

BIOVERIS CORP
Form 10-Q
August 09, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006

OR

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

Commission File Number: 000-50583

BioVeris Corporation

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of incorporation)

80-0076765
(IRS Employer Identification No.)

16020 INDUSTRIAL DRIVE, GAITHERSBURG, MD 20877

(Address of principal executive offices) (Zip Code)

301-869-9800

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(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Act of 1934 during the preceding 12 months, (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

27,238,969 shares of common stock, par value \$0.001, issued and outstanding at July 28, 2006

BIOVERIS CORPORATION

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As used herein, BioVeris, we, us and our refer to BioVeris Corporation and its subsidiaries. M-SERIES, TRICORDER, BIOVERIFY and BIOVERIS are our trademarks. This Form 10-Q also contains disclosure relating to brand names, trademarks or service marks of other companies, and these brand names, trademarks or service marks are the property of those other holders.

PART 1 FINANCIAL INFORMATION**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****BIOVERIS CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share data)****(Unaudited)**

	June 30, 2006	March 31, 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 37,266	\$ 29,693
Short-term investments	24,226	39,938
Accounts receivable, net	2,920	3,360
Inventory, net	6,476	5,429
Other current assets	2,329	2,508
Total current assets	73,217	80,928
Equipment and leasehold improvements, net	3,340	3,456
OTHER NONCURRENT ASSETS:		
Note receivable, net	5,857	5,666
Technology licenses	14,869	15,356
Other	447	447
TOTAL ASSETS	\$ 97,730	\$ 105,853
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 5,055	\$ 5,362
Accrued wages and benefits	1,267	1,862
Other current liabilities	1,739	1,520
Total current liabilities	8,061	8,744
NONCURRENT DEFERRED LIABILITIES	135	546
Total liabilities	8,196	9,290
SERIES B PREFERRED STOCK, 1,000 shares designated, issued and outstanding	7,500	7,500
STOCKHOLDERS' EQUITY:		
Preferred stock, par value \$0.01 per share, 15,000,000 shares authorized, issuable in series:		
Series A, 600,000 shares designated, none issued	-	-
Common stock, par value \$0.001 per share, 100,000,000 shares authorized, 27,239,000 and 27,238,000 shares issued and outstanding at June 30, 2006 and March 31, 2006, respectively	27	27
Additional paid-in capital	204,593	205,997
Deferred compensation	-	(1,688)
Accumulated other comprehensive loss	(47)	(128)
Accumulated deficit	(122,539)	(115,145)
Total stockholders' equity	82,034	89,063
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 97,730	\$ 105,853

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The accompanying notes are an integral part of these condensed consolidated financial statements.

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BIOVERIS CORPORATION**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(Unaudited)**

	Three Months Ended	
	June 30, 2006	June 30, 2005
REVENUES:		
Product sales	\$ 3,590	\$ 4,580
Royalty income	498	309
Total	4,088	4,889
OPERATING COSTS AND EXPENSES:		
Product costs	2,384	2,048
Research and development	4,262	4,765
Selling, general, and administrative	6,202	5,681
Total	12,848	12,494
LOSS FROM OPERATIONS	(8,760)	(7,605)
INTEREST INCOME	1,201	1,318
OTHER, NET	187	(381)
NET LOSS	\$ (7,372)	\$ (6,668)
Net loss per common share (basic and diluted)	\$ (0.27)	\$ (0.25)
COMMON SHARES OUTSTANDING (basic and diluted)	26,880	26,728

The accompanying notes are an integral part of these condensed consolidated financial statements.

BIOVERIS CORPORATION**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	Three Months Ended	
	June 30, 2006	June 30, 2005
OPERATING ACTIVITIES:		
Net loss	\$ (7,372)	\$ (6,668)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	935	1,632
Loss on disposal of equipment	18	-
Accretion of interest on note receivable	(549)	(403)
Amortization of premium on short-term investments	49	-
Stock based compensation	284	-
Changes in assets and liabilities:		
Decrease (increase) in accounts receivable	440	(1,383)
(Increase) decrease in inventory	(1,239)	220
Decrease in other current assets	179	294
(Increase) in accounts payable and accrued expenses	(312)	(2,024)
(Decrease) increase in accrued wages and benefits	(595)	309
Increase (decrease) in other liabilities	149	(210)
Net cash used in operating activities	(8,013)	(8,233)
INVESTING ACTIVITIES:		
Expenditures for equipment and leasehold improvements	(158)	(182)
Purchases of short term-investments	(19,994)	(9,998)
Sales and maturities of short-term investments	35,738	8,000
Net cash provided by (used in) investing activities	15,586	(2,180)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,573	(10,413)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	29,693	41,739
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 37,266	\$ 31,326
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of inventory into fixed assets	\$ 192	\$ -

The accompanying notes are an integral part of these condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

BioVeris Corporation (the Company) is a global integrated healthcare company developing proprietary technologies in diagnostics and vaccinology. The Company is dedicated to the commercialization of innovative products and services for healthcare providers, their patients and their communities.

The Company was organized as IGEN Integrated Healthcare, LLC, a Delaware limited liability company, on June 6, 2003, and converted into BioVeris Corporation, a newly formed Delaware corporation on September 22, 2003. On February 13, 2004, IGEN International, Inc. (IGEN or Parent) and Roche Holding Ltd (Roche) consummated a merger transaction pursuant to which Roche acquired IGEN and IGEN simultaneously distributed the common stock of the Company to its stockholders.

The accompanying condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements have been condensed or omitted. In the opinion of the Company's management, the financial statements reflect all adjustments necessary for a fair presentation of the results of operations and cash flows for the three month periods ended June 30, 2006 and 2005, and the Company's financial position at June 30, 2006. The year end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The results of operations for the interim periods are not necessarily indicative of the results for any future interim period or for the entire year. These financial statements should be read together with the audited financial statements and notes contained in the Company's Annual Report on Form 10-K for the year ended March 31, 2006 filed with the Securities and Exchange Commission (SEC).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation Accounting The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances have been eliminated.

Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

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Cash and Cash Equivalents Cash and cash equivalents include cash in banks, money market funds, securities of the U.S. Treasury, and certificates of deposit with original maturities of three months or less.

Short-Term Investments Short-term investments consist primarily of corporate, federal and municipal debt-securities that are classified as available-for-sale. The Company invests its excess cash in accordance with a policy approved by the Company's Board of Directors. This policy is designed to provide both liquidity and safety of principal. The policy limits investments to certain types of instruments issued by institutions with strong investment grade credit ratings and places restrictions on the Company's investment by terms and concentrations by type and issuer. These available-for-sale securities are accounted for at their fair market value and unrealized gains and losses on these securities, if any, are included in accumulated other comprehensive gain or loss in stockholders' equity. The Company uses the specific identification method in computing realized gains and losses on the sale of investments, which are included in results of operations as generated. For the three months ended June 30, 2006 and 2005, the Company did not have any realized gains or losses.

The following is a summary of the Company's available-for-sale marketable securities as of June 30, 2006:

June 30, 2006				
<i>(in thousands)</i>				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Certificates of deposit	\$ 2,500	\$ -	\$ -	\$ 2,500
U.S. government agencies	5,000	-	(49)	4,951
U.S. corporate debt	4,504	-	(4)	4,500
Asset-backed securities	12,269	6	-	12,275
Total	\$ 24,273	\$ 6	\$ (53)	\$ 24,226
March 31, 2006				
<i>(in thousands)</i>				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Certificates of deposit	\$ 5,000	\$ -	\$ -	\$ 5,000
U.S. government agencies	15,000	-	(84)	14,916
U.S. corporate debt	20,066	-	(44)	20,022
Total	\$ 40,066	\$ -	\$ (128)	\$ 39,938

Concentration of Credit Risk The Company places its cash and cash equivalents and short-term investments with highly rated financial institutions. At June 30, 2006 and March 31, 2006, the Company had \$61.1 million and \$69.2 million, respectively, of cash and cash equivalents and short-term investments in excess of federally insured limits. The Company has not experienced any losses on these accounts related to amounts in excess of insured limits. During the three months ended June 30, 2006 and 2005, agencies of the U.S. government accounted for 30% and 32% of total revenues, respectively. As of June 30, 2006 and March 31, 2006, agencies of the U.S. government accounted for 42% and 43% of total consolidated accounts receivable, respectively.

