TRANSGENOMIC INC
Form 10-Q
August 14, 2006

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2006

Or

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

For the transition period from ______ to ______

Commission file number: 000-30975

TRANSGENOMIC, INC.

(Exact name of registrant as specified in its charter)

Delaware	**911789357**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
12325 Emmet Street, Omaha, Nebraska	**68164**
(Address of principal executive offices)	**(Zip Code)**

(402) 452-5400

(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 Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 Securities Exchange Act of 1934.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934) Yes ¨ No x

As of August 14, 2006, the number of shares of common stock outstanding was 49,189,672.

TRANSGENOMIC INC.

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TRANSGENOMIC, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)

	June 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 7,362	$ 6,736
Accounts receivable (net of allowances for bad debts of $378 and $615, respectively)	6,605	7,542
Inventories	2,403	2,990
Prepaid expenses and other current assets	709	653
Current assets of discontinued operations	197	197
Total current assets	17,276	18,118
PROPERTY AND EQUIPMENT:		
Equipment	10,214	10,108
Furniture and fixtures	3,802	3,797
	14,016	13,905
Less: accumulated depreciation	11,986	11,328
	2,030	2,577
OTHER ASSETS:		
Goodwill	638	638
Other assets	900	1,074
Non-current assets of discontinued operations	3,061	2,933
	$ 23,905	$ 25,340
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 1,439	$ 1,796
Other accrued expenses	2,949	3,114
Accrued compensation	760	602
Current liabilities of discontinued operations	1,046	1,922
Total current liabilities	6,194	7,434
Total liabilities	6,194	7,434
COMMITMENTS AND CONTINGENCIES (Note F)		
STOCKHOLDERS EQUITY:		
Preferred stock, $.01 par value, 15,000,000 shares authorized, none outstanding		
Common stock, $.01 par value, 100,000,000 and 60,000,000 shares authorized, respectively, 49,189,672 and 49,182,121 shares outstanding, respectively	497	497
Additional paid-in capital	138,805	138,800

Accumulated other comprehensive income	1,203	703
Accumulated deficit	(122,794)	(122,094)
Total stockholders equity	17,711	17,906
	$ 23,905	$ 25,340

See notes to condensed consolidated financial statements.

TRANSGENOMIC, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
NET SALES	$ 6,189	$ 6,889	$ 12,686	$ 13,817
COST OF GOODS SOLD	3,140	3,403	6,654	6,932
Gross profit	3,049	3,486	6,032	6,885
OPERATING EXPENSES:				
Selling, general and administrative	2,820	3,306	5,529	6,592
Research and development	531	581	1,135	1,187
	3,351	3,887	6,664	7,779
LOSS FROM OPERATIONS	(302)	(401)	(632)	(894)
OTHER INCOME (EXPENSE):				
Interest expense		(83)		(1,740)
Other, net	44	25	88	17
	44	(58)	88	(1,723)
LOSS BEFORE INCOME TAXES	(258)	(459)	(544)	(2,617)
INCOME TAX EXPENSE		14	17	18
LOSS FROM CONTINUING OPERATIONS	(258)	(473)	(561)	(2,635)
LOSS FROM DISCONTINUED OPERATIONS, NET OF TAX	(125)	(525)	(139)	(1,255)
NET LOSS	$ (383)	$ (998)	$ (700)	$ (3,890)
BASIC AND DILUTED LOSS PER SHARE:				
From continuing operations	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.08)
From discontinued operations	0.00	(0.02)	0.00	(0.04)
	$ (0.01)	$ (0.03)	$ (0.01)	$ (0.12)
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	49,189,672	34,237,042	49,187,211	32,122,502

See notes to condensed consolidated financial statements.

TRANSGENOMIC, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

Six Months Ended June 30, 2006

(Dollars in thousands except per share data)

	Common Stock					
	Outstanding Shares	Par Value	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2006	49,182,121	$ 497	$ 138,800	$ (122,094)	$ 703	$ 17,906
Net loss				(700)	(700)	(700)
Other comprehensive income (loss):						
Foreign currency translation adjustment					500	500
Comprehensive loss					(200)	
Issuance of shares for employee stock purchase plan	7,551		5			5
Balance, June 30, 2006	49,189,672	$ 497	$ 138,805	$ (122,794)	$ 1,203	$ 17,711

See notes to condensed consolidated financial statements.

TRANSGENOMIC, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (700)	$ (3,890)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	956	2,101
Non-cash financing costs		1,434
Gain on sale of securities		(9)
Loss on sale of assets	7	
Other		2
Changes in operating assets and liabilities:		
Accounts receivable	1,131	1,241
Inventories	785	611
Prepaid expenses and other current assets	(90)	399
Accounts payable	(477)	(841)
Accrued expenses	(947)	(2,220)
Net cash flows from operating activities	665	(1,172)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the maturities and sales of available for sale securities		617
Purchase of property and equipment	(178)	(671)
Change in other assets	(41)	(1)
Proceeds from asset sales	40	139
Net cash flows from investing activities	(179)	84
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in credit line		2,050
Payments on term note		(178)
Issuance of common stock	5	7
Net cash flows from financing activities	5	1,879
EFFECT OF FOREIGN CURRENCY EXCHANGE RATE CHANGES ON CASH	139	(79)
NET CHANGE IN CASH AND CASH EQUIVALENTS	626	712
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	6,736	1,002
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 7,362	$ 1,714
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$	$ 316
Income taxes, net	17	18
Non-cash transactions:		
Available for sale securities acquired for goods and services		608
Conversions of debt to equity		2,579

See notes to condensed consolidated financial statements.

