

OXIS INTERNATIONAL

PROSPECTUS SUPPLEMENT NO. 5 DATED August 15, 2006

TO THE PROSPECTUS DATED APRIL 12, 2006

This Prospectus Supplement No. 5 supplements our Prospectus dated April 12, 2006 with the following attached documents:

- A. Form 10-QSB Quarterly Report dated August 14, 2006

The attached information modifies and supersedes, in part, the information in the prospectus. Any information that is modified or superseded in the prospectus shall not be deemed to constitute a part of the Prospectus except as modified or superseded by this Prospectus Supplement.

This Prospectus Supplement No. 5 should be read in conjunction with Prospectus Supplement No. 1, Prospectus Supplement No. 2, Prospectus Supplement No. 3, Prospectus Supplement No. 4 and the Prospectus, each of which are required to be delivered with this Prospectus Supplement.

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INVESTING IN OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK.  
SEE "RISK FACTORS" BEGINNING ON PAGE 4 OF THE PROSPECTUS, AS  
SUPPLEMENTED BY THIS PROSPECTUS SUPPLEMENT.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE  
SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE  
SECURITIES OR DETERMINED IF THIS PROSPECTUS SUPPLEMENT IS  
TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A  
CRIMINAL OFFENSE.

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The date of this prospectus supplement is August 15, 2006.

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INDEX TO FILINGS

**U. S. SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

**FORM 10-QSB**

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2006

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_ to \_

Commission File Number 0-8092



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

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**94-1620407**  
(I.R.S. employer  
identification number)

**323 Vintage Park Drive, Suite B, Foster City, CA 94404**

(Address of principal executive offices and zip code)

**(650) 212-2568**

(Registrant's telephone number, including area code)

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

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

At August 11, 2006, the issuer had outstanding the indicated number of shares of common stock: 43,066,985.

Transitional Small Business Disclosure Format YES  NO

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**OXIS International, Inc.**  
**Form 10-QSB**  
**For the Quarter Ended June 30, 2006**  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

OXIS INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEETS

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 461,000	\$ 614,000
Accounts receivable, net	930,000	865,000
Inventories, net	623,000	650,000
Prepaid expenses and other current assets	121,000	238,000
Deferred tax assets	13,000	14,000
Restricted cash	3,060,000	3,060,000
Total current assets	<u>5,208,000</u>	<u>5,441,000</u>
Property, plant and equipment, net	259,000	243,000
Patents, net	815,000	831,000
Goodwill and other assets	1,299,000	1,291,000
	<u>\$ 7,581,000</u>	<u>\$ 7,806,000</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	778,000	\$ 505,000
Accrued expenses	375,000	468,000
Accounts payable to related party	129,000	194,000
Notes payable to related party	200,000	—
Notes payable	3,460,000	3,060,000
Total current liabilities	<u>4,942,000</u>	<u>4,227,000</u>
Long-term deferred taxes	41,000	41,000
Total liabilities	<u>4,983,000</u>	<u>4,268,000</u>
Minority interest in subsidiary	690,000	604,000
Shareholders' equity:		
Convertible preferred stock - \$0.01 par value; 15,000,000 shares authorized; Series C - 96,230 shares issued and outstanding	1,000	1,000
Common stock- \$0.001 par value; 95,000,000 shares authorized; 42,988,547 and 42,538,397 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	43,000	43,000
Additional paid-in capital	68,929,000	68,686,000
Accumulated deficit	(66,648,000)	(65,379,000)
Accumulated other comprehensive loss	(417,000)	(417,000)
Total shareholders' equity	<u>1,908,000</u>	<u>2,934,000</u>
	<u>\$ 7,581,000</u>	<u>\$ 7,806,000</u>

See accompanying condensed notes to consolidated financial statements.

**OXIS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Product revenues	\$ 1,356,000	\$ 555,000	\$ 2,869,000	\$ 1,186,000
Cost of product revenues	833,000	287,000	1,649,000	573,000
Gross profit	523,000	268,000	1,220,000	613,000
Operating expenses:				
Research and development	178,000	60,000	391,000	122,000
Selling, general and administrative	837,000	545,000	1,901,000	1,081,000
Total operating expenses	1,015,000	605,000	2,292,000	1,203,000
Loss from operations	(492,000)	(337,000)	(1,072,000)	(590,000)
Other income (expenses):				
Interest income	11,000	44,000	31,000	52,000
Other income	2,000	—	2,000	—
Interest expense	(28,000)	(7,000)	(55,000)	(11,000)
Total other income (expenses)	(15,000)	37,000	(22,000)	41,000
Allocation to minority interest in subsidiary	(36,000)	—	(86,000)	
Loss before provision for income taxes	(543,000)	(300,000)	(1,180,000)	(549,000)
Provision for income taxes	36,000	—	89,000	—
Net loss	\$ (579,000)	\$ (300,000)	\$ (1,269,000)	\$ (549,000)
Net loss per share - basic and diluted	\$ (0.01)	\$ (0.01)	\$ (0.03)	\$ (0.01)
Weighted average shares outstanding - basic and diluted	42,621,928	42,241,523	42,580,393	41,935,199

See accompanying condensed notes to consolidated financial statements.

**OXIS INTERNATIONAL, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (1,269,000)	\$ (549,000)
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Depreciation of property, plant and equipment	38,000	14,000
Amortization of intangible assets	64,000	24,000
Share-based compensation expense	180,000	8,000
Minority interest in subsidiary	86,000	—
<b>Changes in assets and liabilities:</b>		
Accounts receivable	(65,000)	(43,000)
Inventories	27,000	(51,000)
Prepaid expenses and other current assets	117,000	(28,000)
Deferred tax asset	1,000	—
Other assets	(8,000)	—
Accounts payable	241,000	(92,000)
Accrued expenses	(93,000)	(412,000)
Accounts payable to related party	(65,000)	—
Net cash used in operating activities	<u>(746,000)</u>	<u>(1,129,000)</u>
<b>Cash flows from investing activities:</b>		
Investment in restricted certificate of deposit	(3,060,000)	—
Purchases of property, plant and equipment	(38,000)	(6,000)
Increase in patents	(32,000)	(131,000)
Proceeds from restricted certificate of deposit	3,060,000	—
Net cash used in investing activities	<u>(70,000)</u>	<u>(137,000)</u>
<b>Cash flows from financing activities:</b>		
Collection of private placement proceeds receivable, net of registration statement costs	—	1,958,000
Issuance of common stock	—	239,000
Proceeds from exercise of stock options	63,000	34,000
Proceeds from short-term borrowing	3,660,000	—
Repayment of short-term borrowings	(3,060,000)	(1,200,000)
Net cash provided by financing activities	<u>663,000</u>	<u>1,031,000</u>
Net decrease in cash and cash equivalents	(153,000)	(235,000)
Cash and cash equivalents - beginning of period	614,000	4,687,000
Cash and cash equivalents - end of period	<u>\$ 461,000</u>	<u>\$ 4,452,000</u>

See accompanying condensed notes to consolidated financial statements.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**June 30, 2006**

**1. The Company and Summary of Significant Accounting Policies**

OXIS International, Inc. with its subsidiaries (collectively, "OXIS" or the "Company") is a clinical diagnostics company engaged in the development of clinical and research assays, diagnostics, nutraceutical and therapeutic products, which include new technologies applicable to conditions and diseases associated with oxidative stress. OXIS derives its revenues primarily from sales of research diagnostic assays to research laboratories. The Company's diagnostic products include five cardiac marker assays and 25 research assays to measure markers of oxidative and nitrosative stress.

In 1965, the corporate predecessor of OXIS, Diagnostic Data, Inc., was incorporated in the State of California. Diagnostic Data changed its incorporation to the State of Delaware in 1972 and changed its name to DDI Pharmaceuticals, Inc. in 1985. In 1994, DDI Pharmaceuticals merged with International BioClinical, Inc. and Bioxytech S.A. and changed its name to OXIS International, Inc. The Company's principal executive offices were relocated to Foster City, California from Portland, Oregon on February 15, 2006.

On September 19, 2005, the Company entered into a stock purchase agreement with BioCheck, Inc. ("BioCheck") and certain stockholders of BioCheck to purchase all of the common stock of BioCheck for \$6.0 million in cash. On December 6, 2005, the Company purchased 51% of the common stock of BioCheck from each of the shareholders of BioCheck on a pro rata basis, for \$3,060,000 in cash. The consolidated statements of operations for the three and six months ended June 30, 2006 include the results of operations of BioCheck and the consolidated balance sheets at December 31, 2005 and June 30, 2006 include the assets and liabilities of BioCheck.

The Company incurred net losses of \$1.3 million in the six months ended June 30, 2006 and \$3.1 million in 2005. The Company began expensing stock options effective January 1, 2006 in accordance with the Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payments" ("SFAS 123R"). The Company is also seeking debt financing that may have related warrants. Non-cash financing charges resulting from such financing and the additional non-cash charges related to stock options may delay profitability. The Company's plan is to increase revenues to generate sufficient gross profit in excess of selling, general and administrative, and research and development expenses in order to achieve profitability. However, the Company cannot provide assurances that it will accomplish this task and there are many factors that may prevent the Company from reaching its goal of profitability.

On a consolidated basis, the Company had cash and cash equivalents of \$461,000 at June 30, 2006 of which \$441,000 was held by BioCheck. Since BioCheck has been and is expected to continue to be cash flow positive, management believes that its cash will be sufficient to sustain its operating activities.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

The OXIS parent company had cash and cash equivalents of \$20,000 at June 30, 2006. OXIS cannot access the cash held by its majority-held subsidiary, BioCheck, to pay for the corporate purposes of the OXIS parent company. The Company incurred negative operating cash flows of \$0.7 million during the six months ended June 30, 2006 and \$2.1 million during 2005. The current rate of cash usage raises substantial doubt about the OXIS parent Company's ability to continue as a going concern, absent any new sources of significant cash flows. In an effort to mitigate this near-term concern, the Company is seeking debt and equity financings to obtain sufficient funds to sustain operations, implement its marketing campaign and purchase the remaining 49% of BioCheck for approximately \$3.0 million. The Company plans to increase revenues by executing its marketing campaign and introducing new products. However, the Company cannot provide assurances that it will successfully obtain debt or equity financing, if any, sufficient to finance its goals or that the Company will increase product related revenues. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

*Basis of Presentation*

The consolidated financial statements have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission regarding interim financial information. Accordingly, these financial statements and notes thereto do not include certain disclosures normally associated with financial statements prepared in accordance with accounting principles generally accepted in the United States of America. This interim financial information should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2005 included in the Company's Annual Report on Form 10-KSB.

The consolidated financial statements include the accounts of OXIS International, Inc. and its subsidiaries. All intercompany balances and transactions have been eliminated. On December 6, 2005, the Company purchased 51% of the common stock of BioCheck. The consolidated statements of operations for the three and six months ended June 30, 2006 include the results of operations of BioCheck and the consolidated balance sheets include the assets and liabilities of BioCheck at December 31, 2005 and June 30, 2006. BioCheck's revenues and expenses are not included in the consolidated statements of operations for the three and six months ended June 30, 2005 because those results of operations were incurred before the December 6, 2005 date of acquisition. In the opinion of the Company's management, the consolidated financial statements include all adjustments (consisting of only normal recurring adjustments) and disclosures considered necessary for a fair presentation of the results of the interim periods presented. This interim financial information is not necessarily indicative of the results of any future interim periods or for the Company's full year ending December 31, 2006.

*Segment Reporting*

The Company operates in one reportable segment.