Allowance for Doubtful Accounts The Company maintains reserves on customer accounts where estimated losses may result from the inability of its customers to make required payments. These reserves are determined based on a number of factors, including the current financial condition of specific customers, the age of accounts receivable balances and historical loss rates. Amounts later determined and specifically identified to be uncollectible are charged or written-off against the reserve. Historically, the Company has not experienced significant credit losses related to an individual customer or group of customers and estimated losses have been within the Company's expectation. Allowance for doubtful accounts was \$101,000 and \$253,000 at June 30, 2006 and March 31, 2006, respectively.

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Inventory Inventory is recorded at the lower of cost or market using the first-in, first-out method and consists of the following:

	June 30, 2006	March 31, 2006
	<i>(in thousands)</i>	
Finished Goods	\$ 1,910	\$ 2,058
Work in process	1,152	865
Raw materials	3,414	2,506
Total	\$ 6,476	\$ 5,429

Equipment and Leasehold Improvements Equipment and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Depreciation on equipment, which includes lab instruments and furniture, is computed over the estimated useful lives of the assets, generally three to five years, using the straight-line method of depreciation. Leasehold improvements are amortized on a straight-line basis over the shorter of the estimated useful life or the term of the lease. Equipment and leasehold improvements consist of the following:

	June 30, 2006	March 31, 2006
	<i>(in thousands)</i>	
Lab instruments and equipment	\$ 7,781	\$ 7,579
Office furniture and equipment	4,683	4,659
Leasehold improvements	4,202	4,194
	16,666	16,432
Accumulated depreciation and amortization	(13,326)	(12,976)
Total	\$ 3,340	\$ 3,456

Technology Licenses Simultaneous with the execution of the merger transaction with Roche (see Note 1), the Company entered into worldwide, non-exclusive polymerase chain reaction (PCR) license agreements with certain affiliates of Roche. One agreement grants the Company rights to make, import, use and sell certain PCR products within specified fields, while the other agreement grants the Company rights to perform certain PCR services within specified fields.

The Company paid Roche a license fee of \$50 million in fiscal 2004 and will also pay royalties on sales of the licensed products in the licensed fields and on any instrument, accessory, device or system sold for use with the licensed products in the licensed fields depending on the field, the year, the country of sale and the patents covering such products. During fiscal 2004, the Company performed a valuation of the PCR technology licenses and recorded a value of \$19.5 million and reflected a \$30.5 million adjustment reducing the amount recorded for consideration paid by Roche with respect to the merger and related transactions with IGEN.

These PCR licenses are being amortized over an estimated useful life of ten years, which is based upon a consideration of the range of patent lives and the weighted average remaining life of the most important underlying patents, as well as a consideration of technological obsolescence and product life cycles. Amortization expense was \$488,000 for each of the three months ended June 30, 2006 and 2005. Accumulated amortization was \$4.6 million and \$4.1 million at June 30, 2006 and March 31, 2006, respectively. Amortization expense is expected to approximate \$2.0 million for each year through March 31, 2014.

Evaluation of Long-lived Assets The Company evaluates the potential impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. In evaluating the recoverability of an asset,

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management's policy is to compare the carrying amount of an asset with the projected undiscounted future cash flow. An impairment loss is measured and recorded based on discounted estimated future cash flows. Management believes that no impairment of these assets exists as of June 30, 2006.

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Warranty Reserve - The Company warrants its products against defects in material and workmanship for one year after sale and records estimated future warranty costs at the time revenue is recognized. A reserve for future warranty claims is recorded based upon management's review of historical claims, supplemented by expectations of future costs. The Company also offers extended warranty arrangements to customers, under which revenue recognition for the payment is initially deferred and amortized over the contract period, and related costs are recorded as incurred.

The following is a reconciliation of the Company's general product warranty reserve (in thousands):

	Three Months Ended June 30, 2006	June 30, 2005
Balance, beginning of period	\$ 390	\$ 366
Provisions recorded	87	11
Actual costs incurred	(147)	(90)
Balance, end of period	\$ 330	\$ 287

The following is a reconciliation of the Company's deferred revenue related to extended warranty contracts and includes a summary of the revenue and cost components associated with extended warranties (in thousands):

	Three Months Ended June 30, 2006	June 30, 2005
Deferred revenue, beginning of period	\$ 670	\$ 621
Extended warranties issued	358	322
Amortization of extended warranties	(281)	(293)
Costs incurred during the period	376	238
Settlement during the period of costs incurred	(376)	(238)
Balance, end of period	\$ 747	\$ 650

Fair Value of Financial Instruments - The carrying amounts of the Company's financial instruments, which include cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses, approximate their fair value due to their short maturities.

Comprehensive Loss- Comprehensive loss is comprised of net loss and other items of comprehensive loss. The Company's comprehensive loss for the three months ended June 30, 2006 and 2005 was \$7.3 million and \$6.8 million, respectively. For the three months ended June 30, 2006, other comprehensive income was \$81,000 and for the three months ended June 30, 2005, other comprehensive loss was \$123,000. Other comprehensive income or loss includes unrealized gains and losses on available-for-sale securities that are excluded from net loss.

Revenue Recognition- The Company derives revenue principally from three sources: product sales, royalty income and contract fees.

Product sales revenue is recognized when persuasive evidence of an arrangement exists, the price to the buyer is fixed or determinable, collectibility is reasonably assured and the product is shipped to the customer thereby transferring title and risk of loss. For instrument sales, the instrument and the related installation are considered to be separate elements under Emerging Issues Task Force (EITF) Issue No. 00-21 (EITF 00-21) Accounting for Revenue Arrangements with Multiple Deliverables. Revenue is recognized for the instrument upon shipment or delivery, depending on the terms of each order, and is recognized for the installation when complete using the residual value method. For instrument and reagent sales, there is no option of return and refund and instead there is only the option to repair or replace the product.

Other than the installation required for the instruments and the standard warranty, there are no contingencies, allowances or other post-sale obligations. For instrument leases, the instrument rental and related minimum reagent purchases are considered to be separate elements under EITF 00-21 and, accordingly, the sales price is allocated to the two elements based upon their relative fair values. Instrument rental revenue is recognized ratably over the life of the lease agreements and the related reagent revenue is recognized upon shipment. Revenue associated with extended warranty arrangements is recognized over the term of the extended warranty contract.

Royalty income is recorded when earned, based on information provided by licensees.

Revenue from services performed under contracts is recognized when obligations under the contract have been satisfied. The satisfaction of obligations may occur over the term of the underlying customer contract, if the contract is based on the achievement of certain milestones, or may occur at the end of the underlying customer contract, if based only upon delivery of the final work product.

Research and Development Research and development costs are expensed as incurred and are comprised of costs incurred in performing research and development activities including salaries, benefits, facilities costs, overhead costs, contract services and other outside costs. The Company has entered into several license and option agreements providing patent rights to certain technology under which the Company is responsible for conducting or sponsoring the research and for which it paid approximately \$456,000 and \$247,000 for the three months ended June 30, 2006 and 2005, respectively. These amounts are included as research and development costs.

Foreign Currency - Gains and losses from foreign currency transactions such as those resulting from the settlement of foreign receivables or payables, are included in the results of operations as incurred. These amounts were not material during the three months ended June 30, 2006 and 2005.

Income Taxes - Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized.

Share-based Payments Effective April 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, a revision of SFAS 123, Share-Based Payments, which requires that companies recognize expense associated with share-based compensation arrangements, including employee stock options, using a fair value-based option model. See Note 3 for a complete discussion on accounting for share-based payments.

Loss Per Share - The Company uses SFAS No. 128 Earnings per Share for the calculation of basic and diluted loss per share. For each of the three months ended June 30, 2006 and 2005, the Company incurred a net loss; therefore, net loss per common share does not reflect the potential dilution that could occur to common shares related to outstanding stock options and it did not assume exercise of 888,900 and 123,000 outstanding options, respectively, because to do so would have been anti-dilutive.

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New Accounting Pronouncements - In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes and interpretation of FASB Statement No. 109 (FIN 48), to clarify certain aspects of accounting for uncertain tax positions, including issues related to the recognition and measurement of these tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. While the Company is currently evaluating FIN 48, this pronouncement is not currently expected to have a significant impact on the Company's results of operations and financial condition.

3. SHARE-BASED PAYMENTS

In December 2004, the FASB issued SFAS No. 123R, a revision of SFAS 123, Share-Based Payments. SFAS 123R requires that companies recognize expense associated with share-based compensation arrangements, including employee stock options, using a fair value-based option model, and eliminates the alternative to use the intrinsic value method of accounting for share-based payments under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). SFAS 123R is effective for the Company's fiscal year beginning April 1, 2006. The Company has adopted SFAS 123R using the modified prospective transition method. Under this method, compensation expense is reflected in the financial statements beginning April 1, 2006 with no restatement of prior periods. As such, compensation expense is recognized for awards that are granted, modified, repurchased or cancelled on or after April 1, 2006 as well as for the portion of awards previously granted that have not vested as of April 1, 2006. The Company has implemented the straight-line expense attribution method.

