	2004	Inception through 2005
Cash flows from operating activities			
Net loss	\$ (19,414,197)	\$ (4,620,664)	\$ (24,160,864)
Adjustments to reconcile net loss to net cash used in operating activities			
Stock issued for services	1,012,400	849,000	1,861,400
Additional stock issued under debt conversion	109,070	-	109,070
Amortization of discount on notes payable due to warrants and beneficial conversion feature	5,516,638	753,812	6,313,205
Amortization of intangible assets	1,637,129	251,761	1,888,890
Depreciation	98,080	13,058	111,138
Debt financing costs	365,910	-	365,910
Option and warrant expense	4,861,629	123,333	4,984,962
Loss on disposition of fixed assets	22,810	457,122	479,932
Changes in:			
Accounts payable	26,360	58,670	85,167
Prepaid expenses	(88,185)	(38,950)	(127,135)
Accrued expenses	23,655	23,822	54,981
Other assets	(388,210)	-	(388,210)
Net cash used in operating activities	(6,216,911)	(2,129,036)	(8,421,554)
Cash flows from investing activities			
Purchase of licenses	-	(232,742)	(232,742)
Purchase of property & equipment	(258,903)	(173,004)	(431,907)
Net cash used in investing activities	(258,903)	(405,746)	(664,649)
Cash flows from financing activities			
Common stock sold for cash, net of offering costs	5,346,217	9,000	5,356,217
Common stock repurchased and canceled	-	-	(325)
Proceeds from debt	2,896,885	3,382,706	6,354,591
Repayments on notes payable	(58,614)	(5,000)	(63,614)
Net cash provided by financing activities	8,184,488	3,386,706	11,646,869
Net change in cash	1,708,674	851,924	2,560,666
Cash at beginning of year	851,992	68	--
Cash at end of year	\$ 2,560,666	\$ 851,992	\$ 2,560,666

See accompanying summary of accounting policies
and notes to consolidated financial statements

PHARMAFRONTIERS CORP.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Year ended December 31, 2004 and the Period from January 22, 2003
(Inception) through December 31, 2003 and 2004

	2005	2004	Inception through 2005
NON-CASH TRANSACTIONS			
Issuance of common stock for purchase of O pexa	\$ -	\$ 23,750,000	\$ 23,750,000
Issuance of common stock to Sportan shareholders	-	147,733	147,733
Issuance of common stock for University of Chicago license	1,868,384	427,075	2,295,459
Issuance of common stock for accrued interest	525,513	-	525,513
Conversion of notes payable to common stock	6,159,610	248,370	6,407,980
Conversion of accrued liabilities to common stock	17,176	-	17,176
Conversion of accounts payable to note payable	-	93,364	93,364
Discount on convertible notes relating to:			
- warrants	1,433,108	1,848,502	3,309,790
- beneficial conversion feature	831,944	855,849	1,715,973
- stock attached to notes	999,074	288,366	1,287,440

See accompanying summary of accounting policies
and notes to consolidated financial statements

PHARMAFRONTIERS CORP.
(a development stage company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF ACCOUNTING POLICIES

PharmaFrontiers Corp. ("Pharma") was incorporated in Texas on January 22, 2003 as a bio-pharmaceutical company engaged in developing autologous personalized cell therapies. During the development stage, Pharma acquired the worldwide license to technology developed at Argonne National Laboratory, a U.S. Department of Energy Laboratory Operated by the University of Chicago ("Argonne"). This is an exclusive license to a stem cell technology in which adult pluripotent stem cells are derived from monocytes obtained from the patient's own blood (the "License"). A patent application was filed in November 2003, with the United States Patent and Trade Office regarding the technology involved in the License.

On October 7, 2004 Pharma entered into an agreement to acquire all of the outstanding stock of Opexa Pharmaceuticals, Inc. ("Opexa"). The agreement closed on November 5, 2004. A total of 2,500,000 shares of Pharma's common stock were exchanged for all of the outstanding stock of Opexa. 2,250,000 shares was issued to Opexa shareholders in December 2004 and the balance of 250,000 shares, that had been held in escrow for the prerequisite one year period, was issued in November 2005. The acquisition was accounted for under the purchase method, where all of Opexa's assets are restated to their fair market value on the acquisition date, which approximated book value. The 2,500,000 shares of Pharma were valued at \$23,750,000 or \$9.50 per share, which represents their current value at the time. See Note 12 for details.

Opexa holds rights to technology to diagnose and treat multiple sclerosis through modified autoreactive T cells and is currently in FDA Phase I/II human dose ranging clinical trials to evaluate its safety and effectiveness in treating multiple sclerosis.

Basis of presentation. The consolidated financial statements include the accounts of Pharma and its wholly-owned subsidiary, Opexa. Significant inter-company accounts and transactions have been eliminated.

Reclassifications. Certain amounts in the 2004 consolidated financial statements have been reclassified to conform to the 2005 consolidated financial statement presentation.

Use of Estimates in Financial Statement Preparation. The preparation of consolidated 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, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents. For purposes of the statements of cash flows, cash equivalents include all highly liquid investments with original maturities of three months or less.

Long-lived Assets. Property and equipment are stated on the basis of historical cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Major renewals and improvements are capitalized, while minor replacements, maintenance and repairs are charged to current operations.

Impairment losses are recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

Income Taxes. Income tax expense is based on reported earnings before income taxes. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for consolidated financial reporting purposes and such amounts recognized for tax purposes, and are measured by applying enacted tax rates in effect in years in which the differences are expected to reverse.

Stock-Based Compensation. Pharma accounts for stock-based compensation under the intrinsic value method. Under this method, Pharma recognizes no compensation expense for stock options granted when the number of underlying shares is known and exercise price of the option is greater than or equal to the fair market value of the stock on the date of grant. The following table illustrates the effect on net loss and net loss per share if Pharma had applied the fair value provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

	2005	2004	Inception through 2005
Net loss as reported	\$ (19,414,197)	\$ (4,620,664)	\$ (24,160,864)
Add: stock based compensation determined Under intrinsic value based method	2,487,741	123,333	2,611,074
Less: stock based compensation determined under fair value based method	(4,264,013)	(153,364)	(4,417,377)
Pro forma net loss	\$ (21,190,469)	\$ (4,650,695)	\$ (25,967,167)
Basic and diluted			
Net loss per common share:			
As reported	\$ (1.24)	\$ (.73)	N/A
Pro forma	\$ (1.35)	\$ (.74)	N/A

The weighted average fair value of the stock options granted during 2004 was \$3.09. Variables used in the Black-Scholes option-pricing model include (1) 2% risk-free interest rate, (2) expected option life is the actual remaining life of the options as of each year end, (3) expected volatility is from 0.1% to 796.30% and (4) zero expected dividends.

The weighted average fair value of the stock options granted during 2005 was \$2.49. Variables used in the Black-Scholes option-pricing model include (1) 2% risk-free interest rate, (2) expected option life is the actual remaining life of the options as of each year end, (3) expected volatility is 175.40% and (4) zero expected dividends.

The basic net loss per common share is computed by dividing the net loss by the weighted average number of common shares outstanding. Diluted net loss per common share is computed by dividing the net income adjusted on an "as if converted" basis, by the weighted average number of common shares outstanding plus potential dilutive securities. Basic and diluted loss per share is the same due to potential dilutive securities had an anti-dilutive effect and were not included in the calculation of diluted net income per common share.

Research and development. Research and development expenses include salaries, related employee expenses, consulting fees, facility costs, and laboratory costs. All costs for research and development activities are expensed as incurred. Pharma expenses the costs of licenses of patents and the prosecution of patents until the issuance of such patents and the commercialization of related products is reasonably assured.

Recently Issued Accounting Pronouncements. In December 2004, the FASB issued SFAS No.123R, "Accounting for Stock-Based Compensation." SFAS No.123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No.123R requires that the fair value of such equity instruments be recognized as expense in the historical financial statements as services are performed. Prior to SFAS No.123R, only certain pro forma disclosures of fair value were required. SFAS No.123R shall be effective for small business issuers as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. While Pharma has issued options to employees recently, the adoption of this new accounting pronouncement is not expected to have a material impact on the consolidated financial statements of Pharma during the calendar year 2006.

Pharma does not expect the adoption of any other recently issued accounting pronouncements to have a significant impact on their consolidated financial position, results of operations or cash flow.

NOTE 2 - GOING CONCERN

As shown in the accompanying consolidated financial statements, Pharma incurred recurring net losses of \$19,414,197 and \$4,620,664 in 2005 and 2004 , respectively, and has an accumulated deficit of \$24,160,864 as of December 31, 2005. These conditions raise substantial doubt as to Pharma's ability to continue as a going concern. Management is trying to raise additional capital through sales of convertible debt and equity. The consolidated financial statements do not include any adjustments that might be necessary if Pharma is unable to continue as a going concern.

NOTE 3 - LICENSE AGREEMENT

In February 2004, Pharma entered into an agreement with the University of Chicago ("University") for the worldwide license to technology developed at Argonne National Laboratory, a U.S. Department of Energy Laboratory Operated by the University. In consideration for the license, Pharma paid the University \$57,742 and agreed to issue 375,375 shares of its common stock. 187,688 shares valued at \$75,075 were issued on February 20, 2004. In December 2004, the License Agreement was amended granting Pharma an exclusive, non-transferable worldwide license to the University's stem cell technology. In consideration for the amendment, Pharma paid the University an additional \$175,000, issued the University 55,000 shares of common stock valued at \$352,000, bringing the total ownership of Pharma by the University to 242,688 shares, agreed to pay the University \$1,500,000 on the earlier of October 30, 2005 or upon the closing of a Pharma financing where proceeds are greater than \$10 million and agreed to issue the University shares of Pharma common stock, including the shares already issued, equal to 2.6% of the total outstanding number of shares after conversion of the 15% exchangeable convertible subordinated promissory notes upon the later of the First financing or November 30, 2005 and after issuance of any and all equity in the form of stock at the close of the first Financing.

In June 2005, 274,836 shares of common stock were issued to the University of Chicago per the terms of a license agreement. These shares were recorded at \$867,064.

In August 2005, 17,099 shares of common stock were issued to the University of Chicago per the terms of a license agreement. These shares were recorded at \$109,434.

By amendment dated October 31, 2005 Pharma and the University agreed to extend the date upon which the \$1,500,000 to April 30, 2006.

In June of 2004, Pharma paid \$50,000 to The University of Texas MD Anderson Cancer Center for an option to negotiate a licensing agreement for the use of peripheral blood stem cells for cardiac regeneration. This option to negotiate the licensing agreement expired on September 21, 2004 and the non-refundable fee of \$50,000 was written off during 2004.

NOTE 4 - INTANGIBLE ASSETS

Intangible assets consisted of the following at December 31, 2005:

Description	Life	Amount
University of Chicago license (see Note 3)	19 years	\$ 4,028,204
Opexa intangible group (see Note 12)	16 years	23,991,128
Subtotal		28,019,332
Less: accumulated amortization		(1,888,891)
Intangible assets, net		\$ 26,130,441

Amortization expense totaled \$1,637,129 and \$251,761 in fiscal 2005 and 2004, respectively.

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31, 2005:

Description	Life	Amount
Computer equipment	3 years	\$ 77,730
Office furniture and equipment	3-5 years	145,921
Laboratory equipment	5-10 years	512,427
Subtotal		736,078
Less: accumulated depreciation		(256,082)
Property and equipment, net		\$ 479,996

Depreciation expense totaled \$98,080 and \$13,058 in fiscal 2005 and 2004, respectively.

NOTE 6 - INCOME TAXES

Pharma uses the liability method, where deferred tax assets and liabilities are determined based on the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial and income tax reporting purposes. During fiscal 2005 and 2004, Pharma incurred net losses and, therefore, has no tax liability. The net deferred tax asset generated by the loss carry-forward has been fully reserved. The cumulative net operating loss carry-forward is approximately \$12,000,000 at December 31, 2005, and will expire in the years 2024 through 2025.

At December 31, 2005, deferred tax assets consisted of the following:

Deferred tax assets	
Net operating losses	\$ 4,080,000
Less: valuation allowance	(4,080,000)
Net deferred tax assets	<u>\$ -</u>

NOTE 7 - THIRD PARTY CONVERTIBLE NOTES

Between September 2004 and February 2005, Pharma issued convertible notes to investors totaling \$6,124,859. In March 2005, 451,688 shares of common stock with a relative fair value of \$999,074 were issued to note holders as their additional shares for their subscription investment in Pharma. In June 2005 a total of \$6,650,372 comprised of the principal of the notes of \$6,124,859 and accumulated interest of \$525,513, which accrued at a rate of 15% per annum, was exchanged for 4,433,598 units at \$1.50 per share. Each unit is comprised of one share of common stock and three separate types of warrants to purchase a total of 2.75 shares of common stock as stated below. In addition, 1,224,977 shares of Common Stock were issued in consideration for the surrender of the rights to the Bridge Warrants held by the note holders. All of the Bridge Notes and Bridge Warrants were exchanged so that none are now outstanding.

- Warrants: In connection with the bridge note exchange and private placement offerings in June and July three separate types of warrants to purchase a total of 2.75 shares of common stock were issued as follows: (i) a Series A Warrant which expired on February 17, 2006; (ii) a Series B Warrant for one-half of a share with an exercise price of \$2.90 which expires on October 17, 2006; (iii) and a Series C Warrant for one share with an exercise price of \$4.00 that expires on May 25, 2010.
- Pharma analyzed the convertible notes and the warrants for derivative accounting consideration under SFAS 133 and EITF 00-19. Pharma determined the embedded conversion option in the convertible notes and the warrants met the criteria for classification in stockholders equity under SFAS 133 and EITF 00-19. Therefore, derivative accounting was not applicable for these convertible notes payable or their associated warrants.

NOTE 8 - NOTE PAYABLE

Note payable consists of the following:

Note payable to the University of Chicago; no interest; due earlier of Pharma raising \$10,000,000 in an Equity Financing or April 30, 2006; secured by license (See Note 3 for details)	
	\$1,500,000

NOTE 9 - COMMITMENTS AND CONTINGENCIES

After purchasing Opexa, Pharma assumed an eighteen-month operating lease from Opexa for a research facility. The lease commenced in June 2003 and was due to expire in November 2004. Pharma extended the lease initially until March 31, 2005 and extended it again until September 30, 2005. Pharma terminated the lease on October 7, 2005 and entered into a ten-year lease with a new landlord which commenced on October 1, 2005.

Future minimum lease payments under the non-cancellable operating lease are \$72,474 for 2006, \$117,774 for 2007, \$137,196 for 2008, \$139,782 for 2009, \$147,540 for 2010 and \$731,883 for thereafter

Rent expense for 2005 was \$178,963 and \$389,300 for 2004.