**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

*Restricted Cash*

The Company invested \$3,060,000 of cash into a 30-day certificate of deposit at KeyBank, N.A. ("KeyBank") and entered into a \$3,060,000 non-revolving one-year loan agreement with KeyBank on December 2, 2005 for the purpose of completing the initial closing of the BioCheck acquisition. The Company granted a security interest in its \$3,060,000 certificate of deposit to KeyBank under the loan agreement. The \$3,060,000 loan with KeyBank was repaid during February 2006 and a new one-year loan agreement for \$3,060,000 was entered into at Bridge Bank, N.A. ("Bridge Bank"). As part of the loan arrangement with Bridge Bank, the Company granted a security interest in a \$3,060,000 certificate of deposit transferred from KeyBank to Bridge Bank. The certificate of deposit bears interest at 1.0%. Consequently, these certificates of deposit were classified as restricted cash on the consolidated balance sheets at June 30, 2006 and December 31, 2005 as the cash is restricted as to use.

*Share-Based Compensation*

The Company has historically accounted for stock options granted to employees and directors and other share-based employee compensation plans using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations. As such, the Company recognized compensation expense for stock options only if the quoted market value of the Company's common stock exceeded the exercise price of the option on the grant date. Any compensation expense realized using this intrinsic value method is being amortized over the vesting period of the option.

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS 123R which requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date (with limited exceptions). That cost will be recognized in the entity's financial statements over the period during which the employee is required to provide services in exchange for the award.

Management implemented SFAS 123R effective January 1, 2006, using the modified prospective application method. Under the modified prospective application method, SFAS 123R applies to new awards and to awards modified, repurchased or cancelled after January 1, 2006. Additionally, compensation costs for the portion of awards for which the requisite service has not been rendered that are outstanding as of January 1, 2006 are recognized as the requisite service is rendered on or after January 1, 2006. The compensation cost for that portion of awards is based on the grant-date fair value of those awards as calculated for proforma disclosures under Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). The compensation cost for awards issued prior to January 1, 2006 attributed to services performed in years after January 1, 2006 uses the attribution method applied prior to January 1, 2006 according to SFAS 123, except that the method of recognizing forfeitures only as they occur was not continued.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

The recognition of share-based employee compensation costs during 2006 had no related tax effect since the Company provides a valuation allowance equal to its net deferred tax assets. The adoption of SFAS 123R had no effect on cash flow from operations, cash flow from financing activities and basic and diluted earnings per share. The effect of adoption of SFAS 123R on the results of operations for the six months ended June 30, 2006 was:

	<b>Loss from Operations</b>	<b>Loss Before Provision for Income Taxes</b>	<b>Net Loss</b>
Results as reported	\$ (1,072,000)	\$ (1,180,000)	\$ (1,269,000)
Additional compensation expense - effect of adoption of SFAS 123R	131,000	131,000	131,000
Proforma results applying the original provisions of SFAS 123 using the intrinsic value method of APB 25	<u>\$ (941,000)</u>	<u>\$ (1,049,000)</u>	<u>\$ (1,138,000)</u>

The following table presents the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS 123 to share-based awards to employees prior to January 1, 2006:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net loss as reported	\$ (579,000)	\$ (300,000)	\$ (1,269,000)	\$ (549,000)
Share-based employee compensation expense included in reported net loss	60,000	—	131,000	—
Share-based employee compensation expense that would have been included in net income if the fair value method had been applied to all awards	(60,000)	(41,000)	(131,000)	(89,000)
Pro forma net loss	<u>\$ (579,000)</u>	<u>\$ (341,000)</u>	<u>\$ (1,269,000)</u>	<u>\$ (638,000)</u>
Net loss per share:				
Basic and diluted - as reported	\$ (0.01)	\$ (0.01)	\$ (0.03)	\$ (0.01)
Basic and diluted - pro forma	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>

The Company undertook a comprehensive study of options issued from 1994 through 2001 to determine historical patterns of options being exercised and forfeited. The results of this study were used as a source to estimate expected life and forfeiture rates. The new estimated life of 4.45 years was applied only to determine the fair value of awards issued after January 1, 2006. The estimated forfeiture rate of 40% was applied to all awards that vested after January 1, 2006, including awards issued prior to that date, to determine awards expected to be exercised.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

The Company issued no options to employees and directors during the three months ended June 30, 2006. The Company issued options to purchase 15,000 shares of the Company's common stock to employees and directors during the three months ended June 30, 2005, and options to purchase 280,000 and 615,000 shares of the Company's common stock during the six months ended June 30, 2006 and 2005, respectively. The fair values of employee stock options are estimated for the calculation of employee compensation expense in 2006 and the pro forma adjustments in 2005 in the above table at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions during 2006 and 2005: expected volatility of 90% and 170%, respectively; average risk-free interest rate of 4.45% and 4.00%, respectively; initial expected life of 4.45 years and 6 years, respectively; no expected dividend yield; and amortization over the vesting period of typically one to four years.

Stock options issued to non-employees as consideration for services provided to the Company have been accounted for under the fair value method in accordance with SFAS 123 and Emerging Issues Task Force No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," which requires that compensation expense be recognized for all such options. The Company issued options to purchase 50,000 shares of the Company's common stock to non-employees and a warrant to purchase 108,000 shares of the Company's common stock under a warrant to a director under a consulting agreement during the three and six months ended June 30, 2006. The Company issued no options to non-employees during the six months ended June 30, 2005.

*Net Loss Per Share*

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period, plus the potential dilutive effect of common shares issuable upon exercise or conversion of outstanding stock options and warrants during the period. The weighted average number of potentially dilutive common shares were 975,052 and 908,665 for the three months ended June 30, 2006 and 2005, respectively, and 781,559 and 1,041,575 for the six months ended June 30, 2006 and 2005, respectively. These shares were excluded from net diluted loss per share because of their anti-dilutive effect.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

*Recent Accounting Pronouncements*

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" ("SFAS No. 156"). SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations: a transfer of the servicer's financial assets that meets the requirements for sale accounting; a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities; or an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates. SFAS No. 156 also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable and permits an entity to choose either the amortization or fair value method for subsequent measurement of each class of servicing assets and liabilities. SFAS No. 156 further permits, at its initial adoption, a one-time reclassification of available for sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available for sale securities under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities", provided that the available for sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective for fiscal years beginning after September 15, 2006, with early adoption permitted as of the beginning of an entity's fiscal year. Management believes the adoption of SFAS No. 156 will have no impact on the Company's financial condition or results of operations.

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments, an Amendment of FASB Standards No. 133 and 140" ("SFAS No. 155"). SFAS No. 155 established the accounting for certain derivatives embedded in other instruments. It simplifies accounting for certain hybrid financial instruments by permitting fair value remeasurement for any hybrid instrument that contains an embedded derivative that otherwise would require bifurcation under Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" as well as eliminating a restriction on the passive derivative instruments that a qualifying special-purpose entity ("SPE") may hold under Statement of Financial Accounting Standards No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS No. 140"). SFAS No. 155 allows a public entity to irrevocably elect to initially and subsequently measure a hybrid instrument that would be required to be separated into a host contract and derivative in its entirety at fair value (with changes in fair value recognized in earnings) so long as that instrument is not designated as a hedging instrument pursuant to the statement. SFAS No. 140 previously prohibited a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for fiscal years beginning after September 15, 2006, with early adoption permitted as of the beginning of an entity's fiscal year. Management believes the adoption of SFAS No. 155 will have no impact on the Company's financial condition or results of operations.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 to have a material impact on our financial reporting, and the Company is currently evaluating the impact, if any, the adoption of FIN 48 will have on our disclosure requirements.

## **2. Acquisition of BioCheck**

On September 19, 2005, the Company entered into a stock purchase agreement with BioCheck and certain stockholders of BioCheck to purchase all of the common stock of BioCheck for \$6.0 million in cash. BioCheck is a privately held California corporation engaged in the development of immunoassays, with a number of clinical diagnostic tests that have been approved by the United States Food and Drug Administration. On December 6, 2005, the Company purchased 51% of the common stock of BioCheck from each of the shareholders of BioCheck on a pro rata basis, for \$3,060,000 in cash. This acquisition was accounted for by the purchase method of accounting according to Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS No. 141").

Pursuant to the stock purchase agreement, OXIS will use its reasonable best efforts to consummate a follow-on financing transaction to raise additional capital with which to purchase the remaining outstanding shares of BioCheck in one or more additional closings. The purchase price for any BioCheck shares purchased after the initial closing will be increased by an additional 8% per annum from December 6, 2005. If OXIS has not purchased all of the outstanding shares of BioCheck within twelve months of December 6, 2005, the earnings before interest, taxes, depreciation and amortization expenses, if any, of BioCheck, will be used to repurchase the remaining outstanding BioCheck shares at one or more additional closings. The purchase of the remaining outstanding shares of BioCheck will be accounted for the same as the initial purchase of 51% of BioCheck using the purchase method of accounting according to SFAS No. 141. The additional purchase price will be allocated over the purchased assets of BioCheck and the consolidated statements of operations will continue to include the results of operations of BioCheck reduced by the minority interest, if any, in BioCheck. The Company may obtain additional independent valuations of BioCheck's assets related to the acquisition of the remaining 49% of BioCheck and additional acquisition costs may be incurred. Such information and costs may affect the disclosures as presented herein.

On June 23, 2006, OXIS entered into a mutual services agreement with BioCheck. Each of OXIS and BioCheck will provide certain services to the other corporation to be charged monthly at an hourly rate with an overhead surcharge. The services that BioCheck will provide include manufacturing the bulk of OXIS' research assay test kits, assisting in packaging and shipping such research assay test kits to OXIS customers, and undertaking research and development of certain new OXIS research assay test kits on a case-by-case basis to be agreed upon between the parties. OXIS will provide services to BioCheck, including marketing and sales, website management and materials requirement and control systems.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

The agreement terminates on December 6, 2009, or earlier upon mutual consent of the parties, upon 90 day prior written notice by either party, by either party if a monthly billing is unpaid after 60 days if a 15 day notice and opportunity to cure has been provided, or upon a material breach of the Agreement after 30 days' notice and opportunity to cure the breach.

**3. Notes Payable**

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Note payable to KeyBank, N.A.	\$ —	\$ 3,060,000
Note payable to Bridge Bank, N.A.	3,060,000	—
Note payable to the Company's President & CEO	200,000	—
Note payable to Fagan Capital, Inc.	400,000	—
<b>Total notes payable</b>	<b>\$ 3,660,000</b>	<b>\$ 3,060,000</b>

On December 2, 2005, the Company entered into non-revolving one-year loan agreement with KeyBank in the amount of \$3,060,000, for the purpose of completing the initial closing of the BioCheck acquisition. The Company granted a security interest in its \$3,060,000 certificate of deposit at KeyBank under the loan agreement. The loan bore interest at an annual rate that was 2.0% greater than the interest rate on the certificate of deposit. The Company's \$3,060,000 loan with KeyBank was repaid during February 2006 and a new one-year loan agreement was entered into with Bridge Bank. The Company has granted a security interest in its \$3,060,000 certificate of deposit transferred from KeyBank to Bridge Bank. The loan bears interest at 3.0% and the certificate of deposit bears interest at 1.0%.

On March 10, 2006, the Company received \$200,000 in exchange for an unsecured promissory note with the Company's president and chief executive officer. The related party note bears interest at 7.0%. Interest and principal are due on September 10, 2006 or, at the option of the holder, on the date the Company receives net proceeds in the amount of \$500,000 or more from a debt or equity financing. In addition, if, at any time on or before the maturity date, the Company enters into an agreement to incur debt, the holder has the right to rollover this note into such debt arrangement, on the same terms and conditions offered to such future lenders. The purpose of this loan was to provide the Company with short term financing as it seeks longer term financing.