Prior to the adoption of SFAS No. 123R, the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25, as allowed under SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123). Under the intrinsic value method, no employee stock-based compensation expense had been recognized in its Consolidated Statements of Operations for any period prior to its adoption of SFAS No. 123R on April 1, 2006, as the exercise price of the stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Stock Option Plan In September 2003, the Board of Directors of the Company adopted the 2003 Stock Incentive Plan (Stock Plan) under which 5.3 million shares of common stock have been reserved for issuance upon exercise of options granted to employees, non-employee directors or consultants of the Company and its subsidiaries. The Stock Plan was approved by an affirmative vote of the IGEN stockholders prior to the completion of the merger and related transactions with Roche.

The Stock Plan provides for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, non-statutory stock options, restricted stock awards and other share-based awards, including the grant of shares based upon certain conditions, the grant of securities convertible into common stock of the Company and the grant of stock appreciation rights. Incentive stock options may only be granted to employees of the Company and its subsidiaries. The Stock Plan also provides that on the day following each annual meeting of the Company's stockholders each non-employee director will receive an automatic grant of options to purchase 4,000 shares of the Company's common stock. In addition, any person who is appointed or elected as a non-employee director at any other time will receive an automatic grant of options to purchase 4,000 shares of the Company's common stock on the date of such appointment or election. Each grant will have an exercise price equal to fair market value on the date of grant and will vest in full on the first anniversary of the grant date.

Adoption of SFAS 123R Share-based compensation expense recognized during the three months ended June 30, 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company recorded share-based compensation expense during the three months ended June 30, 2006, associated with its Stock Plan as follows (in thousands):

Product costs	\$ 4
Research and development	9

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Selling, general, and administrative	124
Total	\$ 137
Effect on net loss per common share (basic and diluted)	\$ (0.51)

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As of June 30, 2006, total compensation cost related to non-vested stock options not yet recognized was \$2.0 million, which is expected to be allocated to expense and production costs over a weighted-average period of 3.86 years.

Pro-forma Information for Period Prior to Adoption of SFAS123R : The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions to share-based employee compensation during the quarter ended June 30, 2005 (in thousands, except per share amounts):

Net loss, as reported		\$	(6,668)
Deduct: Total stock-based employee compensation expense determined under fair value method			(63)
Pro-forma net loss		\$	(6,731)
Loss per share:			
Basic and diluted loss per common share	as reported	\$	(0.25)
Basic and diluted loss per common share	pro forma	\$	(0.25)

The pro-forma net loss and pro-forma net loss per share disclosed above is not representative of the effects on net loss and net loss per share on a pro-forma basis in future periods, as future periods may include grants by the Company of options for the Company's common stock.

No options were granted during the three months ended June 30, 2005.

Stock Option Activity - Activity related to options under the Stock Plan was as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Term	Aggregate Intrinsic Value
Outstanding at April 1, 2006	458,000	\$ 5.87		
Granted	432,000	\$ 7.68		
Exercised	-	\$ -		
Cancelled/forfeited	(1,100)	\$ 15.80		
Outstanding at June 30, 2006	888,900	\$ 6.74	9.38	\$ 1,166,000
Options exercisable at June 30, 2006	178,900	\$ 6.79		\$ 225,000
Options available for future grant	3,899,081			

There were no options that expired during the three months ended June 30, 2006.

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Summary information about the Company's stock options outstanding at June 30, 2006 is as follows:

Range of Exercise Prices	Options Outstanding	Weighted Average Remaining Years of Contractual Life	Weighted Average Exercise Price	Total Intrinsic Value	Options Exercisable	Weighted Average Exercise Price	Total Intrinsic Value
\$4.33-\$6.62	447,900	8.94	\$ 5.21		149,900	\$ 5.26	
\$7.84-\$11.85	420,000	9.93	\$ 7.92		8,000	\$ 11.85	
\$15.80	21,000	7.75	\$ 15.80		21,000	\$ 15.80	
Total	888,900	9.38	\$ 6.74	\$ 1,166,000	178,900	\$ 6.79	\$ 225,000

The fair value of the Company's options for the three months ended June 30, 2006 was estimated at the date of grant using a Black-Scholes option pricing model. Option valuation models require the input of subjective assumptions and these assumptions can vary over time. The assumptions used are as follows:

Expected dividend yield	0%
Expected stock price volatility	55%
Risk-free interest rate	5.08%
Expected option term (in years)	7.5

Based on this calculation, the weighted average fair value of options granted during the three months ended June 30, 2006 was \$4.85.

Restricted Stock - During the year ended March 31, 2006, the Company granted 510,871 shares of restricted stock under the Stock Plan. The fair value of the restricted stock awards on the date of grant is amortized on a straight line basis over the vesting period. Deferred compensation of \$2,533,000 was initially recorded based on the fair value of the shares on the respective grant dates and is being recognized as compensation expense on a straight line basis over the vesting term through July 2010. The Company did not deem a discount appropriate for post-vesting restrictions and did not use a discount in the calculation of the total deferred compensation. In accordance with SFAS 123R, deferred share-based compensation is no longer reflected as a separate component of stockholders' equity in the condensed consolidated balance sheet. As a result, the Company reclassified its deferred share-based compensation at March 31, 2006 to additional paid-in capital.

Activity related to the restricted stock is as follows:

Non-vested shares at April 1, 2006	301,493
Granted	1,148
Vested	(27,652)
Forfeited	-
Non-vested shares at June 30, 2006	274,989

4. NOTE RECEIVABLE FROM MESO SCALE DIAGNOSTICS

Meso Scale Diagnostics, LLC. (MSD) was a joint venture formed by IGEN and Meso Scale Technologies, LLC. (MST) in 1995. MST was established and was wholly-owned by Mr. Jacob Wohlstadter, a son of the Company's chief executive officer, and Jacob Wohlstadter is the president and chief executive officer of MSD. MSD develops, manufactures, markets and sells products utilizing a combination of MST's multi-array technology together with the Company's electrochemiluminescence (ECL) technology. MSD's Sector line of instrumentation is used for high throughput screening, high content screening, multiplexing and target validation. MSD also manufactures and markets a line of its own reagents, assays and plates that are used on these systems.

Pursuant to the agreements executed in connection with the merger and related transactions between IGEN and Roche, the MSD joint venture agreement expired upon the completion of the merger on February 13, 2004. However, the MSD limited liability company agreement continued (and the Company remained a member of MSD) and many provisions of the MSD joint venture agreement survived its expiration. In addition, certain other MSD agreements, including certain licenses, subleases and other arrangements with MSD, MST and Jacob Wohlstadter assigned to the Company by IGEN continue indefinitely in accordance with their terms.

In August 2004, an independent committee of the Company's Board of Directors, with the advice of independent counsel, negotiated and approved an agreement with MSD, MST and Jacob Wohlstadter to settle pending litigation and other disputes, pursuant to which MSD or MST agreed to purchase the Company's interest in MSD, as provided for in the MSD Agreements (the settlement). The Company also agreed to further amendments to the MSD limited liability company agreement and certain of the other MSD agreements that continue to be in effect. On December 13, 2004, the Company completed the sale to MST of its interests in MSD.

Until the time of the sale of its interests in MSD, the Company held a voting equity interest in MSD. The Company also held non-voting interests that entitled it to receive a preferred return on substantially all of its capital contributions. Following the completion of the buyout of the Company's interests in MSD on December 13, 2004, the Company no longer holds these interests and is entitled to receive only the buyout purchase price.

Buyout of the Company's interest in MSD

Pursuant to the MSD joint venture agreement, MSD and MST had a joint right to purchase the Company's entire interest in MSD upon termination or expiration of the MSD joint venture agreement at a price equal to fair market value less a discount that depended on the circumstances giving rise to termination or expiration of the agreement. Pursuant to the settlement, MST agreed to purchase, and the Company agreed to sell, its entire interest in MSD. The purchase of the Company's interests was completed on December 13, 2004.