NOTE 10 - EQUITY

During 2003, Pharma sold 5,250,000 shares of common stock for \$1,000.

In April 2003, 1,706,250 shares were reacquired for \$325 and canceled.

Additional contributions to capital of \$56,360 resulted from the discounted value to notes payable due to warrants and beneficial conversion features attached to convertible notes was issued in 2003.

During 2004, 22,500 shares of common stock were sold for \$9,000.

During 2004, 2,065,000 shares of common stock valued at their then fair value of \$849,000 were issued to Pharma's employees and consultants for their services.

In February 2004, 187,688 shares of common stock valued at their then fair value of \$75,075 were issued to the University of Chicago per the terms of a license agreement. In December 2004, 55,000 shares of common stock valued at their then fair value of \$352,000 were issued to the University of Chicago per the terms of an amended license agreement. See Note 3 for details.

In June 2004, 997,399 shares of common stock were issued for net liabilities of \$147,733 to Sportan's shareholders for the reverse merger with Sportan. See Note 14 for details.

In November 2004, 2,500,000 shares of common stock valued at their then fair value of \$23,750,000 were issued to 30 accredited investors in connection with the acquisition of Opexa, of which 2,250,000 shares were issued immediately and the balance of 250,000 shares held in escrow were issued in November 2005. See Note 12 for details.

In December 2004, 161,000 shares of common stock with a relative fair value of \$288,366 were issued to note holders as their additional shares for their subscription investment in Pharma.

During 2004, 607,501 shares of common stock were issued to note holders for the conversion of \$248,370 of principal and interest from convertible notes.

In November 2004, 80,000 shares of common stock were cancelled pursuant to the terms of an employment separation agreement.

During 2004, there were additional contributions to capital of \$2,704,351 relating to the discounted value to notes payable from warrants, beneficial conversion features attached to convertible notes.

Employee stock option expense was \$123,333 in 2004.

In June 2005, Pharma sold 3,387,217 shares of common stock with 9,314,868 warrants for \$5,080,826. The warrants have exercise prices ranging from \$2 to \$4 and expire in seven months to four years. The relative fair value of the common stock is \$886,913 and the relative fair value of the warrants is \$4,198,913. Offering costs of \$434,262 related to shares issued were charged to additional paid in capital.

In July 2005, Pharma sold 507,292 shares of common stock with 1,395,053 warrants for \$760,943. The warrants have exercise prices ranging from \$2 to \$4 and expire in seven months to four years. The relative fair value of the common stock is \$216,801 and the relative fair value of the warrants is \$544,137. Offering costs of \$61,290 related to shares issued were charged to additional paid in capital.

In March 2005, 451,688 shares of common stock with a relative fair value of \$999,074 were issued to note holders as their additional shares for their subscription investment in Pharma.

In June 2005, 5,658,575 shares of common stock were issued to note holders for the conversion of \$6,124,859 of principal and \$525,513 interest from convertible notes.

During February 2005, 23,000 shares of common stock valued at their fair value of \$161,000 were issued to note holders for the conversion of \$51,930 of principal and interest from the notes.

In June 2005, 274,836 shares of common stock were issued to the University of Chicago per the terms of a license agreement. These shares were recorded at \$1,758,950.

In August 2005, 17,099 shares of common stock were issued to the University of Chicago per the terms of a license agreement. These shares were recorded at \$109,434.

During 2005, 240,000 shares of common stock valued at their fair value of \$1,012,400 were issued to Pharma's consultants for their services.

During 2005, offering costs of \$495,552 related to the equity financing were charged to additional paid in capital.

During 2005, there were additional contributions to capital of \$2,265,052 relating to the discounted value to notes payable from warrants, beneficial conversion features attached to convertible notes.

Employee stock option expense was \$2,487,741 in 2005.

Warrant expense was \$2,373,888 in 2005.

NOTE 11 - STOCK OPTIONS AND WARRANTS

In 2004 Pharma adopted the 2004 Stock Option Plan ("the Plan"). The Plan provides for the granting of stock options to employees and consultants of Pharma.

Options granted under the Plan may be either incentive stock options or nonqualified stock options. Incentive stock options ("ISO") may be granted only to Pharma employees (including officers and directors who are also employees). Nonqualified stock options ("NSO") may be granted to Pharma employees and consultants. The Board of Directors has discretion to determine the number, term, exercise price and vesting of all grants.

During 2003, 150,000 warrants were granted to investors related to the convertible notes.

During 2004, 965,000 options were granted to employees, 200,000 warrants were granted to consultants and 1,427,993 warrants were granted to investors related to the convertible notes.

Stock Options:

In January 2005, options to purchase 192,000 shares of Common Stock were issued to several employees at an exercise price of \$3.00 per share. One third of the options vest on the first anniversary date, one third of the options vests on the second anniversary date, and the remaining one third vests on the third anniversary date. These options have an intrinsic value of \$785,800, of which \$261,933 has been expensed during 2005.

In April 2005, options to purchase 12,500 shares of Common Stock were issued to three Opexa employees at an exercise price of \$3.00 per share. One third of the options vest on the first anniversary date, one third of the options vests on the second anniversary date, and the remaining one third vests on the third anniversary date. These options have an intrinsic value of \$14,925, of which \$4,975 has been expensed during 2005.

In June 2005, options to purchase 30,000 shares of Common Stock were issued to two employees at an exercise price of \$3.00 per share, of which options vested immediately. These options have no intrinsic value due to exercise price exceeded the market price at the date of the grant.

In August 2005, options to purchase 20,000 shares of Common Stock were issued to an employee at an exercise price of \$1.14 per share. One third of the options vested immediately, one third of the options vest on the first anniversary date, and the remaining one third vests on the second anniversary date. These options have no intrinsic value due to exercise price exceeded the market price at the date of the grant.

In December 2005, options to purchase 376,000 shares of Common Stock were issued to fifteen Opexa employees at an exercise price of \$0.70 per share. One fourth of the options vest on the first anniversary date, one fourth of the options vests on the second anniversary date, one fourth of the options vests on the third anniversary date, and the remaining one fourth vests on the fourth anniversary date. These options have no intrinsic value due to exercise price equaled the market price at the date of the grant.

In 2005, 41,667 options previously granted were forfeited.

Consultant warrants:

In January 2005, warrants to purchase 25,000 shares of Common Stock were issued to a consultant at an exercise price of \$3.00 per share of which one third of the warrants vest on the first anniversary date, one third of the warrants vests on the second anniversary date, and the remaining one third of warrants vests on the third anniversary date. These warrants have a fair value of \$183,033, of which \$61,011 has been expensed during 2005.

In April 2005, warrants to purchase 100,000 shares of Common Stock were issued to a consultant at an exercise price of \$3.00 per share of which 40,000 warrants vested immediately, and the remaining 60,000 warrants vest at the rate of 2,500 warrants per month for twenty-four months. These warrants have a fair value of \$417,812, of which \$261,133 has been expensed during 2005.

In April 2005, warrants to purchase 20,000 shares of Common Stock were issued to a consultant at an exercise price of \$3.00 per share of which one third of the warrants vest on the first anniversary date, one third of the warrants vests on the second anniversary date, and the remaining one third of warrants vests on the third anniversary date. These warrants have a fair value of \$83,562, of which \$27,854 has been expensed during 2005.

In June 2005, warrants to purchase 175,000 shares of Common Stock were issued to four consultants at an exercise price of \$4.00 per share. One third of the warrants vested immediately, one third of the warrants vest on the first anniversary date, and the remaining one third of the warrants vests on the second anniversary date. These warrants have a fair value of \$467,120, of which \$84,813 has been expensed during 2005.

In July 2005, warrants to purchase 8,100 shares of Common Stock were issued to a consultant at an exercise price of \$1.50 per share, of which warrants vested immediately. These warrants have a fair value of \$21,150, of which \$21,105 has been expensed during 2005.

In July 2005, warrants to purchase 460,846 shares of Common Stock were issued to several brokerage firms as the offering costs and commissions for Pharma's financing activities at an exercise price of \$1.50 per share. These warrants have a fair value of \$2,197,162 and vest immediately.

In August 2005, warrants to purchase 200,000 shares of Common Stock were issued to a consultant at an exercise price of \$1.19 per share. The warrants vest at a future date at such time that certain pre-determined events occur. These warrants have a fair value of \$175,484.

In September 2005, warrants to purchase 15,000 shares of Common Stock were granted to a consultant at an exercise price of \$1.19 per share of which warrants vested immediately. These warrants have a fair value of \$13,161, of which \$13,161 has been expensed during 2005.

In October 2005, warrants to purchase 167,500 shares of Common Stock were issued to four independent directors at an exercise price of \$1.15 per share. One third of the warrants vested immediately, one third of the warrants vest on the first anniversary date, and the remaining one third vests on the second anniversary date. These warrants have a fair value of \$191,658, of which \$53,397 has been expensed during 2005.

In 2005, 99,134 warrants previously granted were expired.

Investor warrants:

During first quarter of 2005, 965,628 warrants were granted to investors related to the convertible notes.

In connection with the bridge note exchange and private placement offerings in June and July, 2,543,621 warrants granted in prior years and early 2005 were cancelled and three separate types of warrants to purchase a total of 2.75 shares of common stock were issued as follows: (i) 10,411,400 units of Series A Warrant for 1.25 shares with an exercise price of \$2.00 which expires on February 17, 2006; (ii) 4,163,701 units of Series B Warrant for one-half of a share with an exercise price of \$2.90 which expires on October 17, 2006; (iii) and 8,329,108 units of Series C Warrant for one share with an exercise price of \$4.00 that expires on May 25, 2010.

Summary information regarding options is as follows:

	Options	Weighted Exercise Price	Warrants	Weighted Exercise Price
Year ended December 31, 2003:				
Granted	-	\$ -	150,000	\$.10
Outstanding at December 31, 2003	-	-	150,000	.10
Year ended December 31, 2004:				
Granted	965,000	3.17	1,627,993	2.23
Outstanding at December 31, 2004	965,000	3.17	1,777,993	2.24
Year ended December 31, 2005:				
Granted	630,500	1.57	25,041,284	2.86
Forfeited and cancelled	(41,667)	4.28	(2,642,755)	2.45
Outstanding at December 31, 2005	<u>1,553,833</u>	<u>\$ 2.49</u>	<u>24,176,522</u>	<u>\$ 2.85</u>

Options and warrants outstanding and exercisable as of December 31, 2005:

Exercise Price	Remaining Life	Options Outstanding	Options Exercisable	Warrants Outstanding	Warrants Exercisable
\$ 5.00	3 - 4 years	53,333	53,333	50,000	-
4.00	4 - 5 years	-	-	8,504,108	8,362,441
3.00	4 - 5 years	219,500	63,333	145,000	75,000
3.00	3 - 4 years	885,000	395,000	50,000	16,667
2.90	0.83 years	-	-	4,164,567	4,164,567
2.00	0.13 years	-	-	10,411,400	10,411,400
1.50	4 - 5 years	-	-	468,947	8,100
1.19	4 - 5 years	-	-	215,000	-
1.15	4 - 5 years	-	-	167,500	-
1.14	4 - 5 years	20,000	6,667	-	-
0.70	9 - 10 years	376,000	-	-	-
		<u>1,553,833</u>	<u>518,333</u>	<u>24,176,522</u>	<u>23,038,175</u>

NOTE 12 - PURCHASE OF OPEXA

On October 7, 2004 Pharma entered into an agreement to acquire all of the outstanding stock of Opexa. The agreement closed on November 5, 2004. Pharma issued Opexa shareholders 2,500,000 shares of Pharma's common stock for all of the outstanding stock of Opexa. 250,000 of the 2,500,000 shares were put in escrow for a one-year period pursuant to the escrow agreement. The balance of the 250,000 shares were issued to Opexa shareholders in November 2005. The acquisition was accounted for under the purchase method, where all of Opexa's assets are restated to their fair market value on the acquisition date, which approximated book value. The 2,500,000 shares of Pharma were valued at their then fair value of \$23,750,000 or \$9.50 per share.

Pharma acquired Opexa because Opexa holds rights to technology to diagnose and treat multiple sclerosis through modified autoreactive T cells and is currently in FDA Phase I/II human dose ranging clinical trials to evaluate its safety and effectiveness in treating multiple sclerosis.

The results of operations for Opexa from November 6, 2004 through December 31, 2005 are included in the Statements of Operations and the Statements of Cash Flows.

The following table summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition:

Current assets	\$ 55,387
Property, plant and equipment, net	639,160
Intangible assets	<u>23,991,128</u>
Total assets acquired	<u>24,685,675</u>
Current liabilities	<u>935,675</u>
Total liabilities assumed	<u>935,675</u>
Net assets acquired	<u>\$ 23,750,000</u>

Of the \$23,991,128 of acquired intangible assets, the full amount is assigned to an inseparable group of patents and licenses that cannot function independently by themselves. The weighted average useful life of the intangible group as of December 31, 2005 is approximately 15 years.

NOTE 13 - STOCK PURCHASE AGREEMENT

In June 2004, Pharma was acquired by Sportan United Industries, Inc. in a transaction accounted for as a reverse acquisition. Pharma's shareholders were issued 6,386,439 Sportan shares in exchange for 100 percent of the outstanding common shares of Pharma. Immediately following this transaction, Sportan changed its name to Pharma and 7,383,838 shares were outstanding.

NOTE 14 - SUBSEQUENT EVENTS

Pharma entered into a remodeling construction contract to complete three Good Manufacturing Practice ("GMP") production suites at its new facility. The construction contract plus equipment purchased separately cost approximately \$500,000. The construction began October 1, 2005.

The construction of the GMP facilities was completed in January and certified on March 20, 2006 as an ISO 7 facility.

The Series A Warrant issued to investors in connection with the bridge note exchange and private placement offerings in June and July of 2005 expired on February 17, 2006.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 8A. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to its management, including our Chief Executive Officer/Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-14(c). In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. We maintain that the controls and procedures in place do provide reasonable assurance that all necessary disclosures are communicated as required.

At the end of the period covered by this Annual Report, we carried out an evaluation, under the supervision and with the participation of management, including the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Financial Officer concluded that our disclosure controls and procedures were not effective to ensure that all material information required to be disclosed in this Annual Report has been made known to him in a timely fashion, because of an error in internal identification and Black Scholes valuation of stock issued for services. In connection with the completion of its audit of, and the issuance of its report on, our financial statements for the year ended December 31, 2005, Malone & Bailey, PC identified this deficiency that existed in the design or operation of our internal control over financial reporting that it considers to be "material weaknesses." The Public Company Accounting Oversight Board has defined a material weakness as a "significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected."