On March 31, 2006, the Company entered into a \$400,000 unsecured promissory note with Fagan Capital, Inc. ("Fagan Capital"). Interest accrues at an annual rate of 8.0% and interest and principal were initially due on June 2, 2006. On July 26, 2006, Fagan Capital extended the maturity date of the promissory note to June 1, 2007 and the Company issued to Fagan Capital a warrant to purchase 1,158,857 shares of common stock at an initial exercise price of \$0.35 per share. See Note 7. The obligation to pay all unpaid principal and accrued interest will be accelerated upon an event of default, including failure to pay debt when due in an amount exceeding \$200,000, the bankruptcy of the Company or related events. The Company covenants that it will not incur indebtedness, other than its current Bridge Bank loan and normal course trade debt, in excess of \$1 million. The Company also covenants that it will not pledge, grant or convey any new liens on the Company's assets. The purpose of this loan was to provide the Company with short term financing as it seeks longer term financing.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

**4. Supplemental Cash Flow Disclosures**

The Company recognized non-cash compensation expense of \$49,000 and \$8,000 related to the issuance and vesting of stock options issued to consultants in the six months ended June 30, 2006 and 2005, respectively. The Company recognized non-cash compensation expense of \$131,000 related to the issuance and vesting of stock options issued to employees in the six months ended June 30, 2006. No employee non-cash compensation expense was recognized in the six months ended June 30, 2005 prior to the implementation of SFAS 123R. Cash interest paid was \$58,000 and \$11,000 in the six months ended June 30, 2006 and 2005, respectively.

**5. Relocation of Operations**

On December 6, 2005, the Company committed itself to a plan to cease operations in Portland, Oregon and relocate operations to Foster City, California (the "Relocation"). The Company decided to effect the Relocation after reviewing and evaluating all aspects of the Company's operations to determine the profitability and viability of continuing in the Portland, Oregon location. During the first quarter of 2006, operations were relocated to California and on February 15, 2006 the Portland, Oregon facility was closed with the termination of employment of all Portland based employees who did not relocate to California. The Company's subsidiary, BioCheck, has commenced shipping of the Company's products and is manufacturing all of its research assay kit products not manufactured by third party suppliers.

In connection with the Relocation, the Company accrued \$119,000 during 2005 for employee severances offered to all regular full-time employees who were not relocated to Foster City, California. Of this amount, \$78,000 was paid during the first half of 2006, resulting in \$41,000 of accrued expenses at June 30, 2006. The Company expects \$33,000 of this amount to be paid during the remainder of 2006 and \$8,000 is to be paid during 2007. The Company accrues for these benefits in the period when benefits are communicated to the terminated employees. Typically, terminated employees are not required to provide continued service to receive termination benefits. In general, the Company uses a formula based on the number of years of service to calculate the termination benefits to be provided to affected employees.

In connection with the Relocation, the Company signed a lease agreement to occupy 4,136 square feet of space adjacent to space occupied by its BioCheck subsidiary in Foster City, California. The lease commenced on April 1, 2006 at an annual base rent of \$62,000 per year that increases incrementally to \$66,000 by the end of the lease term on March 31, 2009. In addition to the base rent, the Company will be responsible for its proportionate share of the building's operating expenses and real estate taxes. The Company has a renewal option to extend the lease for one three-year period at the prevailing market rental value for rentable property in the same area.

**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

**6. Related Party Transactions**

BioCheck and EverNew Biotech, Inc., a California corporation (“EverNew”), entered into a services agreement dated December 6, 2005 (the “Services Agreement”). The holders of the shares of capital stock of EverNew are substantially the same set of individuals and entities who held BioCheck’s common stock immediately prior to the initial closing of OXIS’ acquisition of BioCheck, including Dr. John Chen, President of BioCheck, as a significant shareholder. EverNew is an emerging point-of-care diagnostics company, with a number of products in development. EverNew renders certain services to BioCheck, including assay research and development work, and BioCheck renders certain administrative services to EverNew. In consideration of services provided by EverNew, BioCheck agreed to pay to EverNew \$12,000 per month, provided, however, if the sum of EverNew’s gross revenues for a consecutive three month period during the term of the Services Agreement equals or exceeds \$100,000, then BioCheck shall no longer be obligated to pay EverNew any amounts for the remainder of the term of the Services Agreement. Further, in such event, EverNew shall pay BioCheck an amount equal to the EverNew Service Cost per month for the remainder of the term of the Services Agreement, and the EverNew Service Cost for such month shall be reduced by the amount of the BioCheck compensation paid to BioCheck for such month under the Services Agreement. As used in the Services Agreement, EverNew Service Cost means the cost of all BioCheck Services provided by BioCheck each month under the Services Agreement, as incurred and determined in good faith by BioCheck. Amounts due to EverNew from BioCheck were \$129,000 and \$194,000 at June 30, 2006 and December 31, 2005, respectively.

**7. Subsequent Events**

On July 26, 2006, Fagan Capital extended the maturity date of the \$400,000 promissory note, as described in Note 3, which was originally issued on March 31, 2006 by entering into a renewal and modification promissory note (“Renewal Note”). The Renewal Note has a principal amount of \$405,600, comprised of the principal amount of the original promissory note plus accrued interest of \$5,600. The effective date of the Renewal Note is June 2, 2006. No payments of interest or principal are required prior to the maturity date of June 1, 2007. The obligation to pay all unpaid principal and accrued interest will be accelerated upon an event of default, including, after October 31, 2006, failure to pay debt when due in an amount exceeding \$300,000, or at any time, the bankruptcy of OXIS or related events. The Company further agreed that, after October 31, 2006, it will not incur indebtedness, other than its current Bridge Bank loan and normal course trade debt, in excess of \$1 million, and that it will not pledge, grant or convey any new liens on its assets. The purpose of this loan was to provide the Company with intermediate term financing as it seeks longer term financing.

In conjunction with the issuance of the Renewal Note, on July 26, 2006 the Company issued to Fagan Capital a common stock purchase warrant to purchase 1,158,857 shares of common stock at an initial exercise price of \$0.35 per share. The exercise price is adjustable pursuant to certain anti-dilution provisions and upon the occurrence of a stock split. The common stock purchase warrant has an effective date of June 2, 2006 and expires on June 1, 2014. The parties are negotiating the terms of a registration rights agreement covering the shares underlying the common stock purchase warrant. This warrant will be valued using the Black-Scholes option-pricing model and that amount will be expensed over the life of the loan as of the date of the agreement.

On July 20, 2006, the Company entered into an amendment to the exclusive license and supply agreement originally signed on September 28, 2004 with HaptoGuard, Inc. (“HaptoGuard”). The Company granted HaptoGuard three-month extensions to fulfill its obligation to begin Phase II clinical trials with a licensed product. HaptoGuard may obtain three such extensions upon payment of \$50,000 for each extension. In addition, the Company agreed to change the timeline for initiation of Phase IIb clinical trials with a licensed product under the license agreement and agreed to allow the same extension arrangement for that milestone. The Company has received a \$50,000 payment from HaptoGuard on July 24, 2006 for the first extension ending on September 30, 2006.



**OXIS INTERNATIONAL, INC.**  
**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**June 30, 2006**

**Item 2. Management's Discussion and Analysis or Plan of Operation.**

***Statement Regarding Forward-Looking Statements***

*The statements contained in this Report on Form 10-QSB that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act, including, without limitation, statements regarding our expectations, objectives, anticipations, plans, hopes, beliefs, intentions or strategies regarding the future. Forward-looking statements include, without limitation, statements regarding:*

*(1) our plan to increase revenues to generate sufficient gross profit in excess of selling, general and administrative, and research and development expenses in order to achieve profitability; (2) our expectation that BioCheck will continue to be cash flow positive, and that its cash will be sufficient to sustain its operating activities; (3) our intention to seek additional loan and equity financings to obtain sufficient funds to sustain our operations, implement our marketing campaign and purchase the remaining 49% of BioCheck for approximately \$3.0 million; (4) our plan to increase revenues by our marketing campaign and the introduction of new products; (5) our belief that the adoption of certain accounting standards will have no impact on our financial condition or results of operations; (6) our expectation that \$33,000 of employee severance package expenses will be paid during the remainder of 2006 and \$8,000 will be paid during 2007; (7) our plan to pursue the development of novel cardiac markers intended to provide a more effective diagnostic predictor test for patients at risk of cardiac events before they occur, given the availability of sufficient capital resources; (8) our plan to develop the cardiac marker product through the combination of our MPO assay with other in-house assays; (9) our belief that our Ergothioneine compound may be well suited for development as a nutraceutical supplement that can be sold over the counter and our testing of Ergothioneine; (10) our intent to pursue the development of Ergothioneine for use in over-the-counter markets, given the availability of sufficient capital resources; (11) our expectation that a new myeloperoxidase research assay will be ready for commercial launch in the third quarter of 2006; (12) our expectation that the ID protein assays and reagents will be ready for commercial launch by late 2006; (13) our plan to continue to build our management team and enhance our Board of Directors during 2006; (14) our projections for 2006, which are based upon our expectations that BioCheck will incur similar revenues and costs in 2006 as it incurred in 2005; (15) our expectation that in the third quarter 2006, product revenues will increase modestly from the second quarter; (16) our intention to develop new diagnostic test kits and evaluate our product offerings, pricing and distribution network in order to increase sales volume; (17) our expectation that third quarter 2006 product costs will increase proportionally with any increases in revenues; (18) our expectation that revenues and expenses will increase substantially from 2005 to 2006 with the consolidation of all of BioCheck's results of operations during the first quarter of 2006; (19) our expectation that third quarter 2006 research and development costs will be approximately the same as the second quarter; (20) our expectation that the actual amount of research and development expenses will fluctuate with the availability of funding; (21) our expectation that third quarter 2006 selling, general and administrative expenses will be approximately the same as the second quarter; (22) our expectation that interest expense will increase during the third quarter of 2006 with the non-cash expense incurred from the issuance of a warrant in the third quarter 2006; and (23) our expectation that our cash position will not be sufficient to sustain our operations through the third quarter of 2006 without additional financing.*

*It is important to note that our actual results could differ materially from those included in such forward-looking statements due to a variety of factors including (1) failure to complete our acquisition of BioCheck or to adequately integrate the operations of the two companies; (2) failure to achieve any benefits in connection with the recent changes in management or personnel; (3) disruption in operations due to the relocation plan and reduction in workforce; (4) inability to hire employees or management; (5) failure to make payments when required under our Mutual Services Agreement with BioCheck to avoid termination; (6) failure to find alternative suppliers; (7) failure to develop or market products successfully; (8) failure to obtain necessary financing; (9) the cost of complying with regulatory requirements; (10) uncertainties exist relating to issuance, validity and ability to enforce and protect patents, other intellectual property and certain proprietary information; (11) our products may not meet product performance specifications; (12) new products may be unable to compete successfully in either existing or new markets; (13) availability and future costs of materials and other operating expenses; (14) weakness in the global economy and changing market conditions, together with general economic conditions affecting our target industries, could cause our operating results to fluctuate; (15) miscalculations in the assessment of our cash position; and (16) our failure to accurately predict the impact of the adoption of certain accounting standards. These and other factors could cause actual results to differ materially from the forward looking statements. For a detailed explanation of such risks, please see the section entitled "Factors that May Affect Future Operating Results" beginning on page 23 of this Report on Form 10-QSB. Such risks, as well as such other risks and uncertainties as are detailed in our Securities and Exchange Commission, or the SEC, reports and filings for a discussion of the factors that could cause actual results to differ materially from the forward- looking statements. Given these uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements. All forward-looking statements included in this Report on Form 10-QSB are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements.*

The following discussion of our financial condition and plan of operation should be read in conjunction with our consolidated financial statements and related notes included in this Report and our audited consolidated financial statements and related notes for the year ended December 31, 2005 included in our Annual Report on Form 10-KSB.

## **Overview**

OXIS International, Inc. develops technologies and products to research, diagnose, treat and prevent diseases of oxidative stress associated with damage from free radical and reactive oxygen species. We derive our revenues primarily from sales of research diagnostic assays to research laboratories. Our diagnostic products include approximately 30 research assays to measure markers of oxidative stress. We hold the rights to three therapeutic classes of compounds in the area of oxidative stress, and have focused our commercialization programs in clinical cardiovascular markers, including MPO (myeloperoxidase) and GPx (glutathione peroxidase), as well as a potent antioxidant, Ergothioneine, that may be appropriate for sale over-the-counter as a dietary supplement. OXIS has acquired a 51% interest in and has the option to purchase the remaining 49% of BioCheck, Inc., or BioCheck.