The following table summarizes the adjustments provided in the joint venture and settlement agreements (in thousands):

Fair market value purchase price	\$9,898
Add:	
Appraisal fees and costs	85

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Rent payment obligations (March 1, 2004 through August 31, 2005)	2,335
Less:	
Prepayment credit	(2,000)
Total	\$10,318

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Upon closing of the sale of the Company's interests in MSD, the total purchase price balance was approximately \$10.3 million (net of the \$2.0 million prepayment by MSD). The Company recorded a discounted note receivable which had an original balance of \$4.5 million. This note receivable had a balance of approximately \$5.9 million at June 30, 2006, which represents the net present value of future payments that the Company expects to realize from the sale of its interests in MSD. The note receivable will be accreted to fair value using the effective interest method over the term of the expected payments on the note. Total accretion during the three months ended June 30, 2006 and 2005 was approximately \$500,000 and \$400,000, respectively, and has been recorded as a component of interest income. Calculating the net present value of future payments that the Company expects to realize as payment for the purchase price requires assumptions about MSD, including the timing and amount of MSD's future financings and revenue, and an appropriate discount rate. If actual results differ from these assumptions, which are assessed and updated periodically, the net present value of future payments received by the Company could differ from the amount reflected on the balance sheet at June 30, 2006.

As provided in the MSD joint venture agreement, MST is required to pay the Company the outstanding purchase price plus simple (cumulated, not compounded) interest at the fixed annual rate of 0.5% over the prime rate, or 5.5%, in effect on the purchase date. The purchase price is payable over time in installments equal to the sum of 5.0% of MSD net sales, as determined in accordance with the MSD agreements, and 20% of the net proceeds realized by MSD from the sale of its debt or equity securities in any third-party financing after the date of the sale of the Company's interest in MSD.

As part of the settlement, the Company received a \$2.0 million non-refundable prepayment from MSD for future amounts payable by MST to the Company for the purchase price in the form of a credit against amounts the Company agreed to pay MSD pursuant to the settlement. This prepayment was recorded as a deferred liability on the Company's balance sheet. The amount of the prepayment credit outstanding from time to time will bear simple interest (cumulated, not compounded) at the fixed annual rate of 0.5% over the prime rate, or 5.0%, in effect on the date that MST purchased the Company's interests in MSD. The amount of the prepayment credit that is outstanding was approximately \$900,000 at June 30, 2006.

No further cash payments will be payable by MST to the Company pursuant to the buyout until the prepayment credit, including accrued interest, is no longer deemed outstanding. In the event sufficient net sales or third-party financings of MSD do not materialize, the Company may not receive all payments due from MST for the purchase of its interests in MSD. As security for the payment obligation, the Company holds a security interest in the interests in MSD that have been purchased. MST may repay all or any part of the outstanding purchase price plus accrued interest at any time and from time to time without penalty.

The holder of the Company's Series B preferred stock is entitled to a pro-rata share of payments from the sale of the Company's MSD interests. This pro-rata share approximates 6.03% of the \$9.9 million sale price, representing the proportionate amount of the Company's Class C interest in MSD that was funded by the sale of the Series B stock (including payments allocated to the \$2.0 million prepayment).

When the company ceased to be a member of MSD, it became entitled to receive quarterly royalty payments from MSD of 3% of the net sales price on all products developed and sold by MSD using the patents licensed from the Company. During the three months ended June 30, 2006 and 2005, the Company received and recognized royalties of approximately \$200,000 and \$100,000, respectively.

Transitional services and subleases

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When the MSD joint venture agreement expired, the Company was no longer required to provide research personnel and corporate services to MSD. The Company has continued, and expects that it will continue, to provide limited corporate services to MSD on a transitional basis at MSD's expense. The Company bills MSD for the cost of these services on a periodic basis.

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MSD leases certain facilities and related equipment from the Company (including laboratory facilities located in the Company's corporate headquarters) pursuant to sublease agreements which remained in effect following the expiration of the joint venture agreement. The term of each sublease will expire one day prior to the expiration of the prime lease for that facility. Each sublease agreement provides that, subject to certain exceptions, the Company must exercise all available extension rights under the prime lease.

Effective September 1, 2005, MSD was required to pay its pro-rata share of all rental and other expenses the Company incurs under the prime lease. As described above, as part of the settlement, MSD's rental and expense payment obligations for the period from March 1, 2004 through August 31, 2005, which approximate \$2.3 million, were included in the purchase price of the Company's interests in MSD in lieu of MSD making payments to the Company.

During the three months ended June 30, 2006 and 2005, operating costs allocated to MSD by the Company in connection with shared personnel and facilities were approximately \$27,000 and \$200,000, respectively. The specific nature and amount of our allocations are being reviewed by MSD. At June 30, 2006 and March 31, 2006, other current assets include \$800,000 and \$820,000, respectively, for net amounts due from MSD for these allocated operating costs.

Certain indemnification agreements and obligations

Jacob Wohlstadter and JW Consulting Services, L.L.C., a company established and wholly-owned by Jacob Wohlstadter, have an indemnification agreement with IGEN that the Company assumed. Pursuant to the indemnification agreement, the Company will indemnify Jacob Wohlstadter and JW Consulting Services, L.L.C. against any claims arising out of the performance or non-performance of services to or for the benefit of the Company.

The Company agreed under the settlement to indemnify MSD, MST and Jacob Wohlstadter and their respective directors, officers, employees and agents for any losses, costs, fees and expenses arising out of or related in any way to past, current or future audits of MSD, or the preparation of MSD audited or unaudited financial statements requested by the Company.

In addition, the Company agreed to indemnify MSD, MST and Jacob Wohlstadter and their respective directors, officers, employees and agents for any losses, costs, fees and expenses with respect to regulatory (Securities and Exchange Commission or otherwise) or legal proceedings and investigations resulting from or related to the fact that the Company is (or its predecessor, IGEN, was) an issuer of publicly traded securities. The Company is not required to indemnify MSD, MST or Jacob Wohlstadter for acts either resulting in a criminal conviction or finally adjudged by a court of competent jurisdiction to constitute fraud or intentional misrepresentations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations as of June 30, 2006 and for the three months ended June 30, 2006 and 2005 should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended March 31, 2006 filed with the SEC.

This quarterly report contains forward-looking statements within the meaning of the safe harbor provision of the Private Securities Litigation Reform Act of 1995. All statements in this quarterly report that are not historical facts are hereby identified as forward-looking statements including any statements about markets and potential markets, market growth for diagnostic products, potential impact of competitive products, our expectations regarding future revenue, the potential market for products in development, the description of our plans and objectives for future operations, assumptions underlying such plans and objectives, the need for and availability of additional capital and other forward-looking statements. The words may, should, will, expect, could, anticipate, believe, estimate, plan, intend and similar expressions have been used to identify certain of the forward-looking statements. These forward-looking statements are based on management's current expectations, estimates and projections and they are subject to a number of risks, uncertainties and assumptions that could cause actual results to differ materially from those described in the forward-looking statements. These statements are not guarantees of future performance, involve certain risks, uncertainties, and assumptions that are difficult to predict, and are based upon assumptions as to future events that may not prove accurate. Therefore, actual outcomes and results may differ materially from what is expressed herein.

In any forward-looking statement in which we express an expectation or belief as to future results, such expectation or belief is expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the statement or expectation or belief will result or be achieved or accomplished. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this quarterly report. We undertake no obligation to publicly update or release any revisions to these forward-looking statements to reflect events or circumstances after the date of this quarterly report or to reflect the occurrence of unanticipated events.

Overview

We develop, manufacture and market our M-SERIES family of products, which can serve as a platform for diagnostic systems to be used for the detection and measurement of biological or chemical substances. We incorporate our technologies into our instrument systems, tests and reagents, which are the biological and chemical components used to perform such tests. Using the M-SERIES platform, we intend to integrate technologies and products to develop small, expandable and modular systems that can perform a wide variety of tests for the following markets:

Clinical diagnostics. The clinical diagnostics market includes the testing of patient samples to measure the presence of disease and monitor medical conditions. We are developing products to be used in the clinical diagnostics market and believe that our products will be ideally suited for the immunodiagnostic and nucleic acid testing market segments of the clinical testing market.

Non-clinical diagnostics for the biosecurity, life science and industrial markets. The non-clinical diagnostics market includes biosecurity products for the detection of bacteria, viruses and toxins that may pose a military or public health threat; life science testing for drug discovery and development that is performed by pharmaceutical and biotechnology companies; and industrial testing for the detection of foodborne and waterborne disease causing pathogens.

We believe that the emergence of simple, more accurate and cost-effective clinical diagnostic products is shifting the site of clinical diagnostic testing from clinical reference laboratories and central hospital laboratories to decentralized patient care centers, such as physicians' offices, ambulatory clinics, hospital emergency rooms, surgical and intensive care units, hospital satellite laboratories and nurses' stations, which are collectively referred to as clinical point-of-care sites.