This error in the Black Scholes adjustment to stock-based compensation was not detected until the audit process and has been appropriately recorded and disclosed in this Form 10-KSB. We are in the process of improving our internal control over financial reporting in an effort to remediate this deficiency through improved supervision and training of our accounting staff. This deficiency has been disclosed to our Board of Directors. We believe that this effort is sufficient to fully remedy this deficiency and we are continuing our efforts to improve and strengthen our control processes and procedures. Our Chief Financial Officer and directors will continue to work with our auditors and other outside advisors to ensure that our controls and procedures are adequate and effective.

ITEM 8B. OTHER INFORMATION

None

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this item with respect to the directors, executive officers and compliance with Section 16(a) of the Exchange Act is incorporated by reference from the information provided under the headings "Election of Directors," "Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance," respectively, contained in the Company's Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of the proxies for the Company's Annual Meeting of Stockholders.

ITEM 10. EXECUTIVE COMPENSATION.

The information required by this item is incorporated by reference from the information provided under the heading "Executive Compensation" of the Company's Proxy Statement.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS .**Equity Compensation Plan Information**

The following table sets forth information, as of December 31, 2005, with respect to the Company's compensation plans under which common stock is authorized for issuance. We issue options to officers, directors, employees and consultants under our stockholder approved 2004 Compensatory Stock Plan. Additionally, prior to July 2004, the Company issued warrants and options to certain officers, directors and consultants not approved by stockholders, which issuances were negotiated between the recipient and the Board of Directors on an issuance basis. We believe that the exercise price for all of the options set forth below reflects fair market value.

Plan Category	Number of Securities To be Issued Upon Exercise of Outstanding Options, Warrants and Rights (A)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (B)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A) (C)
Equity Compensation Plans Approved by Security Holders	2,376,933	\$2.46	623,067
Equity Compensation Plans Not Approved by Security Holders	200,000	\$3.00	-----
Total	2,576,933		623,067

Other information required by this item is incorporated herein by reference from the information provided under the heading "Security Ownership of Certain Beneficial Owners and Management" of the Company's Proxy Statement.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated herein by reference from the information provided in the Company's Proxy Statement.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits. The following exhibits of the Company are included herein.

<u>Exhibit No.</u>	<u>Description</u>
Exhibit 10.1	Second Amended Employment Agreement of William Rouse (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed February 4, 2005)
Exhibit 10.2	Amended Employment Agreement of Warren C. Lau (incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed February 4, 2005)
Exhibit 10.3	Termination, Settlement and Release Agreement with R. Wayne Fritzsche dated October 31, 2004(incorporated by reference to Exhibit 99.3 to the Company's Current Report on Form 8-K filed February 4, 2005)

Exhibit 10.4	Lease Termination Agreement dated January 13, 2005(incorporated by reference to Exhibit 99.4 to the Company's Current Report on Form 8-K filed February 4, 2005)
Exhibit 10.5	Resignation of Jeffrey Adduci dated February 15, 2005 (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed February 18, 2005)
Exhibit 10.6	Director's Agreement of Robert H. Gow (incorporated by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-KSB filed April 15, 2005)
Exhibit 10.7	Director's Agreement of Paul Frison (incorporated by reference to Exhibit 10.7 to the Company's Annual Report on Form 10-KSB filed April 15, 2005)
Exhibit 10.8	Director's Agreement of Tony Kamin (incorporated by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-KSB filed April 15, 2005)
Exhibit 10.9	Form of Warrant Agreement (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-KSB filed April 15, 2005)
Exhibit 10.10	Amended and Restated License Agreement with Baylor College of Medicine (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-KSB filed April 15, 2005)
Exhibit 10.11	Amended and Restated License Agreement with University of Chicago (incorporated by reference to Exhibit 10.15 to the Company's Annual Report on Form 10-KSB filed April 15, 2005)
Exhibit 10.12	License Agreement dated January 13, 2006 by the Company and Shanghai Institute for Biological Services (incorporated by reference to Exhibit 10.23 to the Company's SB-2 Post Amendment #1 filed on February 9, 2006)
Exhibit 10.13(1)	Lease Agreement dated August 19, 2005 by the Company and Dirk D. Laukien
Exhibit 31.1(1)	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2(1)	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1(1)	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2(1)	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this item is incorporated by reference from the information provided in the Company's Proxy Statement under the discussion of the Company Audit Committee and under the item regarding shareholder ratification of the Company's independent accountants.

SIGNATURES

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

PHARMAFRONTIERS CORP.

By: /s/ DAVID B. MCWILLIAMS

David B. McWilliams, President and Chief Executive Officer

Date: March 31, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature

Title

Date

/s/ DAVID B. MCWILLIAMS

David B. McWilliams

President, Chief Executive Officer
And Director

March 31, 2006

/s/ C. WILLIAM ROUSE

C. William Rouse

Chief Financial Officer and
Principal Accounting Officer

March 31, 2006

/s/BROOKS BOVEROUX

Brooks Boveroux

Chairman of the Board and Director

March 31, 2006

/s/ ANTHONY N. KAMIN

Anthony N. Kamin

Director

March 31, 2006

/s/ PAUL M. FRISON

Paul M. Frison

Director

March 31, 2006

/s/ TERRY H. WESNER

Terry H. Wesner

Director

March 31, 2006

LEASE

LEASE (this "Lease") made as of the 19th day of August, 2005 (the "Date of this Lease" or "Date of the Lease") by and between Dirk D. Laukien ("Landlord"), and PharmaFrontiers Corporation, a Texas corporation ("Tenant"). In consideration of the mutual covenants and conditions set forth below, Landlord and Tenant hereby agree as follows.

ARTICLE I
Basic Data, Definitions, Exhibits

1.1 Basic Data. Each reference in this Lease to any of the following subjects shall be construed to incorporate the data stated for that subject in this Section 1.1.

Landlord's Address:	2700 North Crescent Ridge Drive The Woodlands, Texas 77381
with a copy in like manner to:	Nixon Peabody LLP 100 Summer Street Boston, MA 02110 Attention: Kevin P. Joyce, Esquire
Tenant's Address:	2635 North Crescent Ridge Drive, The Woodlands, Texas 77381
Land:	The land located at 2635 North Crescent Ridge Drive, The Woodlands, Texas 77381, which is further described in Exhibit A attached hereto.
Building:	The building(s) presently located on the Land, as shown on Exhibit B attached hereto.
Premises:	The Land, the Building and the driveways, parking areas, loading facilities, walkways, utility lines and other improvements located on the Land.
Term Commencement Date:	October 1, 2005.
Expiration Date:	The day prior to the tenth (10 th) anniversary of the Term Commencement Date.
Term:	The period beginning on the Term Commencement Date and ending on the Expiration Date.
Option to Extend:	The Term may be extended for 2 period(s) of Five (5) years each provided that Tenant gives prior written to Landlord on or before the date that is 9 months prior to the end of the then Term.
Base Rent:	During the first Lease Year, \$59,535 per Lease Year. During the second through tenth Lease Years, the annual amount of Base Rent is set forth in Exhibit C, attached hereto. Base Rent for any extension term(s) shall be set in accordance with Section 3.1.3 below.
Permitted Uses:	[Tenant to provide, subject to Landlord review]
Commercial General Liability Insurance Limits:	\$5,000,000.00 combined single limit.

1.2 Further Definitions. In addition to terms set forth above, the following terms shall be defined as indicated.

1.2.1 Additional Parking. "Additional Parking" shall mean the approximately 20 additional parking spaces Landlord shall build on the Property no later than December 2, 2006, as more fully described in exhibit D attached hereto.

1.2.2 Additional Rent. "Additional Rent" shall mean all Real Estate Taxes, personal property taxes, insurance premiums and utility charges to be paid by Tenant pursuant to Section 3.2, all interest to be paid by Tenant on late payments of rent and late charges pursuant to Section 3.3, and all other charges to be paid by Tenant and

designated as Additional Rent by any other of the terms and conditions of this Lease.

1.2.3 Alterations and Improvements. “Alterations and Improvements” shall mean any alterations, modifications, installations, additions and improvements to the Premises but shall not include the Additional Parking.

1.2.4 Applicable Laws. “Applicable Laws” shall mean all laws, codes, statutes, ordinances, by-laws, regulations, rules, licenses, permits, variances, governmental orders, governmental approvals, title restrictions and requirements of any board of fire underwriters, insurance rating organization and other insurance requirements applicable to any given facts, things, circumstances or events.

1.2.5 Event of Default. “Event of Default” shall refer to a default by Tenant under this Lease as enumerated and described in Section 11.1, and shall have the specific meaning set forth in Section 11.1.

1.2.6 Hazardous Substances . "Hazardous Substances" shall mean any substances, materials or wastes defined or regulated as hazardous or toxic by the federal Comprehensive Environmental Response, Comprehensive and Liability Act, 42 U.S.C. §9601 et. seq., the federal Resource, Conservation and Recovery Act, 42 U.S.C. §6901 et. seq., the federal Hazardous Materials Transportation Act, 49 U.S.C. §1802 et. seq., the federal Toxic Substances Act, 15 U.S.C. §2601 et. seq., the regulations adopted and publications promulgated pursuant to said Acts, and any other Applicable Laws, and shall specifically include, without limitation, oil, petroleum products, asbestos, urea formaldehyde insulation, materials containing lead, radon, and flammable, combustible and explosive substances.

1.2.7 Indemnified Parties . "Indemnified Parties" shall have the meaning set forth in Section 7.1.

1.2.8 Late Payment/Default Interest Rate . "Late Payment/Default Interest Rate" shall mean the prime rate of interest published from time to time in the Wall Street Journal (or if such newspaper ceases publication or ceases publishing such rate, as published from time to time in a reasonably comparable publication), plus 1% per annum, but in no event more, when taken together with any other charges due from Tenant in connection therewith, than the maximum rate of interest allowed by Applicable Laws.

1.2.9 Lease Year . "Lease Year" shall mean each twelve month period during the Term commencing on the Term Commencement Date and on each anniversary of the Term Commencement Date.

1.2.10 Mortgage . "Mortgage" shall mean any mortgage, deed of trust or other similar instrument evidencing a voluntary lien or encumbrance on the Premises and all modifications, amendments, extensions, renewals, replacements, substitutes and consolidations thereto.

1.2.11 Mortgagee . "Mortgagee" shall mean the holder of any Mortgage.

1.2.12 Necessary Permits . "Necessary Permits" shall mean all licenses, permits, approvals and variances necessary under all Applicable Laws to conduct a subject activity.

1.2.13 Parties for Which Landlord Is Responsible . "Parties for Which Landlord Is Responsible" shall mean Landlord's employees, servants, agents, contractors and invitees and any other parties claiming or occupying by, through or under Landlord or for which Landlord is otherwise legally responsible.

1.2.14 Parties for Which Tenant Is Responsible . "Parties for Which Tenant Is Responsible" shall mean Tenant's employees, servants, agents, contractors, assignees, subtenants, licensees, concessionaires, invitees and any other parties claiming or occupying by, through or under Tenant or for which Tenant is otherwise legally responsible.

1.2.15 Party; Parties . "Party" shall mean either Landlord or Tenant generally. "Parties" shall mean both Landlord and Tenant together.

1.2.16 Permitted Assignments and Subleases to Tenant Affiliates or Tenant Successors. "Permitted Assignments and Subleases to Tenant Affiliates or Tenant Successors" shall have the meaning set forth in Section 6.2.

1.2.17 Permitted Hazardous Substances. "Permitted Hazardous Substances" shall mean the Hazardous Substances ordinarily necessary in the conduct of Tenant's business on the Premises pursuant to the Permitted Uses, as set forth on Exhibit E attached hereto. Tenant may bring and use Permitted Hazardous Substances on the Premises, but only subject to and in strict compliance with the requirements, restrictions and conditions set forth in Section 4.7.

1.2.18 Premises Conditions. "Premises Conditions" shall mean (a) title to the Premises, (b) the physical condition of the Premises, (c) what access, easements and utilities are available to the Premises, (d) the Applicable Laws with respect to the Premises, and whether or not the Premises comply therewith, (e) the presence or absence of any Hazardous Substances or other pollutants in, on, or about the Premises, (f) any other environmental conditions, issues or problems with respect to the Premises, (g) the suitability of the Premises for the Permitted Uses, (h) the feasibility of any subject Alterations and Improvements with respect to the Premises, (i) the likelihood of obtaining any Necessary Permits, and (j) any other relevant conditions, facts, things or circumstances with respect to the Premises.

1.2.19 Rent. "Rent" shall mean Base Rent, Additional Rent and any other sums or charges required to be paid by Tenant to Landlord under this Lease.

1.2.20 Real Estate Taxes. "Real Estate Taxes" shall mean (a) all taxes, assessments (special or otherwise), levies, fees, water and sewer rents and charges, and all other government levies and charges, general and special, ordinary and extraordinary, foreseen and unforeseen, which area, at any time prior to or during the Term hereof, imposed or levied upon or assessed against the Premises, the Base Rent, Additional Rent, any other charges payable by Tenant hereunder, this Lease or the leasehold estate created hereby, or which arise with respect to the operation, possession or use of the Premises, (b) all gross receipts and similar taxes imposed or levied upon, assessed against or measured by any Base Rent, Additional Rent or other charges payable by Tenant hereunder, (c) all sales, value added, use and similar taxes at any time levied, assessed or payable on account of the acquisition, leasing or use of the Premises, and (d) all charges for utilities furnished to the Premises which may become a lien on the Premises.

1.2.21 Real Estate Tax Fund Payments. "Real Estate Tax Fund Payments" and "Tax Fund Payments" shall mean payments which Landlord may require Tenant to make to Landlord pursuant to Section 3.2.2 in order to provide a fund adequate to pay all Real Estate Taxes with respect to the Premises when they become due and payable.

1.2.22 Tenant Affiliate. "Tenant Affiliate" shall mean any corporation, person or group of persons, partnership, trust or other entity (a) at least 51% of the outstanding stock, membership interest, partnership interest or beneficial interest of which is owned by Tenant, (b) which owns at least 51% of the outstanding stock, membership interest, partnership interest or beneficial interest of Tenant, (c) at least 51% of the outstanding stock, membership interest, partnership interest or beneficial interest of which is owned by a third corporation, corporation, partnership, trust or other entity which also owns at least 51% of the outstanding stock, membership interest, partnership interest or beneficial interest of Tenant or (d) at least 51% of the outstanding stock, membership interest, partnership interest or beneficial interest of which is owned collectively by stockholders, members, partners or beneficiaries who also own collectively at least 51% of the outstanding stock, membership interest, partnership interest or beneficial interest of Tenant.