Our majority-held subsidiary, BioCheck, is a leading producer of clinical diagnostic assays, including high quality enzyme immunoassay research services and immunoassay kits for cardiac and tumor markers, infectious diseases, thyroid function, steroids, and fertility hormones designed to improve the accuracy, efficiency, and cost-effectiveness of *in vitro* (outside the body) diagnostic testing in clinical laboratories. BioCheck focuses primarily on the immunoassay segment of the clinical diagnostics market. BioCheck offers over 40 clinical diagnostic assays manufactured in its 15,000 square-foot, U.S. Food and Drug Administration, or FDA, certified Good Manufacturing Practices device-manufacturing facility in Foster City, California.

We incurred net losses of \$1.3 million in the six months ended June 30, 2006 and \$3.1 million in 2005. We began expensing stock options effective January 1, 2006 in accordance with the Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payments," or SFAS 123R, and we are seeking debt financing that may have related warrants. Non-cash financing charges resulting from such financing and the additional non-cash charges related to stock options may delay profitability. Our plan is to increase revenues to generate sufficient gross profit in excess of selling, general and administrative, and research and development expenses in order to achieve profitability. However, we cannot assure you that we will accomplish this task and there are many factors that may prevent us from reaching our goal of profitability.

On a consolidated basis, we had cash and cash equivalents of \$461,000 at June 30, 2006 of which \$441,000 was held by BioCheck. Since BioCheck has been and is expected to continue to be cash flow positive, management believes that its cash will be sufficient to sustain its operating activities.

The OXIS parent company had cash and cash equivalents of \$20,000 at June 30, 2006. OXIS cannot access the cash held by its majority-held subsidiary, BioCheck, to pay for the corporate purposes of the OXIS parent company. We have incurred negative operating cash flows of \$0.7 million during the first six months of 2006 and \$2.1 million during 2005. The current rate of cash usage raises substantial doubt about the OXIS parent company's ability to continue as a going concern, absent any new sources of significant cash flows. In an effort to mitigate this near-term concern, we are seeking debt and equity financings to obtain sufficient funds to sustain operations, implement our marketing campaign and purchase the remaining 49% of BioCheck for approximately \$3.0 million. We plan to increase revenues by our marketing campaign and the introduction of new products. However, we cannot assure you that we will successfully obtain debt or equity financing, if any, sufficient to finance our goals or that we will increase product related revenues as such events are subject to factors beyond our control. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event OXIS cannot continue in existence.

## **Recent Developments**

Current significant financial and operating events and strategies are summarized as follows:

### *Stockholder Approval*

On August 1, 2006, at the OXIS 2006 Annual Meeting of Stockholders, the five nominated directors were re-elected, the proposal to amend the Company's Certificate of Incorporation to increase the number of authorized shares of common stock from 95,000,000 to 150,000,000 was approved, and the proposal to increase the number of shares reserved for issuance under the OXIS 2003 Stock Incentive Plan, or the Plan, from 3,600,000 shares to 5,600,000 shares was also approved by the stockholders.

### *License Agreement Extension*

On July 20, 2006, the Company entered into an amendment to the exclusive license and supply agreement originally signed on September 28, 2004 with HaptoGuard, Inc., or HaptoGuard. The Company granted HaptoGuard three-month extensions to fulfill its obligation to begin Phase II clinical trials with a licensed product. HaptoGuard may obtain three such extensions upon payment of \$50,000 for each extension. In addition, the Company agreed to change the timeline for initiation of Phase IIb clinical trials with a licensed product under the license agreement and agreed to allow the same extension arrangement for that milestone. The Company has received a \$50,000 payment from HaptoGuard on July 24, 2006 for the first extension ending on September 30, 2006.

### *Service Agreement with Ambient Advisors LLC*

On May 12, 2006, we entered into an agreement with Ambient Advisors LLC, or Ambient Advisors. Gary M. Post, a member of the board of directors, is the manager of Ambient Advisors. Ambient Advisors will provide certain services pertaining to strategic planning, investor communications and financing strategies or other projects at the request of our chief executive officer for a one year period, and thereafter, on a month-to-month basis. Ambient Advisors compensation is \$5,000 per month and we granted Ambient Advisors a ten year warrant to purchase 108,000 shares of OXIS common stock at an exercise price of \$0.39 per share, with 9,000 shares becoming exercisable each month over the term of the agreement.

### *Acquisition of BioCheck*

On September 19, 2005, we entered into a stock purchase agreement with BioCheck and its stockholders to purchase all of its common stock for \$6.0 million in cash. BioCheck is a leading producer of enzyme immunoassay diagnostic kits for clinical laboratories. On December 6, 2005, we purchased 51% of the shares of BioCheck's common stock from each of its shareholders on a pro rata basis for \$3,060,000 in cash. This acquisition was accounted for by the purchase method of accounting according to Statement of Financial Accounting Standards No. 141, "Business Combinations." The consolidated statements of operations for the three and six months ended June 30, 2006 include the results of operations of BioCheck and the consolidated balance sheets include the assets and liabilities of BioCheck at December 31, 2005 and June 30, 2006. Pursuant to the stock purchase agreement, OXIS will use its reasonable best efforts to consummate a follow-on financing transaction to raise additional capital with which to purchase the remaining outstanding shares of BioCheck in one or more additional closings.

### *Mutual Services Agreement*

On June 23, 2006, we entered into a mutual services agreement with BioCheck. Each of OXIS and BioCheck will provide certain services to the other corporation to be charged monthly at an hourly rate with an overhead surcharge. The services that BioCheck will provide include manufacturing the bulk of OXIS' research assay test kits, assisting in packaging and shipping such research assay test kits to OXIS customers, and undertaking research and development of certain new OXIS research assay test kits on a case-by-case basis to be agreed upon between the parties. OXIS will provide services to BioCheck, including marketing and sales, website management and materials requirement and control systems.

The agreement terminates on December 6, 2009, or earlier upon mutual consent of the parties, upon 90 day prior written notice by either party, by either party if a monthly billing is unpaid after 60 days if a 15 day notice and opportunity to cure has been provided, or upon a material breach of the Agreement after 30 days' notice and opportunity to cure the breach. OXIS owes BioCheck approximately \$73,000 for services that BioCheck had provided to OXIS prior to the signing of the Agreement, on or before June 30, 2006. OXIS has not made that payment. If OXIS receives written notice of breach of the agreement due to this non-payment, it will have 15 days to cure that breach. If OXIS fails to cure the breach during the cure period, BioCheck would have the right to terminate the agreement.

#### *Product Development*

We have expanded our product portfolio of research assay kits for the cardiovascular research markets with the addition of five new assay products from BioCheck for the measurement of biomarkers of inflammation related to cardiovascular disease. Given the availability of sufficient capital resources, we plan to pursue the development of novel cardiac markers intended to provide a more effective diagnostic predictor test for patients at risk of cardiac events before they occur. We are planning to develop this product through the combination of our myeloperoxidase, or MPO, assay with other in-house assays. We also believe that our Ergothioneine compound may be well suited for development as a nutraceutical supplement that can be sold over the counter. We are currently testing Ergothioneine produced in bulk to ensure that its purity level is acceptable. Given the availability of sufficient capital resources and the successful scale-up to a bulk manufacturing process that ensures an acceptable level of purity, we intend to pursue the development of Ergothioneine for use in the over the counter market, however, there can be no assurance as to when or if we will launch Ergothioneine on a commercial basis as a nutraceutical.

BioCheck currently has several products under development for cancer, cardiac/inflammatory and angiogenesis research applications. A research assay and reagents for the detection of HMGA2, a marker for aggressive breast cancer, are under development. Myeloperoxidase is an inflammatory protein that has utility as a prognostic marker for cardiac events. A new myeloperoxidase research assay has been developed that we expect will be ready for commercial launch in the third quarter of 2006. Id proteins play a central role in cell differentiation, and Id1 and Id3 play a central and critical role in tumor related angiogenesis. BioCheck has developed research assays and rabbit monoclonal antibodies for the detection of human and mouse Id proteins. We currently expect that the Id protein assays and reagents will be ready for commercial launch by late 2006.

#### *Loans and Warrant*

The \$3,060,000 loan with KeyBank, N.A., or KeyBank, was repaid during February 2006 and a new one-year loan agreement for \$3,060,000 was entered into with Bridge Bank, National Association, or Bridge Bank. As part of the loan arrangement with Bridge Bank, we granted a security interest in a \$3,060,000 certificate of deposit transferred from KeyBank to Bridge Bank. The loan bears interest at 3.0% and the certificate of deposit bears interest at 1.0%.

On March 10, 2006, we received \$200,000 in exchange for an unsecured promissory note with Steven T. Guillen, our president and chief executive officer. The related party note bears interest at 7.0%. Interest and principal are due on September 10, 2006 or, at the option of Mr. Guillen, on the date we receive net proceeds in the amount of \$500,000 or more from a debt or equity financing. On March 31, 2006, we entered into a \$400,000 unsecured promissory note with Fagan Capital, Inc., or Fagan Capital. Interest accrues at an annual rate of 8.0% and interest and principal were due on June 2, 2006. On July 26, 2006, Fagan Capital extended the maturity date of the promissory note to June 1, 2007 and we issued to Fagan Capital a warrant to purchase 1,158,857 shares of common stock at an initial exercise price of \$0.35 per share. See Note 7 to the unaudited consolidated financial statements included in this Report. The purpose of these loans was to provide us with short term financing as we seek longer term financing.

#### *Relocation of Operations*

On December 6, 2005, we initiated a relocation plan to cease our operations in Portland, Oregon and relocate to Foster City, California. We decided to relocate after reviewing and evaluating all aspects of our operations to determine the profitability and viability of continuing in the Portland, Oregon location. During February 2006, we signed a lease agreement for 4,136 square feet of space located immediately adjacent to those of BioCheck and relocated our manufacturing operations to Foster City, California. On February 15, 2006, we ceased operations at the Portland, Oregon facility and most of the Portland, Oregon employees were terminated. In connection with the relocation, we accrued \$119,000 during 2005 for an employee severance package offered to all regular full-time employees who were not relocated to Foster City, California. Of this amount, \$78,000 was paid during the first half of 2006, resulting in \$41,000 of accrued expenses at June 30, 2006. We expect \$33,000 of this amount to be paid during the remainder of 2006 and \$8,000 is to be paid during 2007.

#### *Management Team and Board of Directors*

During 2006, we have continued to build our management team and enhance our Board of Directors. Michael D. Centron was appointed as our Vice President and Chief Financial Officer during January 2006, replacing Marvin S. Hausman, M.D. as acting Chief Financial Officer. During February 2006, Randall Moeckli was appointed as our Senior Director of Sales and Marketing. On March 15, 2006, Gary M. Post, Managing Director of Ambient Advisors, LLC, joined our Board of Directors.

#### **Results of Operations**

We expect revenues and expenses to increase substantially as described below from 2005 to 2006 with the consolidation of all of BioCheck's results of operations during the first and second quarters of 2006. BioCheck's revenues and expenses are not included in the results of operations for the first and second quarters of 2005 because they were incurred before the December 6, 2005 date of acquisition. Our projections for 2006 are based upon our expectations that BioCheck will incur similar revenues and costs in 2006 as it incurred in 2005. We can give no assurances that we will be able to successfully merge manufacturing operations without adversely affecting revenues and costs, implement an effective marketing campaign that will increase revenues, develop new products, finance our expansion plans and purchase the remaining 49% of the BioCheck common stock we do not own.