Our own product development efforts are focused on M-SERIES instruments and tests for the biosecurity market and for the clinical diagnostics market, particularly for point-of-care sites. We are seeking to develop, market and sell products for the clinical point-of-care market segment

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through a combination of direct efforts and collaborative arrangements. We also are pursuing opportunities in the clinical reference laboratory and central hospital laboratory market segments through collaborative arrangements.

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The first clinical diagnostic system being developed by us is a clinical analyzer that builds on the M-SERIES instruments we sell in the biosecurity and life science markets. We believe that the clinical analyzer will provide results to a physician rapidly with the same levels of sensitivity, accuracy or consistency as a large instrument in a clinical reference laboratory or in a central laboratory, thereby permitting the physician to make a more timely decision regarding the patient's course of treatment. Among the applications that we plan to develop is a proprietary approach for determining an individual's personal immune status through unique diagnostic panels. We will seek approval from the Food and Drug Administration (FDA) for the clinical analyzer and other *in vitro* diagnostics products at the appropriate stage of their product development. There can be no assurance that such approval will be obtained.

Our M-SERIES instruments are used in biodefense programs for homeland security, including by the Department of Defense, or DOD. We believe there will be an increasing opportunity to sell our products as biosecurity tools for use by commercial, governmental and military organizations around the world, as well as in public health.

We are also selling two types of M-SERIES instruments for life science research to pharmaceutical and biotechnology researchers, as well as to scientists at academic and government research institutions. Immunogenicity testing is performed by pharmaceutical and biotechnology companies in order to characterize the ability of protein-based therapeutics to stimulate an immune response. Antibodies that result from an immune response to a protein-based drug can reduce its efficacy and cause significant side effects, such as allergic reactions. Because of serious side effects that have been reported over the last year, it has become increasingly necessary to determine if an immune response to protein-based drugs develops in patients by screening for the presence of antibodies, confirming their specificity, characterizing the type of antibodies present and determining whether they interfere with binding events. Immunogenicity testing is done during pre-clinical studies and may continue through the clinical trials required for regulatory approval. In some cases, the FDA requires additional testing after a drug has been approved. We believe our M-SERIES product line for the life science market is ideally suited to perform immunogenicity testing by measuring low affinity antibodies with high sensitivity, all in the presence of the highly concentrated drug.

In fiscal 2005, we expanded our business model to target the field of vaccines and have rights to certain vaccine candidates through license and option agreements. These vaccine candidates include:

Neisseria meningitidis serogroup B;

Group B Streptococcus;

Chlamydia;

Group A Streptococcus;

Candida albicans;

Pneumococcus;

Anthrax bacilli; and

Urinary tract infection (*E coli*).

It is our intention to continue to license rights to or acquire other vaccine candidates.

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In connection with our efforts to determine an individual's personal immune status through unique diagnostic test panels, we entered into a license and research agreement with Jewish General Hospital (JGH) in Montreal under which we received an exclusive, worldwide license to the use of a JGH database that contains demographic data and the serologic status of an immigrant population linked to numerous infectious diseases.

We expect to incur additional operating losses as a result of our expenses for manufacturing, marketing and sales capabilities, research and product development, and general and administrative costs. Our ability to become profitable in the future will be affected by, among other things, our ability to expand the distribution and increase sales of existing products, upgrade and enhance the M-SERIES family of products, introduce new products into the market, generate higher revenue, develop marketing, sales and distribution capabilities cost-effectively, and continue collaborations originally established by IGEN or establish successful new collaborations with corporate partners to develop, manufacture, market and sell products that incorporate our technologies.

Results of Operations

Three months ended June 30, 2006 and 2005

Revenues. Total revenues for the quarter ended June 30, 2006 decreased to \$4.1 million from \$4.9 million in the corresponding period in the prior year. Our consolidated product sales were \$3.6 million for the quarter ended June 30, 2006, a decrease of \$1.0 million from \$4.6 million in the corresponding period in the prior year. Royalty income increased to \$500,000 for the quarter ended June 30, 2006 from \$300,000 in the corresponding period in the prior year.

Sales of biosecurity products for the three months ended June 30, 2006 decreased to \$1.5 million from \$2.3 million in 2005. Sales of products for the life science market for the three months ended June 30, 2006 decreased to \$2.1 million from \$2.3 million in 2005. These changes in product sales reflect the change of orders and product deliveries which are based on customers' requirements.

Sales of our products for the biosecurity and life science markets are subject to a number of uncertainties, including the fact that we generally are not a party to significant long-term contracts for the sale of our products that would provide predictable sales. Therefore, the volume and timing of product orders from our biosecurity and life science customers are based on their requirements, which may vary over time. As a result, we believe that we do not have sufficient information to reasonably project our future sales.

Operating Costs and Expenses. Product costs were \$2.4 million (66% of total product sales) for the quarter ended June 30, 2006 compared to \$2.0 million (45% of total product sales) in the corresponding prior year period. The current year increase includes approximately \$100,000 of costs incurred in connection with detection module upgrades for certain existing customers. We may incur an additional cost of approximately \$1.3 million related to these voluntary upgrades during the remainder of fiscal 2007 to enhance overall customer satisfaction. Product costs also increased due to higher service costs related to detection modules. Our future profit margin is subject to change due to a number of uncertainties relating to, among other things, the launch of new instrument systems.

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Research and development expenses were \$4.3 million for the quarter ended June 30, 2006, which represents a decrease of 10% from the prior year costs of \$4.8 million. Research and development expenditures decreased in the current period due primarily to lower facilities and personnel costs. Research and development expenses primarily relate to ongoing development costs and product enhancements associated with vaccines, the M-SERIES family of products, development of new assays and research and development of new systems and technologies, including point-of-care products. We expect research and development costs to increase as product development and core research expand, including costs associated with our efforts in vaccines, developing clinical diagnostics and biosecurity testing products, and development of a proprietary approach for determining an individual's personal immune status through unique diagnostic test panels.

We have expanded our business model to target the field of vaccines which will require substantial research and development expenditures. For example, we have entered into several license and option agreements for patent rights to unique vaccine candidates. Under these agreements, we are responsible for conducting or sponsoring the research and development of these vaccine candidates and may be required to make additional payments for license and milestone fees, including for initiating and completing human clinical trials and receiving regulatory approvals. Payments on these agreements totaled \$456,000 and \$247,000 in the three months ended June 30, 2006 and 2005, respectively.

Selling, general and administrative expenses were \$6.2 million in the quarter ended June 30, 2006, which represents an increase of 9% over the prior year costs of \$5.7 million. Our increase in selling, general and administrative costs in the quarter ended June 30, 2006 was primarily attributable to an increase in professional and outside service costs related to our continued compliance with Section 404 of the Sarbanes-Oxley Act of 2002, compensation expense associated with the implementation of SFAS 123R, and to fees incurred in conjunction with our review of Roche's compliance with the restrictions in its license to our ECL technology.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and NASDAQ National Market rules are creating uncertainty for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increases in general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

Interest and Other Income / Expense. Interest and other income was \$1.4 million and \$900,000 in the quarters ended June 30, 2006 and 2005, respectively. Interest income includes approximately \$500,000 and \$400,000, respectively, from the accretion of income related to the note receivable from MSD. Other income includes approximately \$200,000 of foreign currency gains for the three months ended June 30, 2006, compared to approximately \$200,000 of foreign currency losses for the three months ended June 30, 2005.

Share-based Payments. In December 2004, the FASB issued SFAS No. 123R, a revision of SFAS 123, Share-Based Payments. SFAS 123R requires that companies recognize expense associated with share-based compensation arrangements, including employee stock options, using a fair value-based option model, and eliminates the alternative to use the intrinsic value method of accounting for share-based payments under APB 25, Accounting for Stock Issued to Employees. SFAS 123R is effective for the Company's fiscal year beginning April 1, 2006. We have adopted SFAS 123R using the modified prospective transition method. Under this method, compensation expense is reflected in the financial statements beginning April 1, 2006 with no restatement of prior periods. As such, compensation expense is recognized for awards that are granted, modified, repurchased or cancelled on or after April 1, 2006 as well as for the portion of awards previously granted that have not vested as of April 1, 2006. We have implemented the straight-line expense attribution method.

Prior to the adoption of SFAS No. 123R, we accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25, as allowed under SFAS No. 123, Accounting for Stock-Based Compensation. Under the intrinsic value method, no employee stock-based compensation expense had been recognized in our Consolidated Statements of Operations for any period prior to our adoption of SFAS No. 123R on April 1, 2006, as the exercise price of the stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

During the three months ended June 30, 2006, we recorded pre-tax share-based compensation expense associated with our 2003 Stock Incentive Plan of \$137,000, including \$4,000 to product costs, \$9,000 to research and development, and \$124,000 to selling, general and administrative

costs.