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Description.

Transgenomic, Inc., a Delaware corporation, and its subsidiaries (the Company) provide innovative products and services for the synthesis, purification and analysis of nucleic acids. The Company s products and services include automated instrument systems, associated consumables, and genetic variation discovery services. The Company develops, assembles, manufactures and markets its products and services to the life sciences industry to be used in research focused on molecular genetics of humans and other organisms. Such research could lead to development of new diagnostics and therapeutics. The Company s business plan is to participate in the value chain associated with these activities by providing key technology, tools, consumables, biochemical reagents and services to entities engaged in basic biomedical research and the development of diagnostics and therapeutic agents.

The Company develops, assembles, manufactures and markets versatile products and provides analytical services to the medical research, clinical and pharmaceutical markets for use in genetic variation analysis. Products and services are sold through a direct sales force in the United States and throughout much of Western Europe. For the rest of the world, products and services are sold through more than 25 dealers and distributors located in those local markets. Net sales are categorized as bioinstruments, bioconsumables and discovery services.

Bioinstruments. The Company s flagship product is the WAVE® system which has broad applicability to genetic variation detection in both molecular genetic research and molecular diagnostics. There was a world-wide installed base of over 1,300 WAVE® systems as of June 30, 2006. The Company also sells complementary equipment platforms manufactured by others. Service contracts to maintain installed systems are sold and supported by technical support personnel.

Bioconsumables. The installed WAVE® base generates a demand for consumables that are required for the system s continued operation. The Company develops, manufactures and sells these products. In addition, the Company manufactures and sells consumable products that can be used on a number of equipment platforms manufactured by others. The Company s proprietary bioconsumable products include SURVEYOR Nuclease and a range of HPLC separation columns.

Discovery Services. The Company provides various genetic laboratory services through a contract research lab in Gaithersburg, Maryland and a second laboratory in Omaha, Nebraska that operates in a Good Laboratory Practices (GLP) compliant environment and is certified under the Clinical Laboratory Improvement Amendment. The services provided primarily include (1) genomic research services to pharmaceutical and biopharmaceutical companies to support preclinical and clinical development of targeted therapeutics; and (2) molecular-based medical testing services for hematology, oncology and certain inherited diseases for physicians and third-party laboratories.

Historically, the Company operated a segment (the Nucleic Acids operating segment) that developed, manufactured and marketed chemical building blocks for nucleic acid synthesis to biotechnology, pharmaceutical and oligonucleotide synthesis companies and research institutions throughout the world. In the fourth quarter of 2005, the Company implemented a plan to exit this operating segment. Accordingly, results of this operating segment are reflected as discontinued operations for all periods presented.

The Company has experienced recurring net losses and had an accumulated deficit of $122,794 at June 30, 2006. Based on the Company s operating plan, management believes its existing sources of liquidity will be sufficient to meet its cash needs during 2006. If necessary, the Company s management believes they can manage costs and expenses at reduced levels to conserve working capital. The need for any such cost and expense reductions during 2006 would likely delay implementation of the Company s business plan. Additionally, management may pursue additional financing alternatives. Ultimately, the Company must achieve sufficient revenue levels to support its cost structure.

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

Principles of Consolidation.

The consolidated financial statements include the accounts of Transgenomic, Inc. and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents.

Cash and cash equivalents include cash and temporary investments with original maturities at acquisition of three months or less.

Accounts Receivable.

Accounts receivable are shown net of allowance for doubtful accounts. The following is a summary of activity for the allowance for doubtful accounts during the three and six months ended June 30, 2006 and 2005:

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
Beginning balance	$ 581	$ 689	$ 615	$ 701
Charges to income	(75)		(45)	
Deductions from reserves	128	19	192	31
Ending balance	$ 378	$ 670	$ 378	$ 670

While payment terms are generally 30 days, the Company has also provided extended payment terms of up to 90 days in certain cases.

During the three months ended June 30, 2006, the Company completed an extensive review of the accounts receivables, which generated a total write off to the bad debt reserve of $128 and a charge back to bad debt expense of $75.

Inventories.

Inventories are stated at the lower of cost or market. Cost is computed using standard costs for finished goods and average or latest actual cost for raw materials and work in process.

Property and Equipment.

Property and equipment are carried at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the related assets as follows:

Buildings	15 years
Leasehold improvements	3 to 7 years
Furniture and fixtures	5 to 7 years

Production equipment	5 to 7 years
Computer equipment	3 to 5 years
Research and development equipment	3 to 5 years
Demonstration equipment	3 to 5 years

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

Depreciation and amortization totaled $519 and $1,052 during the three months ended June 30, 2006 and 2005, respectively, of which $350 and $473, respectively, related to depreciation of property and equipment from continuing operations. Depreciation and amortization totaled $956 and $2,101 during the six months ended June 30, 2006 and 2005, respectively, of which $721 and $964, respectively, related to depreciation of property and equipment from continuing operations.