## Revenues

The following table presents the changes in revenues from 2005 to 2006:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2006	2005	Increase from 2005		2006	2005	Increase from 2005	
Product revenues	\$ 1,356,000	\$ 555,000	\$ 801,000	144%	\$ 2,869,000	\$ 1,186,000	\$ 1,683,000	142%

For the three months ended June 30, the increase in product revenues was primarily attributable to the consolidation of \$1,014,000 of revenues from BioCheck that was partially offset by a \$213,000 decrease in sales from the OXIS parent company. For the six months ended June 30, the increase in product revenues was primarily attributable to the consolidation of \$2,076,000 of revenues from BioCheck that was partially offset by a \$393,000 decrease in sales from the OXIS parent company. The decrease in OXIS parent company sales is attributable to lower sales volume that was caused, in part, by the interruption arising from moving operations from Portland, Oregon to Foster City, California and consolidating our product offerings. We expect third quarter 2006 product revenues to increase modestly from the second quarter as we introduce new products such as our improved MPO. We intend to develop new diagnostic test kits and evaluate our product offerings, pricing and distribution network with the plan of increasing sales volume.

## Cost of product revenues

The following table presents the changes in cost of product revenues from 2005 to 2006:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2006	2005	Increase from 2005		2006	2005	Increase from 2005	
Cost of product revenues	\$ 833,000	\$ 287,000	\$ 546,000	190%	\$ 1,649,000	\$ 573,000	\$ 1,076,000	188%

For the three months ended June 30, 2006, the increase in cost of product revenues is attributable to the consolidation of \$587,000 of costs from the operations of BioCheck that were partially offset by decreased labor and related costs including contract labor of \$29,000 and facility and related costs of \$12,000. For the six months ended June 30, 2006, the increase in cost of product revenues is attributable to the consolidation of \$1,108,000 of costs from the operations of BioCheck that were partially offset by decreased labor and related costs of \$28,000 and facility and related costs of \$11,000. We expect third quarter 2006 product costs to increase proportionally with any increases in revenues.

Gross profit of \$523,000 for the three months ended June 30, 2006 was higher than the gross profit of \$268,000 in the comparable period of 2005 because of the additional profits from product sales from BioCheck. Gross profit as a percentage of revenues was 39% in the three months ended June 30, 2006, as compared to 48% in the three months ended June 30, 2005. Gross profit of \$1,220,000 for the six months ended June 30, 2006 was higher than the gross profit of \$613,000 in the comparable period of 2005 because of the additional profits from product sales from BioCheck. Gross profit as a percentage of revenues was 43% in the six months ended June 30, 2006, as compared to 52% in the six months ended June 30, 2005.

*Research and development expenses*

The following table presents the changes in research and development expenses from 2005 to 2006:

	<b>Three Months Ended June 30,</b>				<b>Six Months Ended June 30,</b>			
	<b>2006</b>	<b>2005</b>	<b>Increase from 2005</b>		<b>2006</b>	<b>2005</b>	<b>Increase from 2005</b>	
Research and development expenses	\$ 178,000	\$ 60,000	\$ 118,000	197%	\$ 391,000	\$ 122,000	\$ 269,000	220%

For the three months ended June 30, 2006, the increase in research and development expenses is primarily attributable to the consolidation of \$132,000 of costs from the operations of BioCheck and increased patent amortization expense of \$8,000. The increase was partially offset by decreased salary and benefits costs of \$20,000 and direct project expenses of \$10,000. For the six months ended June 30, 2006, the increase in research and development expenses is primarily attributable to the consolidation of \$302,000 of costs from the operations of BioCheck and increased patent amortization expense of \$40,000. The increase was partially offset by decreased salary and benefits costs of \$42,000 and direct project expenses of \$24,000. We expect third quarter 2006 research and development costs to be approximately the same as the second quarter. However, the actual amount of research and development expenses will fluctuate with the availability of funding.

*Selling, general and administrative expenses*

The following table presents the changes in selling, general and administrative expenses from 2005 to 2006:

	<b>Three Months Ended June 30,</b>				<b>Six Months Ended June 30,</b>			
	<b>2006</b>	<b>2005</b>	<b>Increase from 2005</b>		<b>2006</b>	<b>2005</b>	<b>Increase from 2005</b>	
Selling, general and administrative expenses	\$ 837,000	\$ 545,000	\$ 292,000	54%	\$ 1,901,000	\$ 1,081,000	\$ 820,000	76%

For the three months ended June 30, 2006, the increase in selling, general and administrative expenses is primarily attributed to the consolidation of costs from the operations of BioCheck of \$189,000, and increased costs for labor and related costs including contract labor and associated transportation costs of \$61,000; and non-cash compensation of \$85,000 which, effective January 1, 2006, is required for employees to be included in expenses by SFAS 123R. The increase was partially offset by decreased costs for accounting, legal, shareholder communication and investor relations activities of \$40,000. For the six months ended June 30, 2006, the increase in selling, general and administrative expenses is primarily attributed to the consolidation of costs from the operations of BioCheck of \$408,000, and increased costs for accounting, legal, shareholder communication and investor relations activities of \$102,000; labor and related costs including contract labor and associated transportation costs of \$120,000; and non-cash compensation of \$180,000. We expect third quarter 2006 selling, general and administrative expenses to be approximately the same as the second quarter.



### *Interest Income*

The decrease in interest income from \$52,000 for the six months ended June 30, 2005 to \$31,000 in the same period in 2006, is primarily due to reduced cash available for investment activities obtained in the \$6,500,000 equity financing received during December 2004 and January 2005.

### *Other Income*

Other income is related to the sale of surplus equipment.

### *Interest Expense*

Interest expense of \$55,000 in the six months ended June 30, 2006 was primarily due to the loan with KeyBank that was transferred to Bridge Bank incurred in connection with the BioCheck acquisition and the addition of new debt of \$600,000 in March 2006. We expect interest expense for the third quarter to increase from the second quarter of 2006. Warrants were issued with the renewal of a note with Fagan Capital that will result in non-cash financing expense over the life of note being recorded as interest expense. See Note 7 to the unaudited consolidated financial statements included in this Report.

## **Liquidity and Capital Resources**

On a consolidated basis, we had cash and cash equivalents of \$461,000 at June 30, 2006 of which \$441,000 was held by BioCheck. Since BioCheck has been and is expected to continue to be cash flow positive, management believes that its cash will be sufficient to sustain its operating activities.

The cash held by the OXIS parent company was \$20,000 at June 30, 2006. OXIS cannot access the cash held by its majority-held subsidiary, BioCheck, to pay for the corporate purposes of the OXIS parent company. We have incurred negative operating cash flows of \$0.7 million during the six months ended June 30, 2006. Our cash is not sufficient to sustain our operations through the third quarter of 2006 without additional financings. We are seeking debt and equity financings to obtain sufficient funds to sustain operations, implement our marketing campaign and purchase the remaining 49% of BioCheck for approximately \$3.0 million. We plan to increase revenues by our marketing campaign and the introduction of new products. However, we cannot assure you that we will successfully obtain debt or equity financing, if any, sufficient to finance our goals or that we will increase product related revenues as such events are subject to factors beyond our control. If we are unable to raise additional capital in the third quarter of 2006, we will have to curtail or cease operations.

*Net cash used in operating activities*

The following table presents quarterly cash flows from operating activities for 2006 and 2005:

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Cash paid to employees including benefits	\$ (1,161,000)	\$ (454,000)
Cash paid to suppliers	(2,364,000)	(1,859,000)
Total cash paid to employees and suppliers	(3,525,000)	(2,313,000)
Cash received from customers	2,804,000	1,143,000
Interest and other income received	33,000	52,000
Interest paid	(58,000)	(11,000)
Net cash used in operating activities	<u>\$ (746,000)</u>	<u>\$ (1,129,000)</u>

The increase in cash paid to employees is primarily attributed to \$0.7 million of cash paid by BioCheck for payroll and benefits. Cash paid to suppliers is increased by approximately \$1.1 million due to BioCheck that was offset by 2004 expenses recorded as liabilities at December 31, 2004 that were paid in the first quarter of 2005 of approximately \$0.5 million and an increase in accounts payable and accrued expense in the first six months of 2006 of approximately \$0.1 million. The increase in cash received from customers in the first and second quarters of 2006 is attributed to increased revenues of \$1.7 million. Interest paid increased in the first and second quarters of 2006 primarily due to increased debt of \$3,060,000 entered into during December 2005 and \$600,000 during March 2006.

*Cash used in investing activities*

During the first quarter of 2006 we transferred our \$3,060,000 restricted certificate of deposit from KeyBank to Bridge Bank. Capital expenditures during the second quarter of 2006 were primarily for equipment and leasehold improvements at our new Foster City, California location. We had no commitments for capital expenditures at June 30, 2006. We paid \$32,000 and \$131,000 for patent filings that were capitalized in the first and second quarters of 2006 and 2005, respectively.

*Net cash provided by financing activities*

On December 2, 2005, we entered into a non-revolving one-year loan agreement with KeyBank in the amount of \$3,060,000, for the purpose of completing the initial closing of the BioCheck acquisition. This loan was repaid during February 2006 and a new one-year loan agreement for \$3,060,000 was entered into at Bridge Bank.

On March 10, 2006, we received \$200,000 in exchange for an unsecured promissory note with Steven T. Guillen, our president and chief executive officer. The related party note bears interest at 7.0%. Interest and principal are due on September 10, 2006 or, at the option of Mr. Guillen, on the date we receive net proceeds in the amount of \$500,000 or more from a debt or equity financing. On March 31, 2006, we entered into a \$400,000 unsecured promissory note with Fagan Capital. Interest accrues at an annual rate of 8.0% and interest and principal were due on June 2, 2006. On July 26, 2006, Fagan Capital extended the maturity date of the promissory note to June 1, 2007 and we issued to Fagan Capital a warrant to purchase 1,158,857 shares of common stock at an initial exercise price of \$0.35 per share. See Note 7 to the unaudited consolidated financial statements included in this Report. The purpose of these loans was to provide us with short term financing as we seek longer term financing.

The cash held by the OXIS parent company of \$20,000 at June 30, 2006 is not sufficient to sustain our operations through the third quarter of 2006 without additional financings. OXIS cannot access the cash held by its majority-held subsidiary, BioCheck, to pay for the corporate purposes of the OXIS parent company. In an effort to mitigate this near-term concern, we are seeking debt and equity financings to obtain sufficient funds to sustain operations, implement our marketing campaign and purchase the remaining 49% of BioCheck for approximately \$3.0 million. However, we cannot assure you that we will successfully obtain debt or equity financing.

### **Critical Accounting Policies**

We consider the following accounting policies to be critical given they involve estimates and judgments made by management and are important for our investors' understanding of our operating results and financial condition.

#### *Basis of Consolidation*

The consolidated financial statements contained in this Report include the accounts of OXIS International, Inc. and its subsidiaries. All intercompany balances and transactions have been eliminated. On December 6, 2005, we purchased 51% of the common stock of BioCheck. This acquisition was accounted for by the purchase method of accounting according to Statement of Financial Accounting Standards No. 141, "Business Combinations." The consolidated statements of operations for the three and six months ended June 30, 2006 include the results of operations of BioCheck and the consolidated balance sheets include the assets and liabilities of BioCheck at June 30, 2006 and December 31, 2005.

#### *Revenue Recognition*

We manufacture, or have manufactured on a contract basis, research and diagnostic assays and fine chemicals, which are our primary products sold to customers. Revenue from the sale of our products, including shipping fees, is recognized when title to the products is transferred to the customer which usually occurs upon shipment or delivery, depending upon the terms of the sales order and when collectibility is reasonably assured. Revenue from sales to distributors of our products is recognized, net of allowances, upon delivery of product to the distributors. According to the terms of individual distributor contracts, a distributor may return product up to a maximum amount and under certain conditions contained in its contract. Allowances are calculated based upon historical data, current economic conditions and the underlying contractual terms. Our mix of product sales are substantially at risk to market conditions and demand, which may change at anytime.