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Net Loss. The net loss for the quarter ended June 30, 2006 was \$7.4 million (\$0.27 per common share), compared to a net loss of \$6.7 million (\$0.25 per common share) in the corresponding prior year period. The increase in the net loss is primarily caused by a decrease in revenue that was not fully offset by decreased operating expenses.

Liquidity and Capital Resources

		June 30, 2006		March 31, 2006
Cash, cash equivalents and short-term investments	\$	61,492	\$	69,631
Working capital		65,156		72,184
				Three Months Ended
		June 30, 2006		June 30, 2005
Cash provided by(used in):				
Operating activities	\$	(8,013)	\$	(8,233)
Investing activities		15,586		(2,180)
Financing activities		-		-
Capital expenditures (including in investing activities above)		(158)		(182)

Effective in February 2004, we granted Roche a worldwide, non-exclusive, royalty-free license to patents and information relating to our proprietary ECL technology, subject to certain limitations described in the relevant license agreement. The license may be used by Roche to commercially exploit only certain ECL products and is royalty-free provided such products are used in a specified field. Our right to terminate the license is restricted, except under certain circumstances.

Pursuant to the license agreement, the parties can jointly engage an independent field monitor to review Roche's compliance with the license on an annual basis. We and Roche have engaged a field monitor to review placements and sales of products and services by Roche in 2005. The field monitor has been tasked with preparing a written report, including a list of any sales or placements of products and services that were not within the licensed field and identifying sales or placements of products or services in violation of the license grant. Pursuant to the license agreement, Roche must pay to us, within 30 days after receiving the field monitor's report, 65% of all undisputed revenues earned through out-of-field sales of products for 2005. Although Roche may not knowingly sell or actively market outside the field, they may continue the identified out-of-field sales until we notify Roche in writing that they are prohibited from making any further such sales. For a more complete description of the Roche license, refer to the agreement on file with the SEC.

We believe that the potential payment to us for out-of-field sales may be material to our financial position, results of operations and cash flows. Based on its 2005 Annual Report, Roche reported ECL (Elecsys) product sales for the year ending December 31, 2005 of CHF 989 million. For each 1% of Roche's total sales that were out-of-field during 2005, as determined by the field monitor, there would be approximately a \$5.3 million positive impact on our financial position, results of operations and cash flows (using the currency conversion rate of Swiss Francs to U.S. Dollars at August 4, 2006 of 0.8191). Actual differences in the amount of Roche ECL (Elecsys) sales or placements or in the currency rates used would change this amount.

The amount and timing of any payment that we might receive from Roche relating to out-of-field sales in 2005 is uncertain because, among other things: (1) the amount of such sales and placements has not yet been determined; and (2) there may be disputes between Roche and us concerning the agreement and/or the field monitor's findings. Although a field monitor has not been engaged to address 2004, we believe that we are entitled to payment for out-of-field sales during 2004. We are attempting to resolve this matter with Roche.

Product development for our clinical diagnostic and vaccine products are at an early development stage. Product development is subject to a number of technical and commercial uncertainties and in part depends upon our ability to enter into new collaborative arrangements. Accordingly, the business plan for our clinical diagnostic and vaccine products, including immunodiagnostic and PCR technology-based products, is evolving and does not have definitive product introduction timelines or budgets and we have not yet determined the additional funding, personnel, facilities, equipment or technology that may be required to implement our plans.

Our ability to become profitable in the future will depend on, among other things, the introduction of new products to the market. If we are unable to develop new products, our business prospects and financial results would be adversely affected. Furthermore, we will need substantial amounts of money to fund our operations on an ongoing basis. We expect our available cash to be sufficient to fund our operations for at least one year, but we cannot predict how long our available cash will be sufficient to fund our operations thereafter.

We expect that we will from time to time have discussions with third parties, including multinational corporations, regarding various business arrangements including distribution, marketing, research and development, joint venture and other business agreements, which could provide us with substantial up-front fees or payments. We cannot assure you that we will successfully complete any of the foregoing arrangements and access to funds could be adversely impacted by many factors, including the volatility of the price of our common stock, continuing losses from our operations, establishment of new business arrangements, the status of new product launches, general market conditions and other factors. If we are unable to raise additional capital, we may have to scale back, or even eliminate, some programs, which we have the ability to do. Alternatively, we may consider pursuing arrangements with other companies, such as granting licenses or entering into joint ventures or collaborations, on terms that may not be favorable to us.

Cash Used in Operating Activities

Net cash used for operations was \$8.0 million and \$8.2 million during the three months ended June 30, 2006 and 2005, respectively. The decrease in cash used for operations in the current period resulted primarily from a higher net loss, partially offset by lower non-cash adjustments, and further decreased by lower working capital requirements in the current period. The non-cash adjustments for the three months ended June 30, 2006 were primarily due to depreciation and amortization and the accretion of interest income.

Cash Provided by or Used in Investing Activities

We used approximately \$200,000 of cash for the acquisition of equipment and leasehold improvements during each of the three months ended June 30, 2006 and 2005. During the three months ended June 30, 2006 and 2005, we purchased short-term investments of \$20.0 million and \$10.0 million, respectively, and we received proceeds of \$35.7 million and \$8.0 million, respectively, from the sale and maturity of short-term investments.

Cash Used in Financing Activities

During the three months ended June 30, 2006, we declared dividends with respect to shares of series B preferred stock

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of \$22,000, which were paid subsequent to June 30, 2006. During the three months ended June 30, 2005 we declared and paid dividends of \$57.

MSD

The MSD joint venture agreement expired upon completion of the merger. As a result, MSD and MST had the option to purchase our interests in MSD and pursuant to the settlement, MSD or MST agreed to purchase, and we agreed to sell, our entire interest in MSD. The purchase of our interests was completed by MST on December 13, 2004.

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MST is required to pay us the outstanding purchase price over time in installments equal to the sum of 5% of MSD net sales, as determined in accordance with the MSD agreements, and 20% of the net proceeds realized by MSD from the sale of its debt or equity securities in any third-party financing after the date of the sale of our interests in MSD. As part of the settlement, we received a \$2.0 million non-refundable prepayment from MSD for future amounts payable by MSD to us for the purchase price in the form of a credit against amounts we agreed to pay MSD pursuant to the settlement. No further cash payments will be payable by MSD to us pursuant to the buyout until the prepayment credit, which has a balance of \$900,000 at June 30, 2006, is no longer deemed outstanding.

Upon the sale of our interests in MSD, we recorded a discounted note receivable of \$4.5 million that had a balance at June 30, 2006 of approximately \$5.9 million, which represented the net present value of future payments that we expect to realize from the sale of our interests in MSD. Calculating the net present value of future payments that we expect to realize from MSD as payment for the purchase price, requires assumptions about MSD, which are assessed and updated periodically, including the timing and amount of MSD's future financings and revenue, and an appropriate discount rate. If actual results differ from these assumptions, the net present value of future payments received by us could differ from the amount reflected on the balance sheet at June 30, 2006. We expect that MSD will require substantial additional funding for its ongoing operations. If MSD is not able to obtain this funding, or in the event sufficient net sales or third-party financings of MSD do not materialize, we may not receive all payments due from MST for the purchase of our interests in MSD.

For a more complete description of the sale of our MSD interests and the MSD agreements, see Part I ITEM 1, Condensed Consolidated Financial Statements Notes to Condensed Consolidated Financial Statements Note 4 .

During the three months ended June 30, 2006 and 2005, operating costs allocated to MSD by us in connection with shared personnel and facilities totaled \$27,000 and \$200,000, respectively. The specific nature and amount of our allocations are being reviewed by MSD.

Contractual Obligations

We have contractual obligations associated with ongoing business activities which will result in cash payments in future periods. In addition, we believe that material commitments for capital expenditures may be required in a variety of areas, such as product development programs, sponsored research and the build-out of new facilities. We have not, at this time, made material commitments for any such capital expenditures and have not secured additional sources to fund such commitments if they become necessary in the future.

As of June 30, 2006, our material future obligations were as follows (in thousands):

Years Ended March 31,	Operating Leases	Sponsored Research	Total
2007	\$ 3,164	\$ 479	\$ 3,643
2008	4,208	228	4,436
2009	4,122	196	4,318
2010	3,531	98	3,629
2011	1,734	-	1,734
2012 and thereafter	5,401	-	5,401
	22,160	1,001	23,161
Less: sublease income	(4,532)	-	(4,532)
Total	\$ 17,628	\$ 1,001	\$ 18,629

Under vaccine license agreements, we are responsible for conducting or sponsoring the research and development of vaccine candidates and may be required to make additional payments for patent costs, milestone fees, including for initiating and completing human clinical trials and receiving regulatory approvals, and royalties on future sales.