1.2.23 Tenant Successor. “Tenant Successor” shall mean any corporation, person or group of persons, partnership, trust or other entity which is the successor to Tenant by merger, consolidation, non-bankruptcy reorganization or acquisition of substantially all the assets or stock of Tenant.

1.2.24 Tenant’s Broker. “Tenant’s Broker” shall mean Colliers International.

1.3 Exhibits. The Exhibits listed below in this Section 1.3 are incorporated in this Lease by reference and are to be construed as a part hereof:

EXHIBIT A	Legal Description of the Land
EXHIBIT B	Plan of Land
EXHIBIT C	Rent Schedule
EXHIBIT D	Landlord Work
EXHIBIT E	Permitted Hazardous Waste

ARTICLE II Premises and Term

2.1 Premises. Landlord hereby leases and demises the Premises to Tenant, and Tenant hereby leases the Premises from Landlord, subject to and with the benefit of the terms, covenants, conditions and provisions of this Lease.

2.2 Term. TO HAVE AND TO HOLD for the Term, beginning on the Term Commencement Date and ending on the Expiration Date. Tenant is hereby granted two options to extend the Term of this Lease for two (2) consecutive periods of five (5) years each, upon the same terms, covenants and conditions applicable during the initial term, except the Base Rent shall be adjusted as set forth in Section 3.2. Provided that an “event of default” (as defined herein) is not then continuing, Tenant shall be permitted to exercise its options to extend this Lease by giving written notice to Landlord no less than nine (9) months prior to the end of the initial term or first renewal term, as the case may be

2.3 Premises Leased “As Is”. Landlord has no knowledge of any material default or defect in the Premises Conditions and makes no representations or warranties whatsoever with respect to the Premises or any Premises Conditions. Landlord leases the Premises to Tenant “as is, where is and with all faults”. Tenant acknowledges that it has had full, adequate and complete opportunity to inspect, investigate, examine and test all Premises Conditions and that it is fully and completely satisfied therewith. Landlord shall not have any obligation whatsoever to repair or remediate any Premises Conditions, nor shall Landlord have any liability to Tenant with respect thereto except repairs required by section 4.3 hereof. Landlord further shall not be obligated to make any repairs, to construct any Alterations and Improvements or to perform any other work to prepare the Premises for Tenant’s occupancy, with the exception of the Additional Parking. Notwithstanding anything to the contrary herein contained, Landlord is responsible for and shall keep in good order and condition the roof, slab, foundations, structural elements, exterior walls, roofs and chimneys and herein warrants that all such items are in good condition fit for the purposes of this Lease.

2.4 Delivery. Landlord shall deliver the Premises to Tenant on the Term Commencement Date free and clear of all other tenants and occupants, in substantially the same condition as they are in on the Date of this Lease, except for reasonable wear and tear and any modifications made or damage caused by Tenant.

ARTICLE III
Base Rent and Additional Rent

3.1 Base Rent. Tenant covenants and agrees to pay the Base Rent to Landlord throughout the Term without offset, deduction or counterclaim, unless provided for in section 4.2.1, at Landlord's Address or at such other place or to such other person or entity as Landlord may direct by notice to Tenant from time to time, in the annual amount for each Lease Year specified below in monthly installments equal to 1/12 of such annual amount, by the tenth day of each calendar month during the Term, and for any partial month at the beginning or the end of the Term, the pro-rata portion of such monthly amount allocable thereto.

3.1.1 First Lease Year. During the first Lease Year, the Base Rent shall be \$59,535.50 per Lease Year.

3.1.2 Second Through Tenth Lease Years. During each of the second through third Lease Years, inclusive, the annual Base Rent shall be the amount set forth in the Rent Schedule set forth in Exhibit C, attached hereto.

3.1.3 Option Period Rent. During the Option Period(s), the annual Base Rent shall be "Fair Market Rental Value" ("FMRV"). FMRV shall be reasonably determined by Landlord and Tenant to be the annual rental charge as of the termination date of the Term for new leases then being negotiated or executed for comparable space in The Woodlands, Texas for terms commencing on or about the date of termination and ending as of the expiration of what would have been the Term (including Extended Terms). In determining FMRV, the following shall be taken into consideration: the size, location and condition of the applicable comparable premises, lease term, services provided by the landlord, rental concessions and other factors. Landlord and Tenant shall in good faith attempt to agree in writing on FMRV within 30 days after Landlord's receipt of Tenant's notice of extension. If Landlord and Tenant cannot so agree, FMRV shall be determined by impartial appraisers, one each to be chosen by Landlord and Tenant, and, if necessary, a third to be selected as provided below. All appraisers shall be MAI certified, familiar with commercial leasing and leases and rents in the area surrounding the Building, and shall have at least 5 years experience in making real estate appraisals. Landlord and Tenant shall notify each other of its selected appraiser within 5 days following the expiration of such 10 day period. The initial appraisers shall render their written appraisals of FMRV within 30 days after their appointment. If such appraisals are less than 5% apart, then FMRV shall be deemed to be the average of the 2 appraisals. Otherwise, the initial appraisers shall promptly select a third appraiser who shall submit its appraisal to Landlord and Tenant within 21 days after its appointment. The appraisal falling between the other two appraisals (that is, the arithmetic median of the 3 appraisals) shall be binding upon Landlord and Tenant. The cost of each of the initial appraisers shall be paid by the party selecting such appraiser and the cost of the third appraiser shall be shared equally between Landlord and Tenant.

3.2 Additional Rent . This Lease is a NET LEASE, and Landlord shall not be obligated to pay any charge or bear any expense whatsoever against or with respect to the Premises, nor shall the rent payable hereunder be subject to any offset, deduction or counterclaim whatsoever on account of any such charge or otherwise, except only as specifically provided in this Lease to the contrary. In order that the Base Rent shall be absolutely net to Landlord, Tenant covenants and agrees to pay as Additional Rent, without offset, reduction or counterclaim, except as set forth in section 4.2.1, Real Estate Taxes, insurance costs and utility charges with respect to the Premises as follows:

3.2.1 Real Estate Taxes . Tenant shall pay all Real Estate Taxes assessed, levied or imposed on or with respect to the Premises during or with respect to the Term. For each tax or assessment period, or installment period thereof, wholly included in the Term, Tenant shall pay such Real Estate Taxes directly to the authority or authorities charged with the collection thereto not less than ten days prior to the last date on which the same may be paid without interest or penalty. For any fraction of a tax or assessment period, or installment period thereof, included in the Term at the beginning or end thereof, Tenant shall pay to Landlord, within ten days after receipt of an invoice therefor, the fraction of the Real Estate Taxes so levied or assessed or becoming payable which is allocable to such included period. Tenant shall promptly after payment thereof furnish Landlord proof of payment of all items which Tenant is required to pay pursuant to this Section 3.2.1.

Tenant may, at its election, but shall not be obligated to, initiate and prosecute an action or proceeding for abatement or reduction of any Real Estate Taxes. Landlord shall reasonably cooperate with Tenant in seeking such abatement or reduction. Any abatement received shall be paid and distributed first to Landlord in the amount of the reasonable costs and expenses expended by Landlord to obtain such abatement, and the remainder to each Party in the proportion that it paid the Real Estate Taxes which were abated.

Nothing contained in this Lease shall require Tenant to pay any income franchise, corporate, estate, inheritance, succession, capital levy or transfer tax of Landlord, unless such tax is imposed, levied or assessed in substitution for any Real Estate Taxes which Tenant is otherwise required to pay pursuant to this Section 3.2.1.

3.2.2 Tax Fund Payments. If either (a) any Mortgagee shall ever require Real Estate Tax escrow payments by Landlord or (b) Landlord shall in its sole discretion at any time and from time to time elect, rather than have Tenant pay Real Estate Taxes directly to the applicable authorities, to do so itself and have Tenant make Tenant's payments for Real Estate Taxes to Landlord instead, then, upon notice from Landlord requiring the same, Tenant shall thereafter make monthly payments to Landlord equal to 1/12 of the prior fiscal year's total Real Estate Tax ("Real Estate Tax Fund Payments" or "Tax Fund Payments"). If the aggregate of such Tax Fund Payments is not adequate to pay all such Real Estate Taxes, then Tenant shall pay to Landlord the amount by which such aggregate is less than the amount of all such Real Estate Taxes, such payment to be made on or before the later of (a) ten days after receipt by Tenant of notice from Landlord of such amount, or (b) the 30th day prior to the last day on which such Real Estate Taxes may be paid without interest or penalty. If Tenant shall have made the aforesaid Tax Fund Payments, then Landlord shall pay such Real Estate Taxes to the proper authority charged with the collection thereof, up to the amount of such Tax Fund Payments, and furnish Tenant, evidence of such payment. Any balance remaining on December 31 of any given year shall be refunded to Tenant by January 10 of the following year. In the event of any default under the terms of this Lease, any part or all of said reserve fund may, at the election of Landlord, be applied to any of Tenant's obligations under this Lease. Tenant shall continue to make Tax Fund Payments to Landlord until Landlord at its election terminates the requirement for such payments. If at any time Landlord so terminates the requirement for Tax Fund Payments, then Tenant shall resume paying Real Estate Taxes directly to the applicable authorities as required by Section 3.2.1 and shall continue to do so unless and until Landlord again later directs Tenant to make Tax Fund Payments to Landlord pursuant to this Section 3.2.2.

3.2.3 Personal Property Taxes. Tenant shall pay all taxes assessed against Tenant's personal property on or about the Premises directly to the authorities charged with the collection thereof, before or on the dates due from time to time.

3.2.4 Landlord's Insurance Costs. Tenant shall be responsible for all premiums and shall be responsible for procuring and maintaining for Landlord's benefit all-risk fire and casualty insurance, liability insurance, rental value insurance or any Mortgagee may require Landlord to carry with respect to the Premises during the Term. Tenant shall pay such costs directly or, if Tenant fails to comply with the obligation hereunder, Tenant shall pay such costs directly to Landlord within 30 days after billing by Landlord from time to time. In the alternative, if either (a) any Mortgagee shall ever require insurance escrow payments by Landlord or (b) Landlord in its sole discretion at any time and from time to time shall so elect, then, upon notice from Landlord requiring the same, Tenant shall thereafter make monthly payments to Landlord in such amounts equal to 1/12 of the insurance premiums and costs due for that year ("Insurance Fund Payments") on the same terms and conditions and in accordance with the same procedures as provided in Section 3.2.2 for Real Estate Tax Fund Payments. Notwithstanding the foregoing, Landlord shall be responsible for all costs associated with the Additional Parking.

3.2.5 Tenant's Insurance Costs. Tenant shall further pay all premiums and other costs of the insurance which it is required to carry pursuant to Article VII directly to the applicable insurers before or on the dates due from time to time.

3.2.6 Utilities. Tenant shall pay directly to the proper authorities charged with the collection thereof all charges for water, sewer, gas, electricity, telephone and other utilities or services used or consumed on the Premises, whether called charge, tax, assessment, fee or otherwise, including, without limitation, water and sewer use charges and taxes, if any. Tenant shall pay such charges before or on the dates due from time to time.

3.3 Late Payment of Rent. If Tenant fails to make any payment of Rent by the date due, then Tenant shall pay Landlord interest on such payment from the date due until the date paid at the Late Payment/Default Interest Rate. In addition, Tenant shall pay Landlord a late charge for any Rent payment which is not paid within ten days after its due date equal to five percent of such payment.

3.4 Cost of Tenant's Obligations. Tenant shall bear the entire cost and expense of fulfilling and performing all of its obligations under this Lease, including, without limitation, its obligations to perform and make all necessary maintenance, repairs, replacements and Alterations and Improvements to the Premises, without any contributions whatsoever from Landlord except as set forth herein.

3.5 Costs of Landlord's Obligations. Landlord shall bear the entire cost and expense of fulfilling and performing all of its obligations under this Lease, including, without limitation, its obligations to perform and make all necessary maintenance, repairs, replacements to the roof, slab, foundations, structural elements, exterior walls, roofs, and chimneys and the Additional Parking to the Premises, without any contributions whatsoever from Tenant.

ARTICLE IV

Use

4.1 Use. Tenant shall use the Premises only for the Permitted Uses and not for any other purpose.

4.2 Repair and Maintenance. Tenant shall throughout the Term keep and maintain the entire Premises, including, without limitation, all doors, windows, interior walls, lobbies, hallways, stairways, rooms, basements, lawns, grounds, landscaped areas, parking areas, loading areas, driveways, sidewalks, walkways, landings and entryways thereof, all heating, ventilating, air conditioning, hot water, plumbing, electrical, gas, elevator, mechanical, security and alarm fixtures, equipment, lines and systems therein and Tenant's trade fixtures and equipment therein in good, clean, sanitary, safe, sound, working and tenantable condition and repair and in at least as good order, condition and repair as they are in on the Term Commencement Date or may be put during the Term, excepting only (a) reasonable wear and tear and (b) damage by fire or other casualty or taking by condemnation or eminent domain which shall instead be governed by Articles VIII and IX. Tenant shall promptly make all repairs and replacements and do all other work necessary to accomplish the foregoing. If requested by Landlord, Tenant shall secure, pay for and keep in force contracts with appropriate and reputable service companies providing for regular and proper maintenance of all heating, ventilating, air conditioning, elevator, alarm and security systems in the Premises, if requested, furnish copies of all such contracts to Landlord. Tenant shall remove snow and ice from all parking areas, loading areas, driveways, walkways, sidewalks, entryways, porches, landings and fire escapes on or surrounding the Premises promptly after accumulation. Tenant shall also make regular use of and lock any gates on the Premises after normal business hours to prevent unauthorized access the Premises by third-parties. Notwithstanding anything to the contrary herein contained, Landlord shall be responsible for repairs and replacement of the slab, foundations, structural elements, exterior walls, roofs, and chimneys, unless the need for such repair or replacement is the result of Tenant's negligence or willful act.

4.2.1 Landlord's Repair and Maintenance . Tenant shall provide written notice to Landlord for any repair that is or may be needed on the slab, foundation, structural elements, exterior wall, roofs, and chimneys. Landlord shall have ten (10) days to respond to such notice, unless the needed repair will interrupt the Permitted Use of the Premises, in which case, Landlord has seventy-two (72) hours to respond to such notice. If Landlord fails to perform its obligations to repair and maintain the slab, foundation, structural elements, exterior wall, roofs and chimneys, then Tenant may, at its sole discretion, repair the damage and deduct such cost from the Additional Rent owed to Landlord.