We recognize license fee revenue for licenses to our intellectual property when earned under the terms of the agreements. Generally, revenue is recognized upon transfer of the license unless we have continuing obligations for which fair value cannot be established, in which case the revenue is recognized over the period of the obligation. We consider all arrangements with payment terms extending beyond twelve months not to be fixed or determinable. In certain licensing arrangements there is provision for a variable fee as well as a non-refundable minimum amount. In such arrangements, the amount of the non-refundable minimum guarantee is recognized upon transfer of the license and collectibility is reasonably assured or over the period of the obligation, as applicable, and the amount of the variable fee is recognized as revenue when it is fixed and determinable. We recognize royalty revenue based on reported sales by third party licensees of products containing our materials, software and intellectual property. Non-refundable royalties, for which there are no further performance obligations, are recognized when due under the terms of the agreements.

#### *Inventories*

Inventories are stated at the lower of cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review our inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and/or our ability to sell the products and production requirements. Demand for our products can fluctuate significantly. Factors which could affect demand for our products include unanticipated changes in consumer preferences, general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by customers and/or continued weakening of economic conditions. Additionally, our estimates of future product demand may be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory. Our estimates are based upon our understanding of historical relationships which can change at anytime.

#### *Long-Lived Assets*

Our long-lived assets include property, plant and equipment, capitalized costs of filing patent applications and goodwill and other assets. We evaluate our long-lived assets for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Estimates of future cash flows and timing of events for evaluating long-lived assets for impairment are based upon management's judgment. If any of our intangible or long-lived assets are considered to be impaired, the amount of impairment to be recognized is the excess of the carrying amount of the assets over its fair value.

Applicable long-lived assets are amortized or depreciated over the shorter of their estimated useful lives, the estimated period that the assets will generate revenue, or the statutory or contractual term in the case of patents. Estimates of useful lives and periods of expected revenue generation are reviewed periodically for appropriateness and are based upon management's judgment. Goodwill and other assets are not amortized.

### *Share-Based Compensation*

In December 2004, the Financial Accounting Standards Board, or FASB, issued SFAS 123R. SFAS 123R replaces FASB Statement No. 123, "Accounting for Stock-Based Compensation", and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," or APB Opinion No. 25. SFAS 123R establishes standards for the accounting for share-based payment transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. SFAS 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. SFAS 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date (with limited exceptions). That cost will be recognized in the entity's financial statements over the period during which the employee is required to provide services in exchange for the award. Management implemented SFAS 123R effective January 1, 2006. Methodologies used for calculations such as the Black-Scholes option-pricing models and variables such as volatility and expected life are based upon management's judgment. Such methodologies and variables are reviewed and updated periodically for appropriateness and affect the amount of recorded charges. See Note 1 to the unaudited consolidated financial statements included in this Report for more information on the amounts, methodologies and variables related to non-cash share-based compensation charges.

## FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. The following discussion highlights some of these risks and others are discussed elsewhere in this report or in our Annual Report on Form 10-KSB for the period ended December 31, 2005 and our Post-Effective Amendment No. 1 to Form SB-2 Registration Statement (SEC File No. 333-123008).

### Risks Related to Our Business

*We will need to raise additional capital to fund our general and administrative expenses, and if we are unable to raise such capital, we will have to curtail or cease operations.*

The cash held by the OXIS parent company of \$20,000 at June 30, 2006 is not sufficient to continue operations through the third quarter of 2006 without additional financings. OXIS cannot access the cash held by its majority-held subsidiary, BioCheck, to pay for the corporate purposes of the OXIS parent company. We are seeking debt and equity financings to obtain sufficient funds to sustain operations, including our development and commercialization programs, to implement our marketing campaign and purchase the remaining 49% of BioCheck common stock we do not own. We have incurred significant obligations in relation to our relocation to Foster City, California and our integration of operations with BioCheck, including severance benefits for terminated employees, the hiring of new personnel, our contractual obligations to consultants and moving expenses. We will need to repay debt in the amount of \$200,000 to our chief executive officer on or before September 10, 2006 and \$405,600 to Fagan Capital on or before June 1, 2007. On July 26, 2006, Fagan Capital extended the maturity date of the promissory note to June 1, 2007 and the Company issued to Fagan Capital a warrant to purchase 1,158,857 shares of common stock at an initial exercise price of \$0.35 per share. See Note 7 to the unaudited consolidated financial statements included in this Report. If we are unable to raise additional capital in the third quarter of 2006 we will have to curtail or cease operations. If we raise short term capital by incurring additional debt, we will have to obtain equity financing sufficient to repay such debt and accrued interest. Further, incurring additional debt may make it more difficult for us to successfully consummate future equity financings.

*As we have failed to make payments due to BioCheck under our Mutual Services Agreement, BioCheck could exercise its rights under the default provisions of that agreement to terminate the agreement and cease production of many of our research test kit assays.*

As mentioned above, on June 23, 2006, we entered into a Mutual Services Agreement, or Agreement, with our majority owned subsidiary, BioCheck. Pursuant to the Agreement, OXIS agreed to pay BioCheck approximately \$73,000 that it owed to BioCheck for services that BioCheck had provided to OXIS prior to the signing of the Agreement, on or before June 30, 2006. OXIS has not made that payment. If OXIS receives written notice of breach of the Agreement due to this non-payment, it will have 15 days to cure that breach. If OXIS fails to cure the breach during the cure period, BioCheck would have the right to terminate the Agreement. Pursuant to the Agreement, BioCheck is manufacturing the bulk of OXIS' research assay test kits, assisting in packaging and shipping such research assay test kits to OXIS customers, and undertaking research and development of certain new OXIS research assay test kits. If BioCheck ceases to perform services under the Agreement, OXIS will have to turn to third party suppliers for the manufacturing of its research assay test kits, where that is possible, and will likely have to cease research and development of new OXIS research assay test kits. There can be no assurance that possible third party suppliers of research assay test kits will be willing or able to manufacture OXIS' research assay test kits at competitive prices or at all, or that OXIS would be able to pay for such services. Disruption or cessation of manufacturing due to the termination of the Agreement would have immediate and deleterious effects on OXIS future revenues.

*We will need to raise additional capital in order to complete our acquisition of the outstanding shares of BioCheck.*

On September 19, 2005 we entered into a stock purchase agreement with BioCheck and the stockholders of BioCheck pursuant to which OXIS undertook to purchase up to all of the outstanding shares of common stock of BioCheck for an aggregate purchase price of \$6.0 million in cash. On December 6, 2005, pursuant to the terms of the stock purchase agreement with BioCheck, at the initial closing, we purchased an aggregate of fifty-one percent (51%) of the outstanding shares of common stock of BioCheck from each of the shareholders of BioCheck on a pro rata basis, for an aggregate of \$3,060,000 in cash. Pursuant to the stock purchase agreement, OXIS will use its reasonable best efforts to consummate a follow-on financing transaction to raise additional capital with which to purchase the remaining outstanding shares of BioCheck in one or more additional closings. The purchase price for any BioCheck shares purchased after the initial closing will be increased by an additional 8% per annum from the date of the initial closing through the date of such purchase. If OXIS has not purchased all of the outstanding shares of BioCheck within twelve months of the initial closing, the earnings before interest, taxes, depreciation and amortization expenses, or EBITDA, if any, of BioCheck will be used to repurchase the remaining outstanding BioCheck shares at one or more additional closings. There can be no assurance that there will be any EBITDA of BioCheck in the next several years which could be utilized to purchase additional shares of BioCheck pursuant to the stock purchase agreement. Even if there is some amount of BioCheck EBITDA available to purchase additional shares of BioCheck, there can be no assurance that such EBITDA would be sufficient to complete our acquisition of the remaining 49% of BioCheck outstanding shares.

To avoid an increase in the purchase price of the remaining shares of BioCheck at the rate of 8% per annum, we will need to consummate a financing transaction to complete the acquisition of the remaining 49% of the outstanding shares of BioCheck. The successful completion of our acquisition of BioCheck is dependent upon obtaining financing on acceptable terms. No assurances can be given that we will be able to complete such a financing sufficient to undertake our acquisition of the outstanding shares of BioCheck on terms favorable to us, or at all. Any financing that we do undertake to finance the acquisition of BioCheck will likely involve dilution of our common stock if it is an equity financing or will involve the assumption of significant debt by OXIS.

*We will need additional financing in order to complete our development and commercialization programs.*

As of June 30, 2006, we had an accumulated deficit of approximately \$66,648,000. We currently do not have sufficient capital resources to complete the development and commercialization of our antioxidant therapeutic technologies and oxidative stress assays, and no assurances can be given that we will be able to raise such capital in the future on terms favorable to us, or at all. The unavailability of additional capital could cause us to cease or curtail our operations and/or delay or prevent the development and marketing of our potential products. In addition, we may choose to abandon certain issued United States and international patents that we deem to be of lesser importance to our strategic direction, in an effort to preserve our financial resources.

Our future capital requirements will depend on many factors including the following:

- continued scientific progress in our research and development programs and the commercialization of additional products;
- the cost of our research and development and commercialization activities and arrangements, including sales and marketing;
- the costs associated with the scale-up of manufacturing;
- the success of pre-clinical and clinical trials;
- the establishment of and changes in collaborative relationships;
- the time and costs involved in filing, prosecuting, enforcing and defending patent claims;
- the time and costs required for regulatory approvals;
- the acquisition of additional technologies or businesses;
- technological competition and market developments; and
- the cost of complying with the requirements of the Autorité des Marchés Financiers, or AMF, the French regulatory agency overseeing the Nouveau Marché in France.

We will need to raise additional capital to fund our development and commercialization programs. Our current capital resources are not sufficient to sustain operations and our development programs with respect to our cardiovascular predictor product and Ergothioneine as a nutraceutical supplement. We have granted a licensee exclusive worldwide rights, in certain defined areas of cardiovascular indications, to develop, manufacture and market BXT-51072 and related compounds from our library of such antioxidant compounds. The licensee is responsible for worldwide product development programs with respect to the licensed compounds. Due to the lack of financial resources, we ceased further testing of BXT-51072 but continue to review the possibility of further developing applications for BXT-51072 and related compounds outside of the areas defined in the license. However, further development and commercialization of antioxidant therapeutic technologies, oxidative stress assays or currently unidentified opportunities, or the acquisition of additional technologies or businesses, may require additional capital. The fact that further development and commercialization of a product or technology would require us to raise additional capital, would be an important factor in our decision to engage in such further development or commercialization. No assurances can be given that we will be able to raise such funds in the future on terms favorable to us, or at all.

*If we complete our acquisition of BioCheck, our business could be materially and adversely affected if we fail to adequately integrate the operations of the two companies.*

If we complete the acquisition of BioCheck, or the Acquisition, as planned, and we do not successfully integrate the operations of the two companies, or if the benefits of the transaction do not meet the expectations of financial or industry analysts, the market price of our common stock may decline. The Acquisition could result in the use of significant amounts of cash, dilutive issuances of equity securities, or the incurrence of debt or expenses related to goodwill and other intangible assets, any of which could materially adversely affect our business, operating results and financial condition.



We may not be able to successfully integrate the BioCheck business into our existing business in a timely and non-disruptive manner, or at all. In addition, the Acquisition may result in, among other things, substantial charges associated with acquired in-process research and development, future write-offs of goodwill that is deemed to be impaired, restructuring charges related to consolidation of operations, charges associated with unknown or unforeseen liabilities of acquired businesses and increased general and administrative expenses. Furthermore, the Acquisition may not produce revenues, earnings or business synergies that we anticipate. There can be no assurance that BioCheck will continue to manufacture our research assay test kits if that agreement is terminated.

In addition, acquisitions in general involve numerous risks, including:

- difficulties in assimilating the operations, technologies, products and personnel of an acquired company;
- risks of entering markets in which we have either no or limited prior experiences;
- the diversion of management's attention from other business concerns; and
- the potential loss of key employees of an acquired company.