As of June 30, 2006, we had no off-balance sheet arrangements, as defined by SEC Regulation S-K, Item 303 (a) (4).

Critical Accounting Policies

A critical accounting policy is one that is both important to the portrayal of our financial position and results of operations and requires the application of difficult, subjective or complex judgments by management. As a result, critical accounting policies are subject to an inherent degree of uncertainty. In applying those policies, management uses its judgment to determine the appropriate assumptions to be used in the determination of certain estimates. These estimates are based on our management's experience, terms of existing contracts, observance of trends in the industry, information provided by customers, and information available from other outside sources, as appropriate. Significant changes to these estimates could have a material impact on our consolidated financial statements. Our critical accounting policies include:

Revenue Recognition We derive revenue principally from three sources: product sales, royalty income and contract fees.

Product sales revenue is recognized when persuasive evidence of an arrangement exists, the price to the buyer is fixed or determinable, collectibility is reasonably assured and the product is shipped to the customer thereby transferring title and risk of loss. For instrument sales, the instrument and the related installation are considered to be separate elements under EITF 00-21. Revenue is recognized for the instrument upon shipment or delivery, depending on the terms of each order, and is recognized for the installation when complete based upon the residual value method. For instrument and reagent sales, there is no option of return and refund, only the option to repair or replace the product.

Other than the installation required for the instruments and the standard warranty, there are no contingencies, allowances or other post-sale obligations. For instrument leases, the instrument rental and related minimum reagent purchases are considered to be separate elements under EITF 00-21 and, accordingly, the sales price is allocated to the two elements based upon their relative fair values. Instrument rental revenue is recognized ratably over the life of the lease agreements and the related reagent revenue is recognized upon shipment. Revenue associated with extended warranty arrangements is recognized over the term of the extended warranty contract.

Royalty income is recorded when earned, based on information provided by licensees.

Revenue from services performed under contracts is recognized when obligations under the contract have been satisfied. The satisfaction of obligations may occur over the term of the underlying customer contract, if the contract is based on the achievement of certain milestones, or may occur at the end of the underlying customer contract, if based only upon delivery of the final work product.

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The majority of our product sales and contract fees contain standard terms and conditions. Certain transactions may contain negotiated terms that require contract interpretation to determine the appropriate amount of revenue to be recognized. In addition, we must assess whether collectibility is reasonably assured. While management believes its interpretations and judgments are reasonable, different assumptions could result in changes in the timing of revenue recognition.

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Share-based Payments - In December 2004, the FASB issued SFAS No. 123R, a revision of SFAS 123, *Share-Based Payments*. SFAS 123R requires that companies recognize expense associated with share-based compensation arrangements, including employee stock options, using a fair value-based option model, and eliminates the alternative to use the intrinsic value method of accounting for share-based payments under APB 25, *Accounting for Stock Issued to Employees*. SFAS 123R is effective for the Company's fiscal year beginning April 1, 2006. We have adopted SFAS 123R using the modified prospective transition method. Under this method, compensation expense is reflected in the financial statements beginning April 1, 2006 with no restatement of prior periods. As such, compensation expense is recognized for awards that are granted, modified, repurchased or cancelled on or after April 1, 2006 as well as for the portion of awards previously granted that have not vested as of April 1, 2006. We have implemented the straight-line expense attribution method.

The fair value of stock option grants during the three months ended June 30, 2006 were estimated on the date of grant using a Black-Scholes option valuation model that uses the following assumptions:

Expected dividend yield	0%
Expected stock price volatility	55%
Risk-free interest rate	5.08%
Expected option term (in years)	7.5

Expected volatility is based primarily upon our historical volatility. The expected term of options granted is derived from assumed exercise rates based on historical exercise patterns, and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate used is determined by the market yield curve based upon the risk-free interest rates established by the Federal Reserve, or non-coupon bonds that have maturities equal to the expected term. The dividend yield is based upon the fact that we have not historically granted cash dividends on our common stock, and do not expect to issue dividends in the foreseeable future. Stock options granted prior to April 1, 2006 were valued based on the grant date fair value of those awards, using the Black-Scholes option pricing model, as previously calculated for pro-forma disclosures under SFAS 123 *Accounting for Stock-based Compensation*. Alternative estimates and judgments could yield materially different results.

Inventory - We record our inventory at the lower of cost or market using the first-in, first-out method. We regularly review inventory quantities on hand and record a reserve for excess and obsolete inventory based primarily on an estimated forecast of product demand and production requirements for the next twelve months. Reserves are recorded for the difference between the cost and the market value. Those reserves are based on significant estimates. Our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. In addition, our industry is characterized by technological change, frequent new product development and product obsolescence that could result in an increase in the amount of obsolete inventory quantities on hand. Although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the values of our inventory and our reported operating results.

Evaluation of Long-lived Assets - We have different long-lived assets recorded on our balance sheet that include equipment and leasehold improvements, investments, licenses and other assets. We evaluate the potential impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. In evaluating the recoverability of an asset, management's policy is to compare the carrying amount of an asset with the projected undiscounted cash flow. An impairment loss is measured and recorded based on discounted estimated future cash flows.

We recorded a discounted note receivable which had an original balance of \$4.5 million. This note receivable has a balance of approximately \$5.9 million at June 30, 2006, which represents the net present value of future payments that we expect to realize from the sale of our interests in MSD. We accrete to fair value using the effective interest method. Calculating the net present value of future payments that we expect to realize as payment for the purchase price requires assumptions about MSD, including the timing and amount of MSD's future financings and revenue, and an appropriate discount rate. If actual results differ from these assumptions, the net present value of future payments received by us could differ from the amount reflected on the consolidated balance sheet at June 30, 2006.

Warranty Reserve We warrant our products against defects in material and workmanship for one year after sale and record estimated future warranty costs at the time revenue is recognized. A reserve for future warranty claims is recorded based upon management's review of historical results, supplemented by expectations of future costs. Unanticipated changes in actual warranty costs could impact our operating results.

New Accounting Pronouncements In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes and interpretation of FASB Statement No. 109 (FIN 48), to clarify certain aspects of accounting for uncertain tax positions, including issues related to the recognition and measurement of these tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. While we are currently evaluating FIN 48, this pronouncement is not currently expected to have a significant impact on our results of operations and financial condition.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to changes in exchange rates where we sell products directly in local currencies, primarily in the United Kingdom and Germany. Certain other foreign sales are denominated in U.S. dollars and have no exchange rate risk. Gains and losses resulting from foreign currency transactions have historically not been material.

Our balance sheet at June 30, 2006 had cash, cash equivalents and short-term investments of \$61.5 million, which is approximately 63% of total assets. We invest excess cash in accordance with a policy approved by our Board of Directors. The policy is designed to provide both liquidity and safety of principal. The policy limits investments to certain types of instruments issued by institutions with strong investment grade credit ratings and places restrictions on our investments by terms and concentrations by type and issuer. We invest our excess cash in money market funds, securities of the U.S. Treasury, and certificates of deposit with original maturities of three months or less. At June 30, 2006, we had invested \$24.2 million in securities of the U.S. government, municipal bonds, and U.S. corporate debt, which were recorded as short-term investments.

Our invested cash is sensitive to changes in interest rates. Based on our cash, cash equivalents and short-term investments balance at June 30, 2006, a 1% movement in interest rates would have an approximately \$600,000 impact on our annual interest income and annual net loss. Actual changes in rates may differ from the hypothetical assumption used in computing this exposure.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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For the quarterly period ended June 30, 2006, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13(a)-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Form 10-Q. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of June 30, 2006, our disclosure controls and procedures were effective.

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Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures will prevent all errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met and our disclosure controls and procedures are designed to provide this reasonable assurance. Because of the inherent limitations in all control systems, no evaluation of control can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Controls Over Financial Reporting

There were no changes in our internal control over financial reporting during the first quarter of fiscal 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1A. RISK FACTORS

Risks Relating to Us and Our Business

OUR BUSINESS HAS A HISTORY OF LOSSES AND WE EXPECT TO HAVE FUTURE LOSSES AND NEGATIVE CASH FLOW.

We incurred net losses of \$27.9 million, \$77.6 million and \$93.3 million for the years ended March 31, 2006, 2005 and 2004, respectively, and a net loss of \$7.4 million for the three months ended June 30, 2006. We expect to continue to incur operating losses and negative cash flow as a result of our expenses for manufacturing, marketing and sales capabilities, research and product development, and general and administrative costs.