4.3 Compliance with Law . Tenant shall comply, at Tenant's cost and expense, with all recorded restrictive covenants encumbering the Land and all present and future laws, ordinances, orders, rules, regulations and requirements of all federal, state, and municipal governments, including all municipal and road utility districts and municipal utility districts, and all departments, commissions, boards and officers thereof, and any other body exercising similar functions, which now or hereafter may be applicable to the Premises, the improvements in the Premises, or to the use or manner of use of the Premises or the improvements, including but not limited to , all environmental laws and the Americans With Disabilities Act. Without limiting the generality of the foregoing, Tenant shall (a) obtain all Necessary Permits for the Permitted Uses and Tenant's occupancy of the Premises before commencing such uses and occupancy and maintain such permits in force and effect while continuing such use and occupancy, (b) obtain all Necessary Permits for any Alterations and Improvements which Tenant may make to the Premises from time to time pursuant to Article V before commencing any such work, (c) install and maintain all safety equipment required in and on the Premises from time to time by all Applicable Laws and (d) make all repairs, replacements, installations, Alterations and Improvements required to the Premises from time to time by all Applicable Laws. Notwithstanding the foregoing, if Tenant should contest the applicability or validity of any purportedly Applicable Law in good faith and by appropriate legal proceedings, then Tenant may postpone compliance pending the outcome of such contest to the extent (but only to the extent) that such postponement shall not jeopardize the health and safety of any persons or property on, in or about the Premises or expose Landlord to any penalties, sanctions or liabilities.

4.4 No Nuisance; Prohibited Uses . Tenant shall not injure, overload, deface or otherwise harm the Premises; nor overload, impair or interfere with the heating, ventilating, air conditioning, hot water, plumbing, electrical, gas, elevator, mechanical, security, alarm or other systems in the Premises; nor commit any nuisance on, in, from or about the Premises; nor emit or permit the emission of any objectionable noise, vibration, odor, smoke or vapor from the Premises; nor in any way disturb, annoy, inconvenience, or cause discomfort to, other abutting properties or the surrounding neighborhood; nor conduct or allow any illegal, illicit or immoral activities on the Premises; nor make, allow or suffer any waste of the Premises; nor make any use of the Premises which is improper, offensive or contrary to Applicable Laws or which will invalidate any of Landlord's or Tenant's insurance; nor conduct any auction, fire, "going out of business" or bankruptcy sales on the Premises; nor in any way impair or damage the appearance, image or reputation of the Premises.

4.5 Rubbish Removal, Etc. Tenant shall have all trash, refuse, and garbage removed from the Premises at frequent intervals by a qualified removal contractor. Tenant shall keep all trash, refuse and garbage in suitable covered and secured containers and deodorized until removed. In no event shall Tenant allow large amounts of trash, refuse and garbage to accumulate. Tenant shall take reasonable precautions to prevent insect, vermin and pest infestation of the Premises, and shall promptly have insects, vermin and pests exterminated by a qualified extermination contractor should any infestation occur. Tenant shall at all times maintain the Premises in a clean, safe and sanitary condition.

4.6 Safety and Security . Tenant shall at all times maintain safety and provide adequate security in the Premises and with respect to the conduct of its business therein by, without limitation, (a) installing, utilizing, operating and maintaining appropriate locks and safety, security, fire suppression and alarm systems and equipment, (b) establishing appropriate and adequate safety and security procedures, training its employees in such procedures and causing such employees to follow them, and (c) if necessary, employing adequately trained security guards, personnel or services.

4.7 Hazardous Materials . Tenant shall not bring, generate, store, use, install, dispose of, spill, release, emit or discharge any Hazardous Substances on, in or from the Premises, nor suffer, permit or allow any other Party for which Tenant Is Responsible to do so, except only for Permitted Hazardous Substances which are reasonably necessary for the conduct of Tenant's business in accordance with the Permitted Uses. Tenant shall bring, generate, store, use and dispose of any such Permitted Hazardous Substances in strict compliance with all Applicable Laws, manufacturers' directions and industry standards, and shall defend, indemnify and hold Landlord harmless with respect thereto as more particularly set forth in Section 7.1. Tenant shall give Landlord notice of the specific Permitted Hazardous Substance which Tenant uses on the Premises from time to time, the procedures which Tenant follows in the use, storage and disposal thereof and all other relevant facts with respect thereto. In the event that Tenant or any Parties for Which Tenant Is Responsible should spill, release, emit, discharge or dispose of any Hazardous Substances, permitted or otherwise, on, in or from the Premises. Tenant shall (a) immediately notify Landlord thereof, (b) promptly contain, remediate, remove and clean up such substances in strict compliance with all Applicable Laws and (c) defend, indemnify and hold Landlord harmless with respect thereto pursuant to Section 7.1 as aforesaid. Tenant shall further maintain environmental insurance covering its use of any Hazardous Substances on the Premises as provided in Section 7.3.7.

4.8 Utilities . Tenant shall make its own arrangements for water, sewer, gas, electricity, telephone and all other utilities necessary to operate the Premises and to conduct the Permitted Uses therein. Landlord represents that appropriate connections for such utilities currently exist at the Premises.

4.9 Signs . Tenant shall comply with all requirements set forth in Article V in erecting any signs on the Premises, including, without limitation, obtaining Landlord's prior approval of the plans and specifications for any such signs.

4.10 Tenant Responsible for all Services, Etc. Except only for repair and restoration of the Premises after a fire or other casualty or taking of the Premises by condemnation or eminent domain pursuant to Articles VIII and IX or as otherwise specifically provided to the contrary in this Lease, Landlord shall not be obligated to maintain or repair the Premises, to provide water, sewer, gas, electricity, telephone or any other utilities to the Premises, to heat, air condition or ventilate the Premises, to remove trash, refuse and garbage from the Premises, to provide janitorial or security services to the Premises, to make the Premises comply with Applicable Laws or to provide any services, perform any functions or do any work whatsoever with respect to the Premises. Rather, all such services, functions and work shall be Tenant's responsibility, as provided in this Article IV and the other provisions, terms and conditions hereof.

4.11 Landlord's Right to Enter . Tenant shall permit Landlord and its agents to enter the Premises during normal business hours with twenty four (24) hours notice (a) to examine the Premises, (b) to make construction inspections pursuant to Section 5.6, (c) to make such inspections, tests, repairs and replacements as Landlord may elect, without, however, any obligation to do so, (d) to repair and restore the Premises after a fire or other casualty or taking of the Premises by condemnation or eminent domain pursuant to Articles VIII and IX, (e) to cure any defaults by Tenant pursuant to Section 11.4, again without any obligation to do so, and (f) to show the Premises to prospective purchasers and lenders. Tenant shall further permit Landlord and its agents during the last year of the Term to show the Premises to prospective tenants and, during the last six months of the Term, to affix and maintain notices of availability in suitable places in and on the Premises. Notwithstanding the above, Landlord has the right to enter the Premises, at any time, without notice, in the event of an emergency.

ARTICLE V Alterations and Improvements

5.1 Construction by Tenant . Tenant may, from time to time during the Term, at its own cost and expense, make Alterations and Improvements to the Premises as necessary for the Permitted Uses, in compliance with the terms and conditions of this Article V.

5.2 Pre-Construction Obligations . Before commencing construction of any Alterations and Improvements, Tenant shall comply with the following:

5.2.1 Plans and Specifications . Tenant shall have prepared and deliver to Landlord reasonably detailed plans and specifications for such Alterations and Improvements prepared by registered professional architects and engineers and obtain Landlord's written approval thereof. Such plans and specifications shall include a certification by such architects and engineers that such Alterations and Improvements as shown and described thereby comply with all Applicable Laws. Landlord shall approve or disapprove such plans and specifications by written notice to Tenant within 10 days after Tenant's submittal of such plans and specifications. Such approval shall not be unreasonably withheld. If Landlord fails to give Tenant such notice within such 10 days, then Landlord shall be deemed to have approved such plans and specifications. If Landlord disapproves of such plans and specifications, then Landlord shall in its disapproval notice specify in reasonable detail the respects in which such plans and specifications are not satisfactory. Tenant shall then revise such plans and specifications to eliminate, upgrade or correct, as appropriate, the unsatisfactory items, and resubmit the revised plans and specifications to Landlord in accordance with the foregoing. Landlord shall subsequently approve or disapprove any revised and resubmitted plans and specifications in the same manner as is required for new plans and specifications.

5.2.2 Contractor and Major Subcontractors . Tenant shall give Landlord written notice as to what general contractor Tenant proposes to hire to construct such Alterations and Improvements and of all subcontractors who will perform work costing more than 40% of the total construction costs for such improvements and shall obtain Landlord's written approval of such general contractor and subcontractors. Such notice shall include reasonable background information on such general contractor and each such subcontractor, including, without limitation, references and lists of previous projects completed. Landlord shall approve, within 10 days, such general contractor unless such general contractor is not bondable, insurable or competent. Such approval shall not be unreasonably withheld. If Landlord fails to give Tenant such notice within such 10 days, then Landlord shall be deemed to have approved such general contractor. If Landlord disapproves any such general contractor, then Landlord shall in such notice set forth its reasons for disapproval in reasonable detail.

5.2.3 Necessary Permits . Tenant shall obtain all Necessary Permits for such Alterations and Improvements under all Applicable Laws.

5.2.4 Insurance . Tenant shall obtain, or cause its general contractor and subcontractors to obtain, as applicable, the insurance specified in Section 7.3.5 and provide Landlord with original certificates thereof and copies of such policies. Tenant shall maintain, or cause such contractors to maintain, said insurance throughout the course of construction.

5.2.5 Bonds . If reasonably required by Landlord for any particular Alterations and Improvements because of the magnitude or scope thereof, Tenant shall obtain and deliver to Landlord a bond covering the construction costs for the Alterations and Improvements. Landlord and Tenant shall be named as dual obligees under such bonds. Tenant shall maintain such bonds in effect throughout the course of construction and until construction is fully completed. Additionally, Tenant agrees to remove or bond around, within thirty (30) days of notice of a lien placed on the Premises by a contractor or sub-contractor hired by Tenant. Failure by Tenant to remove or bond around such lien, within the specified time period, shall be deemed an Event of Default under Section 11.1.

5.3 Construction . Tenant shall construct the Alterations and Improvements in substantial compliance with the plans and specifications approved by Landlord, the Necessary Permits received and all Applicable Laws. In carrying out such construction, Tenant shall not materially modify or deviate from the plans and specifications approved by Landlord without first obtaining Landlord's approval of such modification or deviation in the manner described in Section 5.2.1. All work shall be done in a good and workmanlike manner using first class materials. Once having commenced, Tenant shall diligently and continuously construct the Alterations and Improvements until completed.

5.4 Safety . Tenant shall perform all work in a safe and proper manner and shall take all necessary precautions to prevent (a) injury to any workers, employees, tenants, occupants, visitors, passers-by and all other persons on, in, about and in the vicinity of the Premises and (b) damage to the Premises and all property in, on, about, abutting and in the vicinity of the Premises. Without limiting the generality of the foregoing, Tenant shall strictly comply with all Applicable Laws with respect to construction safety.

5.5 Payment of Costs; Discharge of Liens . Tenant shall pay promptly when due the entire cost of constructing the Alterations and Improvements so that the Premises shall at all times be free of any liens for labor and materials. If any such lien should be recorded or should otherwise attach against the Premises, Tenant shall remove the same in accordance with Section 5.2.5.

5.6 Inspections . Landlord shall have the right, but shall not be obligated, to inspect Tenant's work from time to time throughout the course of construction in order to determine whether or not such work complies with the requirements of this Article V. Tenant shall promptly correct any non-conformities of which Landlord gives Tenant notice.

5.7 Landlord's Representatives . Landlord may hire architects, engineers, consultants and other qualified professionals to assist it in making all reviews, inspections and decisions which Landlord is required or entitled to make under this Lease. Such persons shall have the same access to the Premises as Landlord has pursuant to Sections 5.6 and 4.11 and shall be entitled to read and review the same documents and materials which Landlord is entitled to receive and review hereunder. Landlord shall bear the cost for hiring any such architects, engineers, consultants and other qualified professionals.

5.8 Landlord Not Responsible for Tenant's Work . No approval given by Landlord or failure by Landlord to raise any objection pursuant this Article V or otherwise shall constitute a representation, warranty or acknowledgment that the element approved or not objected to is in compliance with Applicable Laws, properly designed or constructed or fit for its intended purpose, or that the person approved or not objected to is qualified for the given job or task. All judgments and determinations with respect to such matters shall remain the sole responsibility of Tenant. Landlord shall not be a party to any contract for construction of the Alterations and Improvements or other work by Tenant on the Premises, nor shall Landlord have any obligation or liability to any of Tenant's contractors, subcontractors or any other party with respect to such construction or work, whether under any such contract or otherwise.

5.9 Ownership . All Alterations and Improvements constructed by Tenant shall be deemed part of the Premises and shall be the property of Landlord, subject to Tenant's rights of use and occupancy pursuant to this Lease, except only that Tenant's trade installations, trade fixtures and equipment (as distinguished from base building type items) shall remain Tenant's property.

ARTICLE VI
Assignment and Subletting

6.1 Assignments and Subleasings Generally. Except for Permitted Assignments and Subleasings to Tenant Affiliates or Tenant Successors pursuant to Section 6.2, Tenant shall not assign, transfer, mortgage or pledge this Lease or grant a security interest in Tenant's rights hereunder, or sublease (which term shall be deemed to include the granting of concessions and licenses and the like) all of any part of the Premises, or suffer or permit this Lease or the leasehold interest created hereby to be assigned, transferred or encumbered, in whole or in part, whether voluntarily, involuntarily or by operation of law, without in each instance obtaining Landlord's written consent thereto, which consent shall not be unreasonably withheld or delayed provided that the following conditions are met: (a) Tenant shall not be in default hereunder at the time of such assignment or subletting after notice and the cure period provided for herein, (b) the proposed assignee or subtenant is (i) duly organized and validly existing under the laws of the United States or any state thereof, (ii) qualified to do business in the State of Texas, (iii) of good business reputation, (iv) creditworthy and (v) has the reasonable financial capability, in the case of an assignee, to perform Tenant's obligations hereunder, and in the case of a subtenant, to perform Tenant's obligations under the subject sublease, (c) the assignment instrument or subject sublease is reasonably satisfactory to Landlord in form and substance, and (d) either (i) the proposed assignee executes and delivers an instrument to Landlord by which such assignee attorns to Landlord, agrees to be bound by the terms, provisions and conditions of this Lease and to assume all of Tenant's obligations hereunder, or (ii) the proposed subtenant executes and delivers an instrument to Landlord accepting such reasonable conditions to Landlord's consent as Landlord shall dictate.

6.2 Permitted Assignments and Subleasings to Tenant Affiliates and Tenant Successors. Tenant may from time to time assign this Lease or sublease all or any part of the Premises to a Tenant Affiliate or Tenant Successor without having to obtain Landlord's consent, provided that (a) Tenant shall give Landlord at least 30 days prior written notice of the subject transaction and (b) all of the conditions specified in Section 6.1 are met with respect to the subject transaction (such an assignment or subleasing, a "Permitted Assignment or Subleasing to a Tenant Affiliate or Tenant Successor").