The time, capital management and other resources spent on the Acquisition, if it fails to meet our expectations, could cause our business and financial condition to be materially and adversely affected.

*Our relocation plan could adversely affect our operations.*

As part of our decision to acquire BioCheck, we implemented a relocation and integration plan, including a strategy to reduce our cost structure. In doing so, we significantly reduced our employee workforce from 15 full time employees to four, outsourced certain company functions and have taken other steps intended to reduce costs and improve efficiencies. Our business may continue to be disrupted and adversely affected by this reduction in work force until we employ new personnel to replace certain open positions. Our business may also be disrupted due to our move to new facilities. The payment of severance benefits resulting from employee terminations will cause us to utilize cash. There can be no assurances that we will be able to improve efficiencies and function properly following such reductions.

*We may experience disruption or may fail to achieve any benefits in connection with the recent changes in executive management and in Board membership.*

During the second quarter of 2004, our former Chief Executive Officer retired, and during the third quarter of 2004 our Chief Operating and Financial Officer left the employment of our company. As a result, others who had limited experience with OXIS were appointed to serve as acting Chief Executive Officer, acting Chief Operating Officer and acting Chief Financial Officer. On February 28, 2005, the Board appointed Mr. Steven T. Guillen to the positions of President and Chief Executive Officer of OXIS, and as a member of our board. On January 6, 2006, we hired Michael D. Centron as our Vice President and Chief Financial Officer. In addition, during 2004 and early 2005, following the acquisition of a then-majority interest in OXIS by Axonyx, eight directors resigned from the board resulting in a four person board. During 2005 we added independent director John E. Repine, M.D., and Gary M. Post joined our Board of Directors on March 15, 2006, resulting in a six-person board. Timothy C. Rodell, M.D., declined to stand for re-election at the Annual Meeting of Stockholders held on August 1, 2006. All five directors currently serving on the board commenced their service on the board during the period of 2004 through the date hereof.

One impact of such changes has been to delay our sales promotions in the research assay market and in the development of Ergothioneine market opportunities. Further, we narrowed our strategic focus to concentrate resources, including discontinuing our Animal Health Profiling program. In addition, the decreased OXIS parent company sales during the second quarter of 2006 are attributable to lower sales volume that was caused, in part, by the interruption arising from moving operations from Portland, Oregon to Foster City, California and consolidating our product offerings. There can be no assurances that these changes will not cause further disruptions in, or otherwise adversely affect, our business and results of operations.

*If we fail to attract and retain key personnel, our business could suffer.*

Our future depends, in part, on our ability to attract and retain key personnel. We may not be able to hire and retain such personnel at compensation levels consistent with our existing compensation and salary structure. We deferred the hiring of senior management personnel in order to allow our newly-engaged full time Chief Executive Officer to select such key personnel. While we succeeded in engaging Mr. Steven T. Guillen as our President and Chief Executive Officer and Michael D. Centron as our Chief Financial Officer, we cannot predict whether we will be successful in finding suitable new candidates for key management positions within OXIS. While we have entered into letter agreements of employment with Mr. Guillen and Mr. Centron, they are free to terminate their employment "at will." Further, we cannot predict whether Mr. Guillen or Mr. Centron will be successful in their roles as our President and Chief Executive Officer, and Chief Financial Officer, or whether senior management personnel hires will be effective. The loss of services of executive officers or key personnel, any transitional difficulties with our new Chief Financial Officer or the inability to attract qualified personnel could have a material adverse effect on our financial condition and business. We do not have any key employee life insurance policies with respect to any of our executive officers.

*The success of our business depends upon our ability to successfully develop and commercialize products.*

We cannot assure you that our efforts to develop and commercialize a cardiac predictor product, an Ergothioneine nutraceutical product or any other products will be successful. The cost of such development and commercialization efforts can be significant and the likelihood of success of any such programs is difficult to predict. The failure to develop or commercialize such new products could be materially harmful to us and our financial condition.

*Our future profitability is uncertain.*

We cannot predict our ability to reduce our costs or achieve profitability. We may be required to increase our research and development expenses in order to develop potential new products. As evidenced by the substantial net losses during the first six months of 2006 and the fiscal year 2005, losses and expenses may increase and fluctuate from quarter to quarter. There can be no assurance that we will ever achieve profitable operations.

*We have no biopharmaceutical or clinical diagnostic products available for sale and we may never be successful in developing products suitable for commercialization.*

All of our biopharmaceutical and clinical diagnostic candidates are at an early stage of development and all of such therapeutic and clinical diagnostic candidates will require expensive and lengthy testing and regulatory clearances. None of our therapeutic or clinical diagnostic candidates have been approved by regulatory authorities. We have no therapeutic or clinical diagnostic products available for sale and we may not have any products commercially available for several years, if at all. There are many reasons we may fail in our efforts to develop our therapeutic and clinical diagnostic candidates, including:

- our therapeutic and clinical diagnostic candidates may be ineffective, toxic or may not receive regulatory clearances,
- our therapeutic and clinical diagnostic candidates may be too expensive to manufacture or market or may not achieve broad market acceptance,
- third parties may hold proprietary rights that may preclude us from developing or marketing our therapeutic and clinical diagnostic candidates, or
- third parties may market equivalent or superior products.

*Clinical development is inherently uncertain and expense levels may fluctuate unexpectedly because we cannot accurately predict the timing and level of such expenses.*

Our future success may depend in part upon the results of clinical trials undertaken by us or our licensees designed to assess the safety and efficacy of our potential products. We do not have substantial experience in developing and running clinical trials. The completion of clinical trials often depends significantly upon the rate of patient enrollment, and our expense levels will vary depending upon the rate of enrollment. In addition, the length of time necessary to complete clinical trials and submit an application for marketing and manufacturing approvals varies significantly and is difficult to predict. The expenses associated with each phase of development depend upon the design of the trial. The design of each phase of trials depends in part upon results of prior phases, and additional trials may be needed at each phase. As a result, the expense associated with future phases cannot be predicted in advance. Further, if we undertake clinical trials, we may decide to terminate or suspend ongoing trials. Failure to comply with extensive FDA regulations may result in unanticipated delay, suspension or cancellation of a trial or the FDA's refusal to accept test results. The FDA may also suspend our clinical trials at any time if it concludes that the participants are being exposed to unacceptable risks. As a result of these factors, we cannot predict the actual expenses that we will incur with respect to clinical trials for any of our potential products, and we expect that our expense levels will fluctuate unexpectedly in the future.

*Competition in most of our primary current and potential market areas is intense and expected to increase.*

The diagnostic, pharmaceutical and nutraceutical industries are highly competitive. The main commercial competition at present in our research assay business is represented by, but not limited to, the following companies: Cayman Chemical Company, Assay Designs and Randox Laboratories Ltd. In addition, our competitors and potential competitors include large pharmaceutical/nutraceutical companies, universities and research institutions. Relative to OXIS, these competitors may have substantially greater capital resources, research and development staffs, facilities, as well as greater expertise manufacturing and making products. In addition, these companies, as well as others, may have or may develop new technologies or use existing technologies that are, or may in the future be, the basis for competitive products. There can be no assurance that we can compete successfully.

In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties, thereby increasing the ability of their products to address the needs of our current and prospective customers. Accordingly, it is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share. Such competition could materially adversely affect our ability to commercialize existing technologies or new technologies on terms favorable to us. Further, competitive pressures could require us to reduce the price of our products and technologies, which could materially adversely affect our business, operating results and financial condition. We may not be able to compete successfully against current and future competitors and any failure to do so would have a material adverse effect upon our business, operating results and financial condition.

*Axonyx holds the voting power to influence matters affecting us.*

Axonyx currently owns approximately 33% of our issued and outstanding stock. In addition, Dr. Marvin Hausman is a member of the board of directors of Axonyx and is the chairman of our board of directors, and Mr. S. Colin Neill, the Chief Financial Officer of Axonyx, is a member of our board of directors and the Secretary of OXIS. Given these circumstances, Axonyx may influence our business direction and policies, and, thus, may have the ability to control certain material decisions affecting us. In addition, such concentration of voting power could have the effect of delaying, deterring or preventing a change of control or other business combination that might otherwise be beneficial to our shareholders. Section 203 of the Delaware General Corporation Law prohibits a Delaware corporation from engaging in any business combination with any interested shareholder for a period of three years unless the transaction meets certain conditions. Section 203 also limits the extent to which an interested shareholder can receive benefits from our assets. These provisions could complicate or prohibit certain transactions (including a financing transaction between OXIS and Axonyx), or limit the price that other investors might be willing to pay in the future for shares of our common stock.

*If we are unable to develop and maintain alliances with collaborative partners, we may have difficulty developing and selling our products and services.*

Our ability to realize significant revenues from new products and technologies is dependent upon, among other things, our success in developing business alliances and licensing arrangements with nutraceutical/biopharmaceutical and/or health related companies to develop and market these products. To date, we have had limited success in establishing foundations for such business alliances and licensing arrangements and there can be no assurance that our efforts to develop such business relationships will progress to mature relationships or that any such relationships will be successful. Further, relying on these or other alliances is risky to our future success because:

- our partners may develop products or technologies competitive with our products and technologies;
- our partners may not devote sufficient resources to the development and sale of our products and technologies;
- our collaborations may be unsuccessful; or
- we may not be able to negotiate future alliances on acceptable terms.

*Our revenues and quarterly results have fluctuated historically and may continue to fluctuate, which could cause our stock price to decrease.*

Our revenues and operating results may fluctuate due in part to factors that are beyond our control and which we cannot predict. Material shortfalls in revenues will materially adversely affect our results and may cause us to experience losses. In particular, our revenue growth and profitability depend on sales of our research assays and fine chemicals. Factors that could cause sales for these products and other products to fluctuate include:

- an inability to produce products in sufficient quantities and with appropriate quality;
- an inability to obtain sufficient raw materials;
- the loss of or reduction in orders from key customers;
- variable or decreased demand from our customers;
- the receipt of relatively large orders with short lead times;
- our customers' expectations as to how long it takes us to fill future orders;
- customers' budgetary constraints and internal acceptance review procedures;
- there may be only a limited number of customers that are willing to purchase our research assays and fine chemicals;
- a long sales cycle that involves substantial human and capital resources; and
- potential downturns in general or in industry specific economic conditions.

Each of these factors has impacted, and may in the future impact, the demand for and availability of our products and our quarterly operating results. For example, due to the unavailability of beef liver as a source for bSOD we were unable to sell any bSOD during 2005 and 2004, as compared to sales of \$562,000 in 2003. We do not anticipate this source becoming available again within the foreseeable future and do not anticipate any revenues from sales of this product in the foreseeable future. In addition, a decrease in the demand for our Ergothioneine product resulted in a reduction of sales of Ergothioneine to \$18,000 in 2005 and \$87,000 in 2004, compared to \$333,000 in 2003. We cannot predict with any certainty our future sales of Ergothioneine.

If the sales or development cycles for research assays and fine chemicals lengthen unexpectedly, our revenues may decline or not grow as anticipated and our results from operations may be harmed.

*Changes in accounting standards regarding stock option plans could increase our reported losses, cause our stock price to decline and limit the desirability of granting stock options.*

In December 2004, the FASB issued SFAS 123R. SFAS 123R replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS 123R establishes standards for the accounting for share-based payment transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. SFAS 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. SFAS 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date (with limited exceptions). That cost will be recognized in the entity's financial statements over the period during which the employee is required to provide services in exchange for the award. Management implemented SFAS 123R effective January 1, 2006. Expensing such stock options will add to our losses or reduce our profits, if any. In addition, stock options are an important employee recruitment and retention tool, and we may not be able to attract and retain key personnel if we reduce the scope of our employee stock option program.