While we seek to attain profitability, we cannot be sure that we will ever achieve product or other revenue sufficient for us to attain this objective. Our ability to become profitable in the future will depend on, among other things, our ability to:

expand the distribution and increase sales of certain of our products;

upgrade and enhance the M-SERIES family of products;

introduce new products into the market;

develop our marketing, sales and distribution capabilities cost-effectively; and

continue existing collaborations and establish successful new collaborations with corporate partners to develop and market products that incorporate our technologies and provide necessary funding.

TO ACHIEVE COMMERCIAL SUCCESS, WE MUST COMPLETE THE DEVELOPMENT OF OUR PRODUCTS AND THOSE PRODUCTS MUST GAIN MARKET ACCEPTANCE OR OUR BUSINESS COULD BE MATERIALLY ADVERSELY AFFECTED.

Many of our potential products, including certain M-SERIES products, are at an early stage of development and we have not introduced any clinical diagnostics products into the marketplace. Products under development require additional research and development efforts, including clinical testing and regulatory approval, prior to commercial use. Our potential products are subject to the risks of failure inherent in the development of products based on new technologies. These risks include the possibilities that:

our design or approach may not be successful;

our products may not be compatible with existing technology or may rely on technology that has become obsolete;

our products may be found ineffective or fail to meet the applicable regulatory standards or receive necessary regulatory clearances;

our estimates of the market size and potential for our products may prove incorrect;

third parties may market superior or equivalent products;

our products may not be recognized or accepted in the market due to unfamiliar brand names; or

our product development costs may outweigh potential future cash flows associated with those products.

Our business, business prospects and financial results would be hurt if our products are not accepted as alternatives to other existing or new products and do not gain market acceptance.

In addition, we have licensed certain PCR technology from Roche that we plan to integrate into certain of our new instrument systems. Although we do not currently sell any product based on the PCR technology licensed from Roche, any products that we may develop using PCR technology will be also subject to the risks of failure inherent in the development of products based on new technologies as described above.

We have recorded a net book value for the PCR licenses of \$14.9 million at June 30, 2006. If we are unable to successfully develop any products using PCR technology because such PCR technology has become obsolete or the future cash flows attributable to products using PCR technology are insufficient to realize the remaining carrying value of the license, we would be required to write-off the remaining net book value or record an impairment of the value of the PCR license. Such a write-off or the recording of such an impairment could have a material adverse effect on our future results of operations.

OUR QUARTERLY OPERATING RESULTS MAY FLUCTUATE SIGNIFICANTLY, AND THESE FLUCTUATIONS MAY CAUSE OUR STOCK PRICE TO BE VOLATILE.

Our quarterly operating results will depend upon:

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the volume and timing of orders and product deliveries for biosecurity products, M-SERIES systems or other products, which are based on our customers' requirements that may vary over time;

the success of M-SERIES system upgrades and enhancements and customer acceptance of those enhancements and upgrades;

costs incurred related to expansion into the field of vaccines;

the amount of revenues recognized or collectible from royalties and other contract revenues, which revenues are dependent upon the efforts and compliance of our licensees and collaborators, including Roche;

whether our instruments are sold or leased to customers, which will affect the timing of the recognition of revenue from the sale or lease;

the timing of our introduction of new products, which could involve increased expenses associated with product development and marketing;

the volume and timing of product returns and warranty claims, which, if products are returned or have warranty claims that are unexpected, may involve increased costs in excess of amounts reserved for returns or claims;

our competitors' introduction of new products, which may affect the purchase decision of or timing of orders by our customers and prospective customers while the competitors' product is assessed;

the amount of expenses we incur in connection with the operation of our business, including:

research and development costs, which increase or decrease based on the products in development;

sales and marketing costs, which are based on product launches or promotions and sales incentives that might be in effect from time to time; and

expenses associated with share-based compensation arrangements, including employee stock options;

the amount that we may record related to the potential impairment of the license to use PCR technology;

amounts received from MSD or MST as payment for allocated operating costs, the purchase of our interests in MSD and the related accretion of income on the note receivable from MST;

unexpected termination of government contracts or orders, which could result in decreased sales and increased costs due to excess capacity, inventory, personnel and other expenses; and

additional costs which we may incur as we explore new healthcare opportunities, including costs for acquisitions of technologies, facilities and personnel.

These factors may cause our quarterly operating results to fluctuate significantly, which in turn, may cause our stock price to be volatile. In addition, because our revenues and operating results are expected to be volatile and difficult to predict, we believe that period-to-period comparisons of our results of operations are not a reliable indication of our future performance.

WE MAY CHANGE THE FOCUS OF OUR BUSINESS OR ENTER INTO NEW HEALTHCARE FIELDS, WHICH COULD RESULT IN THE INCURRENCE OF ADDITIONAL COSTS AND EXPOSURE TO ADDITIONAL OR DIFFERENT BUSINESS RISKS.

We have broad discretion in determining the future strategy and focus of our business and may enter new healthcare fields in which we have limited or no experience. During fiscal 2005, we expanded our business model to target the field of vaccines. A significant change in the focus of our business could result in a loss of our investment, the incurrence of additional costs, including research and development costs, and exposure to additional or different business risks. Incurrence of additional costs and exposure to additional risks could materially adversely affect our business.

IF WE ARE UNABLE TO ESTABLISH NEW COLLABORATIONS, OR IF ANY COLLABORATIONS WE ESTABLISH DO NOT RESULT IN THE SUCCESSFUL INTRODUCTION OR MARKETING OF NEW PRODUCTS BASED ON OUR TECHNOLOGY, OUR GROWTH MAY BE SLOWED AND OUR BUSINESS COULD BE MATERIALLY ADVERSELY AFFECTED.

One aspect of our strategy is to enter into collaborative relationships with established healthcare and other companies to assist us in developing our technologies or manufacturing or marketing our products for certain markets. We may not be able to enter into collaborations on terms that are favorable to us, if at all. In addition, we cannot assure that third parties, including our licensees, suppliers or others will not object to possible new collaborations.

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As a result of this strategy, we may have no, or only limited, control over the amount of resources that our collaborators will devote to the development or marketing of products based on our technology. For instance, our collaborators:

may decide not to, or may fail to successfully, develop, market or sell products based on our technology;

may not devote sufficient resources to the development, marketing or sale of these products based on our technology; or,

may terminate their agreements with us.

If any of these events occur with respect to one of the companies we are collaborating with, we would not receive the benefits of the collaboration and our growth could be slowed and our business could be materially adversely affected.

WE MAY NOT BE ABLE TO RAISE SUFFICIENT ADDITIONAL CAPITAL TO SUCCESSFULLY DEVELOP OUR BUSINESS.

We will need substantial amounts of money to fund our operations on an ongoing basis. We expect our available cash to be sufficient to fund our operations for at least one year, but cannot predict how long our available cash will be sufficient to fund our operations thereafter.

We may need to raise substantial amounts of money to fund a variety of future activities integral to the development of our business, including:

for research and development to successfully develop our technologies, including future payment obligations under license or option agreements;

to obtain regulatory approval for our products;

to file and prosecute patent applications to protect our technology;

to respond to innovations that our competitors develop;

to retain qualified employees, particularly in light of competition for qualified scientists and engineers;

to make new arrangements to market our technology;

to manufacture products ourselves or through a third party;

to provide funding for expanded or new facilities; and

to market different products to different geographic markets, either through expanding our sales and distribution capabilities or relying on a third party.

The failure to raise sufficient additional capital for us to develop our business would adversely affect our business prospects.

OUR ACCESS TO FUNDS COULD BE NEGATIVELY IMPACTED BY MANY FACTORS, INCLUDING VOLATILITY IN THE PRICE OF OUR COMMON STOCK, LOSSES FROM OPERATIONS AND CAPITAL MARKET CONDITIONS.

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We may not have access to enough funds on favorable terms, if at all, to successfully operate and develop our business. We may try to raise necessary additional capital by issuing additional debt or equity securities. Holders of debt securities would have priority over our equity holders with respect to the proceeds from the sale of our assets in the event of liquidation of our business, and any debt financings that we obtain may contain restrictive terms that limit our operating flexibility. If we raise additional capital by selling additional common or preferred stock, the holdings of existing stockholders would be diluted.

If we are unable to raise additional capital, we may have to consider pursuing arrangements with other companies that may not be available on terms favorable to us. In addition, we may have to scale back, or even eliminate, some of our programs.