6.3 Information. Tenant shall for each proposed assignment or subleasing provide Landlord with the (a) name and address of the proposed assignee or subtenant, (b) copies of all assignment or sublease instruments, (c) a credit report from a recognized service for the proposed assignee or subtenant, if available, (d) reasonably detailed and appropriate financial statements for the proposed assignee or subtenant for the last two years or so many of them for which such statements are available, and if not available, reasonable alternative financial information which accurately presents the financial condition of the proposed assignee or subtenant, and (e) any other information and documentation which Landlord may reasonably request. Landlord shall not be obligated to pass on the proposed assignment or subleasing until it has received and had reasonable time to review all such information and documentation.

6.4 Excess Sublease Rentals. Tenant shall pay to Landlord 50% of any rentals or other consideration received from any assignee or subtenant in excess of the Rent allocable to the space assigned or subleased.

6.5 Transfer in Violation Void; Tenant's Liability Continues. Any attempted assignment, transfer, mortgage, pledge, grant of security interest, sublease or other encumbrance, except as permitted by this Article VI, shall be void. Any assignment, transfer, mortgage, pledge, grant of security interest, sublease or other encumbrance which is so permitted shall be subject to, and the assignee, transferee, mortgagee, pledgee, grantee or sublessee thereunder shall be bound by, all of the terms, conditions and provisions of this Lease. No assignment, transfer, mortgage, grant of security interest, sublease or other encumbrance, whether or not approved, and no indulgence granted by Landlord to any assignee, sublease or occupant shall in any way impair Tenant's continuing primary liability hereunder, which after an assignment or subletting shall be joint and several with the assignee or sublessee. No consent by Landlord to any particular assignment, transfer, mortgage, pledge, grant of a security interest, sublease or encumbrance shall be construed as a consent to any other assignment, transfer, mortgage, pledge, grant of a security interest, sublease or encumbrance, nor as a waiver of Tenant's obligation to obtain Landlord's consent to any other such transaction in any other instance or case.

ARTICLE VII Indemnity and Insurance

7.1 Indemnity. Tenant shall defend, with counsel reasonably approved by Landlord (which approval shall not be unreasonably withheld or delayed), all actions against Landlord, any manager, member, partner, trustee, stockholder, officer, director, employee or beneficiary of Landlord, Mortgagees and any other party having an interest in the Premises (herein, "Indemnified Parties") with respect to, and shall pay, protect, indemnify and save harmless, to the extent permitted by Applicable Laws, all Indemnified Parties from and against, any and all liabilities, losses, damages, costs, expenses (including reasonable attorneys' fees and expenses), causes of action, suits, claims, demands or judgments of any nature arising from (a) any injury to or death of any person, or damage to or loss of property, in, on or about the Premises or on adjoining sidewalks, streets or ways, or connected with the use, condition or occupancy of any thereof, (b) any breach or violation by Tenant of any of the terms, conditions or provisions of this Lease, (c) any act, omission, fault, misconduct, negligence or violation of Applicable Laws by Tenant or any Parties for Which Tenant Is Responsible, (d) any Hazardous Substances brought, generated, stored, used, installed, disposed of, spilled, released, emitted or discharged on, in or from the Premises, or allowed, permitted or suffered to be brought, generated, stored, used, installed, disposed of, spilled, released, emitted or discharged thereon, therein or therefrom, by Tenant or any Parties for Which Tenant Is Responsible, whether Permitted Incidental Hazardous Substances or otherwise, (e) any construction or other work by Tenant on or about the Premises, including, without limitation, construction of any Alterations and Improvements to the Premises pursuant to Article V, and (f) any contest initiated by Tenant referred to in Section 4.3; provided, however, that Tenant does not hereby indemnify Landlord from any liabilities, losses, damages, costs, expenses, causes of action, suits, claims, demands or judgments to the extent caused by the negligence or willful misconduct of Landlord or any Parties for Which Landlord Is Responsible. Notwithstanding the foregoing, Tenant does not indemnify Landlord for any liabilities, losses, damages, costs, expenses, causes of action, suits, claims, demands or judgment of an any nature arising from any repairs or maintenance work provided by Landlord or related to the construction of the Additional Parking.

7.2 Use and Occupancy at Tenant's Risk. Tenant's use and occupancy of the Premises, and that of any Party for Which Tenant Is Responsible, and all Tenant's furnishings, fixtures, equipment, Alterations and Improvements, materials, supplies, inventory, effects and property of every kind, nature and description and those of any Party for Which Tenant Is Responsible which during the continuance of this Lease or any occupancy of the Premises by Tenant or any Party for Which Tenant Is Responsible may be on the Premises shall be at Tenant's and such parties' sole risk and hazard. Landlord shall not be liable to Tenant or any Party for Which Tenant Is Responsible for injury to or death of any person or damage to or destruction of any property in, on or about the Premises, or for any other losses, damages, costs, expenses or liabilities whatsoever, including, without limitation, where caused by fire, water, explosion, collapse, the leakage or bursting of water, steam, or other pipes, any environmental or other condition in, on, of or about the Premises or any other event, occurrence, condition or cause, except only to the extent caused by the negligence, willful misconduct, acts or omissions of Landlord or any Parties for Which Landlord is Responsible. Tenant and any Party for Which Tenant is Responsible shall be responsible to take out and maintain adequate insurance to protect themselves against the aforesaid losses, damages, costs, expenses and liabilities showing Landlord as insured as its interest may appear.

7.3 Insurance to be Carried. Tenant shall take out and maintain throughout the Term and such further time as Tenant occupies all or any part of the Premises, the following insurance with respect to the Premises at Tenant's sole cost and expense:

7.3.1 Property Insurance. Special form property insurance covering all Alterations and Improvements constructed by Tenant and Tenant's fixtures, furnishings, equipment, materials, supplies, inventory, effects and personal property in the Premises, in the amount of the replacement cost thereof from time to time, with business income and extra expense coverage by endorsement thereto.

7.3.2 Liability Insurance. Commercial general liability insurance indemnifying against all claims and demands for any injury to person or property which may be claimed to have occurred in, on or about the Premises in amounts which shall, at the beginning of the Term, be at least equal to the limits set forth for such insurance in Section 1.1, and, from time to time during the Term, shall be for such higher limits, if any, as are customarily carried in the area in which the Premises are located on property similar to the Premises and used for similar purposes, provided that Tenant shall not be obligated to so increase such insurance unless at least one year has elapsed since the last adjustment and then only if requested to do so by Landlord.

7.3.3 Workmen's Compensation Insurance. Workmen's compensation insurance with statutory limits covering all of Tenant's employees working on the Premises.

7.3.4 Employer's Liability Insurance . Employer's liability insurance in amounts at least equal to the commercial general liability insurance limits set forth in Section 1.1 or such higher limits as may be applicable for such insurance under Section 7.3.2.

7.3.5 Insurance During Construction . At all times during which Tenant undertakes any Alterations and Improvements or other construction or work on or about the Premises, (a) all-risk builder's risk insurance in such amount necessary to provide full replacement coverage to the Premises as improved by such construction or work and (b) owner's contingent or protective liability insurance with respect to such construction in amounts at least equal to the commercial general liability insurance limits set forth in Section 1.1 or such higher limits as may be applicable under Section 7.3.2. Tenant shall further cause its contractors and subcontractors for any such work to take out and maintain workmen's compensation insurance with statutory limits covering all of their employees working on the Premises or otherwise involved in such construction.

7.3.6 Automobile Liability Insurance . At all times during which Tenant or its contractors bring or operate motor vehicles on, from or about the Premises, motor vehicle liability insurance on all of Tenant's and its contractors' motor vehicles, in amounts at least equal to the commercial general liability insurance limits set forth in Section 1.1 or such higher limits as may be applicable for such insurance under Section 7.3.2.

7.3.7 Additional Insurance . Such further insurance in such amounts as Landlord or any Mortgagee may from time to time require, provided that (a) such insurance is, when required, customarily carried in the area in which the Premises are located on property similar to the Premises and used for similar purposes, and (b) such amounts are, when required, not higher than the amounts customarily carried in the area in which the Premises are located on property similar to the Premises and used for similar purposes.

7.4 General Requirements . All policies required under this Article VII shall be obtained from responsible companies qualified to do business in the State of Texas and in good standing therein. All such companies must be rated A or higher by A.M. Best, or have a comparable rating from a comparable rating organization, and must otherwise be reasonably satisfactory to Landlord. Tenant shall be named as the insured and Landlord as an additional insured under all liability policies. Any Mortgagee of which Landlord gives Tenant notice shall also be named as an additional insured on such liability policies. Such policies shall have cross liability coverage endorsements. Liability limits may be achieved by obtaining so-called umbrella policies over the basic coverage. Tenant shall furnish Landlord with original certificates and copies of all policies prior to the beginning of the Term and of each renewal policy at least 30 days prior to the expiration of the policy it renews. Tenant shall also furnish Landlord with reasonable evidence of the timely payment of all premiums for such policies. Each policy under which the Landlord or any such Mortgagee is an additional insured shall be non-cancelable with respect to Landlord's or such Mortgagee's interest without at least 30 days' prior written notice thereto. In the event provision for any such insurance is to be by a blanket insurance policy, the policy shall allocate a specific amount of coverage to the Premises, which allocation shall be sufficient in amount to satisfy the requirements of this Article VII.

7.5 Non-Subrogation Provisions. All property damage insurance which is carried by either Party with respect to the Premises, whether or not required, shall include provisions which either designate the other Party as one of the insureds or deny to the insurer acquisition by subrogation of rights of recovery against the other Party to the extent such rights have been waived by the insured Party prior to occurrence of loss or injury, insofar as and to the extent that such provisions may be effective without making it impossible to obtain insurance coverage from responsible companies qualified to do business in the State of Texas (even though extra premium may result therefrom). In the event that extra premium is payable by either Party as a result of this provision, the other Party shall reimburse the Party paying such premium the amount of such extra premium. If, at the request of one Party, this non-subrogation provision is waived as to such Party, then the obligation of reimbursement by such Party shall cease for such period of time as such waiver shall be effective, but nothing contained in this Section 7.5 shall derogate from or otherwise affect releases elsewhere herein contained of either Party for claims. Each Party shall be entitled to have duplicates or certificates of any policies containing such provisions. Each Party hereby waives all rights of recovery against the other for loss or injury against which the waiving Party is protected by insurance containing said non-subrogation provisions, reserving, however, any rights with respect to any excess of loss or injury over the amount recovered by such insurance.

ARTICLE VIII Casualty

8.1 Right to Terminate. In the event that all or any portion of the Premises are damaged or destroyed by fire or other casualty and such damage or destruction exceeds twenty five percent (25%) of the value of the Premises, then either Party may terminate this Lease by notice to the other party within 30 days after such damage or destruction. In the event that all or any portion of the Premises are damaged or destroyed by fire or other casualty and such damage or destruction prevents Tenant's material use of the Premises for thirty (30) consecutive days, then Tenant shall have the right, upon written notice to Landlord, to terminate this Lease.

8.2 Restoration. If the Premises are damaged or destroyed by fire or other casualty and this Lease is not terminated pursuant to Section 8.1, then Landlord shall promptly and diligently repair and restore the Premises as nearly as practicable to their condition prior to such damage or destruction, and in any event to a condition reasonably suitable for Tenant's use and occupancy, but subject and only to the extent allowed by (a) then Applicable Laws and (b) the net insurance proceeds available to Landlord on account of such damage or destruction after deducting the reasonable costs of collecting such proceeds and any amount retained by any Mortgagee pursuant to the terms of its Mortgage, it being understood and agreed that Landlord shall not be obligated to repair or restore if and to the extent such proceeds are not made available to it for such purpose by any Mortgagee. Rent shall be equitably abated until Landlord restores the Premises to a condition reasonably suitable for Tenant's use and occupancy. If Landlord fails so to restore within 6 months after the occurrence of such damage or destruction, then, regardless of the reason for such failure (and including where a Mortgagee refused to make insurance proceeds available for repair and restoration), Tenant may terminate this Lease by notice to Landlord within 30 days after the expiration of such 6 month period. Landlord shall not be obligated to restore any Alterations and Improvements constructed by Tenant on the Premises. Rather, Tenant shall be responsible for repair and restoration of any such Alterations and Improvements which it has made.

ARTICLE IX
Eminent Domain

9.1 Taking of Entire Premises . In the event that the entire Premises are taken by condemnation or eminent domain, then this Lease shall terminate on the date when title passes to the taking authority, and Rent shall be pro rated and paid to such date.

9.2 Partial Taking - Termination . In the event that only a portion of the Premises are so taken but such portion exceeds twenty five percent (25%) of the value thereof, then Landlord may terminate this Lease by notice to Tenant within 30 days after the date title passes to the taking authority, and Rent shall be pro-rated and paid to such date in the same manner as provided in Section 9.1. In the event that only a portion of the Premises are so taken, if such taking materially affects Tenant's ability to use the Premises for the Permitted Use, Tenant shall at its discretion terminate this Lease immediately upon 30 days written notice. .

9.3 Partial Taking - Restoration . In the event that only a portion of the Premises are so taken but this Lease is not terminated pursuant to Section 9.2 then Landlord shall promptly and diligently repair and restore the Premises or what remains thereof as nearly as practicable to their condition before such taking and in any event to a condition reasonably suitable for Tenant's use and occupancy, but subject and only to the extent permitted by (a) then Applicable Laws and (b) the net takings award available to Landlord after deducting the reasonable costs of obtaining such award and any amounts retained by any Mortgagee pursuant to the terms of its Mortgage, it being understood and agreed that Landlord shall not be obligated to repair and restore if and to the extent such award is not made available to it for such purpose by any such Mortgagee. Rent shall be equitably abated until Landlord restores the Premises to a condition reasonably suitable for Tenant's use and occupancy, and, in the case of a taking which permanently reduced the Premises, Rent shall be equitably abated for the remainder of the Term in just proportion to such permanent reduction. If Landlord fails so to restore the Premises within 6 months after the occurrence of such taking, then, regardless of the reason for such failure (and including where a Mortgagee refused to make the takings award or an adequate portion thereof available for repair and restoration), Tenant may terminate this Lease by notice to Landlord within 30 days after the expiration of such 6 month period. Landlord shall not be obligated to restore any Alterations and Improvements constructed by Tenant in the Premises. Rather, Tenant shall be responsible for repair and restoration of any such Alterations and Improvements which it has made.