*Our income may suffer if we receive relatively large orders with short lead times, or our manufacturing capacity does not otherwise match our demand.*

Because we cannot immediately adapt our production capacity and related cost structures to rapidly changing market conditions, when demand does not meet our expectations, our manufacturing capacity will likely exceed our production requirements. Fixed costs associated with excess manufacturing capacity could adversely affect our income. Similarly, if we receive relatively large orders with short lead times, we may not be able to increase our manufacturing capacity to meet product demand, and, accordingly, we will not be able to fulfill orders in a timely manner. During a market upturn, we may not be able to purchase sufficient supplies to meet increasing product demand. In addition, suppliers may extend lead times, limit supplies or increase prices due to capacity constraints or other factors. These factors could materially and adversely affect our results.

*Our success will require that we establish a strong intellectual property position and that we can defend ourselves against intellectual property claims from others.*

Maintaining a strong patent position is important to our competitive advantage. We currently have 81 patents either granted or applied for in 16 countries with expiration dates ranging from 2009 to 2025. Litigation on patent-related matters has been prevalent in our industry and we expect that this will continue. Patent law relating to the scope of claims in the technology fields in which we operate is still evolving and the extent of future protection is highly uncertain, so there can be no assurance that the patent rights we have or may obtain will be valuable. Others may have filed, or may in the future file, patent applications that are similar or identical to ours. To determine the priority of inventions, we may have to participate in interference proceedings declared by the United States Patent and Trademark Office that could result in substantial costs in legal fees and could substantially affect the scope of our patent protection. We cannot assure investors that any such patent applications will not have priority over our patent applications. Further, we may choose to abandon certain issued United States and international patents that we deem to be of lesser importance to our strategic direction, in an effort to preserve our financial resources. Abandonment of patents could substantially affect the scope of our patent protection. In addition, we may in future periods incur substantial costs in litigation to defend against patent suits brought by third parties or if we initiate such suits.

In addition to patent protection, we also rely upon trade secret protection for our confidential and proprietary information. There can be no assurance, however, that such measures will provide adequate protection for our trade secrets or other proprietary information. In addition, there can be no assurance that trade secrets and other proprietary information will not be disclosed, that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to or disclose our trade secrets and other proprietary information. If we cannot obtain, maintain or enforce intellectual property rights, competitors can design and commercialize competing technologies.

We may face challenges from third parties regarding the validity of our patents and proprietary rights, or from third parties asserting that we are infringing their patents or proprietary rights, which could result in litigation that would be costly to defend and could deprive us of valuable rights.

Extensive litigation regarding patents and other intellectual property rights has been common in the biotechnology and pharmaceutical industries. The defense and prosecution of intellectual property suits, United States Patent and Trademark Office interference proceedings, and related legal and administrative proceedings in the United States and internationally involve complex legal and factual questions. As a result, such proceedings are costly and time-consuming to pursue and their outcome is uncertain. Litigation may be necessary to:

- enforce patents that we own or license;
- protect trade secrets or know-how that we own or license; or
- determine the enforceability, scope and validity of the proprietary rights of others.

Our involvement in any litigation, interference or other administrative proceedings could cause us to incur substantial expense and could significantly divert the efforts of our technical and management personnel. An adverse determination may subject us to loss of our proprietary position or to significant liabilities, or require us to seek licenses that may not be available from third parties. An adverse determination in a judicial or administrative proceeding, or a failure to obtain necessary licenses, may restrict or prevent us from manufacturing and selling our products. Costs associated with these arrangements may be substantial and may include ongoing royalties. Furthermore, we may not be able to obtain the necessary licenses on satisfactory terms, if at all. These outcomes could materially harm our business, financial condition and results of operations.

*We may be exposed to liability due to product defects.*

The risk of product liability claims is inherent in the testing, manufacturing, marketing and sale of our products. We may seek to acquire additional insurance for liability risks. We may not be able to obtain such insurance or general product liability insurance on acceptable terms or in sufficient amounts. A product liability claim or recall could have a serious adverse effect on our business, financial condition and results of operations.

*Disclosure controls are no assurance that the objectives of the control system are met.*

Although we have an extensive operating history, resources are limited for the development and maintenance of our control environment. We have a very limited number of personnel and therefore segregation of duties can be somewhat limited as to their scope and effectiveness. We believe, however, that we are in reasonable compliance with the best practices given the environment in which we operate. Although existing controls in place are deemed appropriate for the prevention, detection and minimization of fraud, theft and errors, they may result in only limited assurances, at best, that the total objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, can be detected and/or prevented and as such this is a risk area for investors to consider.

## Risks Related to Our Common Stock

*Our common stock is traded on the OTCBB, our stock price is highly volatile, and you may not be able to sell your shares of our common stock at a price greater than or equal to the price you paid for such shares.*

Our shares of common stock are currently traded on the Over the Counter Bulletin Board, or OTCBB. Stocks traded on the OTCBB generally have limited trading volume and exhibit a wide spread between the bid/ask quotation. The market price of our common stock is extremely volatile. To demonstrate the volatility of our stock price, during the six-month period ending on June 30, 2006, the volume of our common stock traded on any given day ranged from 0 to 2,786,900 shares. Moreover, during that period, our common stock traded as low as \$0.26 per share and as high as \$0.46 per share, a 77% difference. This may impact an investor's decision to buy or sell our common stock. As of June 30, 2006 there were approximately 5,200 holders of our common stock. Factors affecting our stock price include:

- our financial results;
- fluctuations in our operating results;
- announcements of technological innovations or new commercial health care products or therapeutic products by us or our competitors;
- government regulation;
- developments in patents or other intellectual property rights;
- developments in our relationships with customers and potential customers; and
- general market conditions.

Furthermore, volatility in the stock price of other companies has often led to securities class action litigation against those companies. Any such securities litigation against us could result in substantial costs and divert management's attention and resources, which could seriously harm our business and financial condition.

*Our common stock may be subject to "penny stock" rules which may be detrimental to investors.*

Our common stock may be, or may become, subject to the regulations promulgated by the SEC for "penny stock". SEC regulation relating to penny stock is presently evolving, and the OTCBB may react to such evolving regulation in a way that adversely affects the market liquidity of our common stock. Penny stock currently includes any non-NASDAQ equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. The regulations require that prior to any non-exempt buy/sell transaction in a penny stock, a disclosure schedule set forth by the SEC relating to the penny stock market must be delivered to the purchaser of such penny stock. This disclosure must include the amount of commissions payable to both the broker-dealer and the registered representative and current price quotations for the common stock. The regulations also require that monthly statements be sent to holders of penny stock that disclose recent price information for the penny stock and information of the limited market for penny stocks. These requirements may adversely affect the market liquidity of our common stock.



*Sales of our common stock may require broker-dealers to make special suitability determinations regarding prospective purchasers.*

Our common stock may be, or may become, subject to Rule 15c-1 through 15c-9 under the Exchange Act, which imposes certain sales practice requirements on broker-dealers which sell our common stock to persons other than established customers and “accredited investors” (generally, individuals with a net worth in excess of \$1,000,000 or an annual income exceeding \$200,000 (or \$300,000 together with their spouses)). For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser’s written consent to the transaction prior to the sale. Applicability of this rule would adversely affect the ability of broker-dealers to sell our common stock and purchasers of our common stock to sell their shares of such common stock. Accordingly, the market for our common stock may be limited and the value negatively impacted.

*We will incur expenses in connection with registration of our shares which may be significant.*

We are required to pay fees and expenses incident to the registration with the SEC of the shares issued in the private placement of equity which closed on January 6, 2005 and maintain adequate disclosure in connection with such registration, including updating prospectuses and under certain circumstances, filing amended registration statements. These expenses were \$302,000 in 2005, and we may incur significant additional expenses in the future related to maintaining effective registration statements for prior financings and any additional registrations related to future financings. We have also agreed to indemnify such selling shareholders against losses, claims, damages and liabilities arising out of relating to any misstatements or omissions in our registration statement and related prospectuses, including liabilities under the Securities Act. In the event such a claim is made in the future, such losses, claims, damages and liabilities arising therefrom could be significant in relation to our revenues.

### **Item 3. Controls and Procedures.**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2006, and, based on their evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective. On January 6, 2006, we hired Michael D. Centron as our Vice President and Chief Financial Officer. We relocated our headquarters on February 15, 2006 from Portland, Oregon to Foster City, California, and on that date we terminated the employment of our financial controller. Temporary accounting facilities were established during this transition period. Our accounting procedures and disclosure controls and procedures have changed during this period, and management believes that disclosure controls and procedures have been adequately maintained during this period and that reporting controls and procedures have been improved. There has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

None.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

On May 12, 2006, the Company entered into an Engagement Letter with Ambient Advisors LLC. Gary M. Post, a member of the board of directors, is the manager of Ambient Advisors LLC.

Pursuant to the Engagement Letter, Ambient Advisors will provide certain services pertaining to strategic planning, investor communications and financing strategies or other projects at the request of our Chief Executive Officer for a one year period, thereafter on a month to month basis. Ambient Advisors will receive monthly compensation in the amount of \$5,000. As part of the compensation under the Engagement Letter, we granted Ambient Advisors a ten year common stock purchase warrant to purchase 108,000 shares of OXIS common stock at an exercise price of \$0.39 per share, with 9,000 shares becoming exercisable each month over the term of the agreement.

### **Item 3. Defaults Upon Senior Securities.**

None.

### **Item 4. Submission of Matters to a Vote of Security Holders.**

None.

### **Item 5. Other Information.**

None.

### **Item 6. Exhibits**

See Index to Exhibits on page 41.

**SIGNATURES**

Pursuant to the requirements 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.

**OXIS International, Inc.**

Date: August 14, 2006

By: /s/ Michael D. Centron

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Michael D. Centron  
Title: Chief Financial Officer

## Exhibit Index

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Filing Date	Number	
10.1	Engagement Letter with Ambient Advisors LLC.	8-K	5/31/06	10.1	
10.2	Mutual Services Agreement between OXIS International, Inc. and BioCheck, Inc. dated June 23, 2006.	8-K	6/29/06	10.1	
10.3	Renewal and Modification Promissory Note dated June 2, 2006.	8-K	7/26/06	10.1	
10.4	Common Stock Purchase Warrant dated June 2, 2006.	8-K	7/26/06	10.2	
10.5	Amendment #2 to Exclusive License and Supply Agreement dated July 19, 2006.	8-K	7/26/06	10.3	
31.1	Certification of the Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification of the Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
32.1	Certification of the Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
32.2	Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X

## CERTIFICATION

I, Steven T. Guillen, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of OXIS International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
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 small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the small business issuer 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 small business issuer, 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 small business issuer'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 small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer'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 small business issuer'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 small business issuer's internal control over financial reporting.

Date: August 14, 2006

/s/ Steven T. Guillen

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Steven T. Guillen  
Title: Chief Executive Officer

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## CERTIFICATION

I, Michael D. Centron, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of OXIS International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
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 small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the small business issuer 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 small business issuer, 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 small business issuer'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 small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer'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 small business issuer'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 small business issuer's internal control over financial reporting.

Date: August 14, 2006

/s/ Michael D. Centron

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Michael D. Centron  
Title: Chief Financial Officer

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

In connection with the Quarterly Report of OXIS International, Inc. (the "Company") on Form 10-QSB for the period ending June 30, 2006 as filed with the Securities and Exchange Commission on the date therein specified (the "Report"), I, Steven T. Guillen, Chief Executive Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company at the dates and for the periods indicated.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

/s/ Steven T. Guillen

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Steven T. Guillen  
Title: Chief Executive Officer  
August 14, 2006

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

In connection with the Quarterly Report of OXIS International, Inc. (the "Company") on Form 10-QSB for the period ending June 30, 2006 as filed with the Securities and Exchange Commission on the date therein specified (the "Report"), I, Michael D. Centron, Chief Financial Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company at the dates and for the periods indicated.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

/s/ Michael D. Centron

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Michael D. Centron  
Title: Chief Financial Officer  
August 14, 2006