9.4 Eminent Domain Award . All awards, damages and compensation on account of any such taking of the Premises shall belong exclusively to Landlord, and Tenant hereby assigns and releases to Landlord all of Tenant's right to any such awards, damages and compensation, except only that Tenant may, at its own expense, make a separate claim to the taking authority for Tenant's personal property and relocation expenses, provided that Landlord's award is not reduced thereby. Tenant shall execute and deliver to Landlord all instruments as may be necessary or desirable to confirm Tenant's foregoing assignment and release to Landlord of all such awards, damages and compensation. Tenant hereby irrevocably appoints Landlord, which appointment is coupled with an interest, as Tenant's attorney-in-fact to execute and deliver any such instruments for Tenant in Tenant's name, place and stead, should Tenant fail to do so.

ARTICLE X
Yield Up

10.1 Yield Up. At the expiration of the Term or earlier termination of this Lease, Tenant shall surrender all keys to the Premises, remove all of its furnishings, fixtures, equipment, materials, supplies, inventory, effects and other personal property from the Premises, (including, without limitation, all of Tenant's trade furnishings, trade fixtures and equipment), leave any Alterations and Improvements made by Tenant, remove all of its signs wherever located, repair all damage caused by any such removal and yield up the Premises (including all Alterations and Improvements) in the same good, proper, clean, sanitary, safe, sound, working and tenantable order, condition and repair in which Tenant is obliged to keep and maintain the Premises by the provisions of this Lease. Any of Tenant's property not so removed shall be deemed abandoned and may be retained by Landlord or may be removed and disposed of by Landlord in such manner as Landlord shall determine. Tenant shall pay Landlord the entire cost and expense incurred by Landlord in effecting such removal and disposition and in making any incidental repairs and replacements to the Premises. Without limiting the generality of the foregoing, Tenant shall have the right upon the expiration or termination of this Lease to remove all of its trade fixtures, furnishings and equipment from the Premises, provided that it complies with all requirements of this Section 10.1 in doing so.

10.2 Holdover. For each day after the expiration of the Term, or the earlier termination of this Lease, and prior to Tenant's performance of its obligation to yield up the Premises under this Article, Tenant shall pay to Landlord as rent an amount equal to 150% of the Base Rent computed on a daily basis, together with all Additional Rent and other charges payable with respect to each such day. Tenant shall further indemnify Landlord against all loss, cost and damage suffered by Landlord as a result of Tenant's delay in surrendering the Premises as above provided. Any such holding over by Tenant shall be a tenancy at sufferance only.

ARTICLE XI
Defaults

11.1 Events of Default. (a) If Tenant fails to make any payment of Base Rent, Additional Rent or other charges when due hereunder and does not cure such default within ten days after notice thereof from Landlord, or (b) if Tenant fails to procure or maintain any of the insurance required hereunder and does not cure such default within ten days after notice thereof from Landlord, or (c) if Tenant fails to perform any of its other obligations under this Lease and does not cure such default within 30 days after notice thereof from Landlord, or, if such default is not reasonably susceptible of cure within 30 days, if Tenant does not commence to cure within such 30 days and thereafter diligently and continuously prosecute such cure to completion, or (d) if Tenant or any present or future guarantor of all or any portion of Tenant's obligations under this Lease (a "Guarantor") becomes insolvent, or (e) if the leasehold estate under this Lease or any substantial part of the property of Tenant or of any Guarantor is taken on execution, or by other process of law, or is attached or subjected to any other involuntary encumbrance and such property is not reconveyed to Tenant or Guarantor or such attachment or encumbrance is not dissolved within 60 days thereafter, or (f) if a receiver, trustee, custodian, guardian, liquidator or similar agent is appointed with respect to Tenant or any Guarantor, or if any such person or a mortgagee, secured party or other creditor takes possession of the Premises or of any substantial part of the property of Tenant or of any Guarantor, and, in either case, if such appointment or taking of possession is not terminated within 60 days after it first occurs, or (g) if a petition is filed by or with the consent of Tenant or of any Guarantor under any federal or state law concerning bankruptcy, insolvency, reorganization, arrangement, or relief from creditors, or (h) if a petition is filed against Tenant or against any Guarantor under any federal or state law concerning bankruptcy, insolvency, reorganization, arrangement, or relief from creditors, and such petition is not dismissed within 60 days thereafter, or (i) if Tenant or any Guarantor which is a corporation or other entity dissolves or is dissolved or liquidates or adopts any plan or commences any proceeding, the result of which is intended to include dissolution or liquidation (each of the foregoing an "Event of Default"), then, and in any of such cases, Landlord and the agents and servants of Landlord lawfully may, in addition to and not in derogation of any remedies for any preceding breach of covenant, immediately or at any time thereafter and without demand or notice and with or without process of law (forcibly, if necessary) enter into and upon the Premises or any part thereof in the name of the whole or mail a notice of termination addressed to Tenant, and repossess the same as of Landlord's former estate and expel Tenant and those claiming through or under Tenant and remove its and their effects (forcibly, if necessary) without being deemed guilty of any manner of trespass and without prejudice to any remedies which might otherwise be used for arrears of rent or prior breach of covenant, and, upon such entry or mailing as aforesaid, this Lease shall terminate, Tenant hereby waiving all statutory rights (including, without limitation, rights of redemption, if any, to the extent such rights may be lawfully waived) and Landlord, without notice to Tenant, may store Tenant's effects, and those of any person claiming through or under Tenant at the expense and risk of Tenant, and, if Landlord so elects, may sell such effects at public auction or private sale and apply the net proceeds to the payment of all sums due to Landlord from Tenant, if any, and pay over the balance, if any, to Tenant. Upon such termination, Tenant shall immediately vacate and surrender the Premises and deliver possession thereof to Tenant.

11.2 Remedies . In the event that this Lease is terminated under any of the provisions contained in Section 11.1 or shall be otherwise terminated for breach of any obligation of Tenant, Tenant covenants to pay forthwith to Landlord, as compensation, the excess of the total rent reserved for the residue of the Term over the rental value of the Premises for said residue. In calculating the rent reserved, there shall be included, in addition to the Base Rent and Additional Rent, the value of all other considerations agreed to be paid or performed by Tenant for said residue. Tenant further covenants as additional and cumulative obligations after any such termination to pay punctually to Landlord all the sums and to perform all the obligations which Tenant covenants in this Lease to pay and to perform in the same manner and to the same extent and at the same time as if this Lease had not been terminated. In calculating the amounts to be paid by Tenant pursuant to the immediately preceding sentence, Tenant shall be credited with the portion of any amount paid to Landlord as compensation as in this Section 11.2 provided allocable to the corresponding portion of the Term, and also with the net proceeds of any rent obtained by Landlord by reletting the Premises, after deducting all Landlord's reasonable expenses in connection with such reletting, including, without limitation, all repossession costs, brokerage commissions, fees for legal services and expenses of preparing the Premises for such reletting, it being agreed by Tenant that Landlord may, but shall not be obligated to, (a) relet the Premises or any part or parts thereof, for a term or terms which may at Landlord's option be equal to or less than or exceed the period which would otherwise have constituted the balance of the Term and may grant such concessions and free rent as Landlord in its reasonable judgment considers advisable or necessary to relet the same, (b) make such alterations, repairs and decorations in the Premises as Landlord in its reasonable judgment considers advisable or necessary to relet the same, and (c) keep the Premises vacant unless and until Landlord is able to rent the Premises to a tenant which is at least as desirable and financially responsible as Tenant is on the date of this Lease, on terms not less favorable to Landlord than those of this Lease. No action of Landlord in accordance with the foregoing or failure to relet or to collect rent under reletting shall operate or be construed to release or reduce Tenant's liability as aforesaid.

In lieu of any other damages or indemnity and in lieu of full recovery by Landlord of all sums payable under all the foregoing provisions of this Section 11.2, Landlord may, by notice to Tenant, at any time after this Lease is terminated under any of the provisions contained in Section 11.1 or is otherwise terminated for breach of any obligation of Tenant and before such full recovery, elect to recover, and Tenant shall thereupon pay, as liquidated damages, an amount equal to the aggregate of the Base Rent and Additional Rent accrued in the year ended prior to such termination plus the amount of Rent of any kind accrued and unpaid at the time of termination and less the amount of any recovery by Landlord under the foregoing provisions of this Section 11.2 up to the time of payment of such liquidated damages.

Nothing contained in this Lease shall, however, limit or prejudice the right of Landlord to prove for and obtain in proceedings under any federal or state law relating to bankruptcy or insolvency or reorganization or arrangement an amount equal to the maximum allowed by any statute or rule of law in effect at the time when, and governing the proceedings in which, the damages are to be proved, whether or not the amount be greater than the amount of the loss or damages referred to above.

11.3 Remedies Cumulative . Any and all rights and remedies which Landlord may have under this Lease or at law or equity shall be cumulative and shall not be deemed inconsistent with each other, and any two or more of such rights and remedies may be exercised at the same time insofar as permitted by Applicable Laws.

11.4 Landlord's Right to Cure Defaults . Landlord may, but shall not be obligated to, at any time following ten days' prior notice to Tenant, except in cases of emergency when no notice shall be required, cure any default by Tenant under this Lease; and whenever Landlord so elects, all costs and expenses incurred by Landlord, including reasonable attorneys' fees in curing such default, shall be paid by Tenant to Landlord as Additional Rent on demand, together with interest thereon at the Late Payment/Default Rate from the date of payment by Landlord to the date of payment by Tenant.

11.5 Payment of Landlord's Cost of Enforcement . Tenant shall pay on demand Landlord's expenses, including reasonable attorneys' fees, incurred in enforcing any obligation of Tenant under this Lease or in curing any default by Tenant under this Lease.

11.6 Effect of Waivers of Default . Any consent or permission by Landlord to any act or omission which otherwise would be a breach of any covenant or condition herein, or any waiver by Landlord of the breach of any covenant or condition herein, shall not in any way be held or construed (unless expressly so declared) to operate so as to impair the continuing obligation of any covenant or condition herein or otherwise, except as to the specific instance, operate to permit similar acts or omissions. The failure of Landlord to seek redress for violation of, or to insist upon the strict performance of, any covenant or condition of this Lease shall not be deemed a waiver of such violation nor prevent a subsequent act, which would have originally constituted a violation, from having all the force and effect of an original violation. The receipt by Landlord of rent with knowledge of the breach of any covenant of this Lease shall not be deemed to have been a waiver of such breach by Landlord, or by Tenant, unless such waiver be in writing signed by the party to be charged. No consent or waiver, express or implied, by Landlord to or of any breach of any agreement or duty shall be construed as a waiver or consent to or of any other breach of the same or any other agreement or duty.

11.7 No Accord and Satisfaction . No acceptance by Landlord of a lesser sum than the Base Rent, Additional Rent or any other charge then due shall be deemed to be other than on account of the earliest installment of such rent or charge due, unless Landlord elects by notice to Tenant to credit such sum against the most recent installment due, nor shall any endorsement or statement on any check or any letter accompanying any check or payment as rent or other charge be deemed a waiver, an agreement or an accord and satisfaction, and Landlord may accept such check or payment without prejudice to Landlord's right to recover the balance of such installment or pursue any other remedy in this Lease provided.

ARTICLE XII

Mortgages

12.1 Rights of Mortgagees; Limitation of Liabilities . Until the Mortgagee under any Mortgage shall enter and take possession of the Premises for the purposes of foreclosure, such Mortgagee shall have only such rights of Landlord as are necessary to preserve the integrity of this Lease as security. Upon entry and taking possession of the Premises for the purpose of foreclosure, such Mortgagee shall have all the rights of Landlord. Notwithstanding any other provision of this Lease to the contrary, including, without limitation, Section 13.4, no such Mortgagee shall be liable to perform or liable in damages for failure to perform, any of the obligations of Landlord unless and until such Mortgagee shall enter and take possession of the Premises for the purpose of foreclosure. Upon entry for the purpose of foreclosure, such Mortgagee shall be liable to perform all of the obligations of Landlord accruing from and after such entry, subject to and with the benefit of the provisions of Section 13.4, provided that a discontinuance of any foreclosure proceeding shall be deemed a conveyance under such provisions to the owner of the Premises. No Mortgagee shall ever be liable to perform any obligations of Landlord accruing before such entry. No Base Rent, Additional Rent or any other charge shall be paid more than ten days prior to the due dates thereof and payments made in violation of this provision shall (except to the extent that such payments are actually received by a Mortgagee in possession or in the process of foreclosing its Mortgage) be a nullity as against such Mortgagee, and Tenant shall be liable for the amount of such payments to such Mortgagee. The covenants and agreements contained in this Lease with respect to the rights, powers and benefit of a Mortgagee (including, without limitation, the covenants and agreements contained in this Section 12.1) constitute a continuing offer to any person, corporation or other entity, which by accepting a Mortgage subject to this Lease assumes the obligations herein set forth with respect to such Mortgagee; such Mortgagee is hereby constituted a party to this Lease as an obligee hereunder to the same extent as though its name were written hereon as such; and such Mortgagee shall be entitled to enforce such provisions in its own name. Tenant agrees on request of Landlord to execute and deliver from time to time any agreement which may be necessary to implement the provisions of this Section 12.1.

12.2 Subordination to Mortgages. This Lease is and shall be subject and subordinate to any present or future Mortgage provided that the Mortgagee agrees in writing not to terminate this Lease nor otherwise disturb Tenant's possession of the Premises in the event of a foreclosure, so long as no Event of Default shall have occurred and is continuing.

ARTICLE XIII
Miscellaneous Provisions

13.1 Notices from One Party to the Other. All notices required or permitted under this Lease shall be in writing and delivered by hand or mailed by registered or certified mail, postage prepaid and return receipt requested, addressed if to Tenant to Tenant's Address designated in Section 1.1 or such other address as Tenant shall have last designated by notice in writing to Landlord and, if to Landlord, to Landlord's Address designated in Section 1.1 or such other address as Landlord shall have last designated by notice in writing to Tenant. All notices shall be effective upon delivery to the address of the addressee (even if such addressee refuses delivery thereof).

13.2 Quiet Enjoyment. Landlord agrees that, upon Tenant's paying the rent and performing and observing the terms, covenants, conditions and provisions on its part to be performed and observed, Tenant shall and may peaceably and quietly have, hold and enjoy the Premises during the Term without any manner of hindrance or molestation from Landlord or anyone claiming under Landlord, subject, however, to the terms and provisions of this Lease.

13.3 Lease not to be Recorded. Tenant agrees that it will not record this Lease. Both Parties shall, upon the request of either, execute and deliver a notice of this Lease in such form, if any, as may be permitted by Applicable Laws. If this Lease is terminated before the Expiration Date, then the Parties shall execute, deliver and record an instrument acknowledging such fact and the actual date of termination of this Lease, and Tenant hereby appoints Landlord its attorney-in-fact, coupled with an interest, with full power of substitution to execute such instrument.

13.4 Bind and Inure; Limitation of Landlord's Liability. The obligations of this Lease shall run with the land, and this Lease shall be binding upon and inure to the benefit of the Parties hereto and their respective successors, assigns and legal representatives. No owner of the Premises shall be liable under this Lease except for breaches of Landlord's obligations occurring while owner of the Premises. The obligations of Landlord shall be binding upon the assets of Landlord which comprise the Premises but not upon other assets of Landlord. No individual partner, member, trustee, stockholder, officer, director, manager, employee or beneficiary of Landlord shall be personally liable under this Lease. Tenant shall look solely to Landlord's interest in the Premises in pursuit of its remedies upon Landlord's default hereunder. The general assets of Landlord and of the individual partners, members, trustees, stockholders, officers, directors, managers, employees or beneficiaries of Landlord shall not be subject to levy, execution or other enforcement procedure for the satisfaction of the remedies of Tenant.

13.5 Force Majeure. In any case where either Party is required to do any acts, then, except where specifically provided in this Lease and to the contrary, delays caused by or resulting from acts of God, war, civil commotion, fire, flood or other casualty, labor difficulties, shortages of labor, materials or equipment, government regulations, unusually severe weather, or other causes beyond such Party's reasonable control shall not be counted in determining the time during which such acts shall be completed, whether such time be designated by a fixed date, a fixed time or a "reasonable time", and such time shall be deemed to be extended by the period of such delay.

13.6 Landlord's Default. Landlord shall not be deemed to be in default in the performance of any of its obligations hereunder unless it shall fail to perform such obligations and such failure shall continue for a period of 30 days following receipt of notice from Tenant or, if such default is not reasonably susceptible of cure within 30 days, if Landlord does not commence to cure within such 30 days and thereafter diligently and continuously prosecute such cure to completion

13.7 Brokerage. Landlord warrants and represents that it has had no dealings with any broker or agent in connection with this Lease. Tenant represents and warrants that it has not engaged the services of any real estate broker or other broker or finder in connection with this transaction except Tenant's Broker. Tenant shall defend, with counsel approved by Landlord, hold harmless and indemnify Landlord from and against any and all cost, expense or liability for any compensation, commissions and charges claimed by Tenant's Broker with respect to Tenant's dealings in connection with this Lease or the negotiation. The terms and provisions of this Section 13.7 shall survive the termination of this Lease.

13.8 Estoppel Certificate. Upon not less than ten days' prior notice by Landlord, Tenant shall execute, acknowledge and deliver to Landlord a statement in writing, addressed to such party as Landlord shall designate in its notice to Tenant, certifying that this Lease is unmodified and in full force and effect and that Tenant has no defenses, offsets or counterclaims against its obligations to pay the Base Rent, Additional Rent and any other charges and to perform its other covenants under this Lease (or, if there have been any modifications that the same is in full force and effect as modified and stating the modifications and, if there are any defenses, offsets or counterclaims, setting them, forth in reasonable detail), the dates to which the Base Rent, Additional Rent and other charges have been paid and a statement that Landlord is not in default hereunder (or if in default, the nature of such default, in reasonable detail). Any such statement delivered pursuant to this Section 13.8 may be relied upon by any prospective purchaser or mortgagee of the Premises or any prospective assignee of any Mortgagee.

13.9 Landlord's Consents. No approval or consent hereunder by Landlord, express or implied, in any one case or instance shall be deemed an approval or consent in any other case or instance. Notwithstanding Section 5.7, whenever Tenant requests Landlord to take any action not required of Landlord under this Lease or give any consent required or permitted under this Lease, Tenant shall reimburse Landlord for Landlord's reasonable, out-of-pocket costs payable to third parties and incurred by Landlord in reviewing the proposed action or consent, including reasonable attorneys', engineers' or architects' fees, within 30 days after Landlord's delivery to Tenant of a statement of such costs. Tenant shall be obligated to make such reimbursement without regard to whether Landlord consents to any such proposed action.

13.10 Furniture and related items. All case goods, modular office furniture and fixtures owned by Landlord and located in the Premises as of the Commencement Date will be made available for the exclusive use and enjoyment of Tenant during the Term and any extensions thereof. Landlord make no warranties or representation concerning the condition of the property described herein and all such use and enjoyment by Tenant shall be at Tenant's sole risk and expense and subject to the indemnity provisions given by Tenant to Landlord as contained herein.

13.11 Tenant's Post-Termination Obligations. The expiration or termination of this Lease shall not relieve Tenant of any of its obligations hereunder which by their terms or nature Tenant is to perform after such expiration or termination, nor of any indemnity given by Tenant hereunder, all of which shall continue and remain in full force and effect for as long as allowed by Applicable Laws.

13.12 Applicable Law. This Lease shall be governed by and construed in accordance with the laws of the State of Texas. If any term, covenant, condition or provision of this Lease or the application thereof to any person or circumstances shall be declared invalid, or unenforceable by the final ruling of a court of competent jurisdiction having final review, the remaining terms, covenants, conditions and provisions of this Lease and their application to persons or circumstances shall not be affected thereby and shall continue to be enforced and recognized as valid agreements of the Parties, and in the place of such invalid or unenforceable provision, there shall be substituted a like, but valid and enforceable provision which comports to the findings of the aforesaid court and most nearly accomplishes the original intention of the Parties.

13.13 No Other Agreement. There are no oral or written agreements between Landlord and Tenant affecting this Lease. This Lease may be amended, and the provisions hereof may be waived or modified, only by instruments in writing executed by Landlord and Tenant.

13.14 No Representations by Landlord. Neither Landlord nor any agent of Landlord has made any representations or promises with respect to the Premises except as herein expressly set forth, and no rights, privileges, easements or licenses are granted to Tenant except as herein expressly set forth.

13.15 Time of Essence. Time is of the essence with respect to all terms, conditions and provisions of this Lease.

13.16 Titles. The titles of the several Articles and Sections contained herein are for convenience only and shall not be considered in construing this Lease.

13.17 "Landlord" and "Tenant". Unless repugnant to the context, the words "Landlord" and "Tenant" appearing in this Lease shall be construed to mean those named above and their respective successors, assigns, legal representatives and those claiming through or under them respectively. If there be more than one tenant, then the obligations imposed by this Lease upon Tenant shall be joint and several.

13.18 Submission Not an Offer. The submission of a draft of this Lease or a summary of some or all of its provisions does not constitute an offer to lease or demise the Premises, it being understood and agreed that neither Landlord nor Tenant shall be legally bound with respect to the leasing of the Premises unless and until this Lease has been executed and delivered by both Landlord and Tenant.

Executed under seal as of the Date of this Lease.

Landlord:

By: /s/ Dirk Laukien
Print Name: Dirk Laukien
Print Title: Owner

Tenant:

PHARMAFRONTIERS CORPORATION

By: /s/ C. W. Rouse
Print Name: C.W. Rouse
Print Title: CFO and Secretary

EXHIBIT A

Legal Description of the Land

EXHIBIT B

Plan of Land

EXHIBIT C

Rent Schedule

	<u>Rent</u>	<u>Annual Base Rent</u>
Year 1:	\$5.75 per RSF	\$59,535.50
Year 2:	\$10.75 per RSF	\$111,305.50
Year 3:	\$13.25 per RSF	\$137,190.50
Year 4:	\$13.25 per RSF	\$137,190.50
Year 5:	\$14.25 per RSF	\$147,544.50
Year 6:	\$14.25 per RSF	\$147,544.50
Year 7:	\$14.25 per RSF	\$147,544.50
Year 8:	\$15.25 per RSF	\$157,898.50
Year 9:	\$15.25 per RSF	\$157,898.50
<u>Year 10:</u>	<u>\$15.25 per RSF</u>	<u>\$157,898.50</u>

EXHIBIT D

Landlord's Work

Approximately twenty (20) additional parking spaces to be located at Landlord's sole discretion.

EXHIBIT E

Permitted Hazardous Material**Chemical List by Department****Research and Development Laboratories**

AIM-V medium	Human Serum	Human Interleukin 2
RPMI 1640 medium	Lyophilized ATP Standard Solution	CXCR-3, antibody to
L-glutamine	Lyophilized ATP Substrate Solution	FACS Lysin Buffer (10X)
Penicillin/Streptomycin	Synthetic Peptides	FACS Perm II (10X)
Trypan Blue Solution	Trypsin	Propidium Iodide
Hank's Balanced Salt Solution	Anti-hCD3 g antibody	Origen Freezing medium
DEPC-treated Water	DNA Quality Control particles	Isopropanol
Ficoll-Paque Plus	CaliBRITE 3 beads	Dynabeads CD3/CD28 T Cell expander
PHA Stock solution (1 mg/mL)	BD Multi-Check Control	SPOR-KLENZ cleaning solution
Concanavalin A (Con A)	Phosphate Buffered Saline (10X)	Glacial Acetic Acid
ATP Lite Kit	Ultra bleach	CD-3 antibody
Mitomycin C Stock solution (0.5 mg/mL)	Albumin (Bovine)	CD-4 antibody
Formaldehyde	Deoxyribonuclease I	CD-8 antibody
Ethylenediaminetetraacetic acid	Cell Mab Medium	CD-11b antibody
Sporicidin cleaning solution	Brefeldin A	CD-14 antibody
Sodium azide	Dimethylsulfoxide	CD-15 antibody
Flow check Fluorospheres	FACS Rinse	CD-19 antibody
Click's medium	FACS Clean	CD-20 antibody
Cell Genix Dendritic Cell Medium	FACS Flow	CD-25 antibody
Gamma Interferon Secretion Assay	Sodium dodecyl sulfate	CD-45 antibody
Annexin V-FITC Apoptosis Detection Kit	Sodium Chloride	CD-69 antibody
BrdU Flow Kit	TCR antibody	CD-80 antibody
FITC-conjugated Antibody set	Gamma Interferon antibody	CD-86 antibody
2-mercaptoethanol	Thymidine -H ³	CD34 antibody

Manufacturing & Production Laboratory

Ficoll-Paque Plus	Peptide #1 (MBP - Myelin Basic Protein)	Trypan Blue
HEPES Buffer	Peptide #2 (MBP - Myelin Basic Protein)	Phytohemagglutinin
AIM-V Medium	Peptide #3 (PLP - Proteolipid Protein)	Isopropanol
RPMI 1640 Medium	Peptide #4 (PLP - Proteolipid Protein)	SPOR-KLENZ
Dimethylsulfoxide	Peptide #6 (MOG - Myelin Oligodendrocyte Glycoprotein)	Sporicidin
Hank's Balanced Salt Solution	Peptide #7 (MOG - Myelin Oligodendrocyte Glycoprotein)	Bleach
Human AB Serum	Drierite	Glacial Acetic Acid
Origen Freezing Medium	Proleukin, recombinant human interleukin 2	L-Glutamine
Sodium Chloride	Sterile water	

Quality Control Laboratories

Trypticase Soy Agar with 5% Sheep's Blood	BBL McFarland Standard No. 0.5	Omni Pur Tris-EDTA Buffer Solution
Thioglycollate Medium	BACTEC PEDS Plus/F	100 bp DNA Ladder (50 ug/mL)
Tryptic Soy Broth	Tris-Acetate-EDTA (TAE) 10X Buffer	DEPC-treated Water
Sabouraud-Dextrose Agar	Gram Stain Kit: Crystal Violet	Nuclease Free Water
DNA Gel Loading Buffer	Gram Stain Kit: Grams Iodine	Hank's Balanced Salt Solution
Anaero-Indicator	Gram Stain Kit: Decolorizer	DNA-Zap (Solution 1 and Solution 2)
Lymphoprep	Gram Stain Kit: Safranin Stain	Septihol
Endotoxin (Escherichia coli) Control Standard	Saline 0.85% Solution	Ultraclean DNA BloodSpin Kit (50 purifications)
Pyrotubes Depyrogenated Reaction Tubes (Sample)	Pack-Anaero	Proteinase K
Pyrotubes Depyrogenated Reaction Tubes (Dilution)	Mycoplasma Detection Kit (Version 2.0)	LAL Reagent Water (LRW)
QualiSwab - Streptococcus pyogenes	Mycoplasma Detection Kit: M. pirum DNA	Methylene Blue Chloride
Bactrol Plus - Escherichia coli ATCC# 25922	Mycoplasma Detection Kit: A. laidlawii DNA	Ethidium Bromide
Bactrol Plus - Staphylococcus aureus ATCC# 25923	Mycoplasma Detection Kit: Lysis solution	667 Polaroid Film
Bactrol Plus - Candida albicans ATCC# 14053	Mycoplasma Detection Kit: 1st Stage Primer	RNase Away
NovaTaq PCR Kit: 25 mm MgCL2	Mycoplasma Detection Kit: 2nd Stage Primer	Parafilm
NovaTaq PCR Kit: PCR grade water	Mycoplasma Detection Kit: 1.1 X Taq Polymerase Buffer	Bleach EZ Starter Kit
NovaTaq PCR Kit: 10 mm dNTP Mix	Platinum Taq DNA Polymerase (5 units/uL; 250 reactions)	Agarose
NovaTaq PCR Kit: NovaTaq DNA Polymerase (5 u/uL)	Mycoplasma Plus PCR Primer Set	TAP (Thermal Activated) DNA polymerase (sample pack)
Limulus Amebocyte Lysate (LAL) Pyrotell Multitest vials	Limulus Amebocyte Lysate (LAL) Pyrotell Single Test vials	

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT**

I, David B. McWilliams, certify that:

1. I have reviewed this annual report on Form 10-KSB of PharmaFrontiers Corp. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 (e) and 15d-15(e)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DAVID B. MCWILLIAMS

David B. McWilliams

President and Chief Executive Officer

Date: March 31, 2006

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT**

I, C. William Rouse, certify that:

1. I have reviewed this annual report on Form 10-KSB of PharmaFrontiers Corp. (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ C. WILLIAM ROUSE

C. William Rouse
Chief Financial Officer and Principal Accounting Officer

Date: March 31, 2006

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350, the undersigned Officer of PharmaFrontiers Corp. (the “Company”), hereby certifies, to such officer’s knowledge, that the Company’s Annual Report on Form 10-KSB for the year ended December 31, 2005 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ DAVID B. MCWILLIAMS

David B. McWilliams

President and Chief Executive Officer

Date: March 31, 2006

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350, the undersigned Officer of PharmaFrontiers Corp. (the “Company”), hereby certifies, to such officer’s knowledge, that the Company’s Annual Report on Form 10-KSB for the year ended December 31, 2005 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ C. WILLIAM ROUSE

C. William Rouse

Chief Financial Officer and Principal Accounting Officer

Date: March 31, 2006