Goodwill and other Intangible Assets

Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets,* provides that goodwill and other intangible assets with indefinite lives will not be amortized, but will be tested for impairment annually. The Company performs this impairment analysis during the fourth quarter of each year. Impairment occurs when the carrying value is not recoverable and the fair value of the asset is less than the carrying value. If impaired, the asset s carrying value is reduced to its fair value. Identifiable intangible assets with definite lives are amortized over their estimated useful lives and tested for impairment as events or changes in circumstances indicate the carrying amount of the asset may be impaired.

Other Assets.

Other assets include capitalized software, intellectual property, patents, deferred financing costs and other long-term assets.

Capitalized Software. The Company capitalized software development costs for products offered for sale in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*. This Standard allows for the capitalization of certain development costs once a software product has reached technological feasibility. The Company capitalized no software development costs during the three or six months ended June 30, 2006 or 2005.

Intellectual Property. Initial costs paid to license intellectual property from third parties are capitalized and amortized using the straight line method over the license period. Ongoing royalties related to such licenses are expensed as incurred.

Patents. The Company capitalizes external legal costs, filing fees and other expenses associated with obtaining patents and amortizes these costs using the straight-line method over the shorter of the legal life of the patent (17 to 20 years depending on when issued) or its economic life beginning on the date the patent is issued.

Deferred Financing Costs. Certain financing costs are capitalized and amortized to interest expense over the life of the related financing.

Other Long-Term Assets. Other long-term assets consist primarily of demonstration inventory that has been at customer or prospective customer sites for greater than one year and security deposits on leased facilities. Long-term demonstration inventory is stated at the lower of cost or market.

Stock Based Compensation.

The Company accounts for its employee stock option grants under the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share Based Payment. The Company adopted this standard on January 1, 2006 using the modified prospective method. All share-based payment transactions (primarily employee stock options) that existed at December 31, 2005 were fully vested at that date. Therefore, the adoption of this standard had no material impact on the Company s financial position, results of operations or cash flows during the three and six months ended June 30, 2006. The Company was not party to any share-based payment transactions during the three and six months ended June 30, 2006.

9

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

The following table illustrates the effect on net loss and loss per share for the three and six months ended June 30, 2005 as if the Company had recorded compensation expense for all of its stock-based awards in the first quarter of 2005 based the fair value method under SFAS 123 Accounting for Stock-Based Compensation ;

	For Three Months June 30, 2005	For Six Months June 30, 2005
Net Loss:		
As reported	$ (998)	$ (3,890)
Pro forma	$ (1,071)	$ (4,033)
Basic and Diluted Loss Per Share:		
As reported	$ (0.03)	$ (0.12)
Pro forma	$ (0.03)	$ (0.13)

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rates ranging from 3.10% to 6.53%, volatility ranging from 35% to 100%, an expected option life of 3 years and no common stock dividends.

Income Taxes.

Deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax basis of assets and liabilities at each balance sheet date using tax rates expected to be in effect in the year the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that it is more likely than not that they will not be realized.

Revenue Recognition.

Revenue on the sales of products is recognized in accordance with the terms of the sales arrangement. Such recognition is based on receipt of an unconditional customer order and transfer of title and risk of ownership to the customer, typically upon shipment of the product. The Company s sales terms do not provide for the right of return unless the product is damaged or defective. Revenue from certain services associated with our analytical instruments, to be performed subsequent to shipment of the products, is deferred and recognized when the services are provided. Such services, mainly limited to installation and training services that are not essential to the functionality of the instruments, typically are performed in a timely manner subsequent to shipment of the instrument. The Company also enters into various service contracts that cover installed WAVE® systems. These contracts cover specific time periods and revenue associated with these contracts is deferred and recognized over the service period. At June 30, 2006 and December 31, 2005, deferred revenue mainly associated with the Company s service contracts was approximately $1,770 and $2,124, respectively.

Research and Development.

Research and development costs are charged to expense when incurred.

Translation of Foreign Currency.

Financial statements of subsidiaries outside the U.S. are measured using the local currency as the functional currency. The adjustments to translate those amounts into U.S. dollars are accumulated in a separate account in stockholders equity and are included in accumulated other comprehensive income. Foreign currency transaction gains or losses resulting from changes in currency exchange rates are included in the determination of net income. Foreign currency transaction adjustments, from continuing operations, reduced net loss by $72 and $180 during the three and six months ended June 30, 2006, respectively and increased net loss $279 and $461 during the six months ended June 30, 2006 and 2005, respectively.

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

Comprehensive Income.

Accumulated other comprehensive income at June 30, 2006 and December 31, 2005 consisted of foreign currency translation adjustments, net of applicable tax of $0. The Company deems its foreign investments to be permanent in nature and does not provide for taxes on currency translation adjustments arising from converting its investments in a foreign currency to U.S. dollars.

Fair Value of Financial Instruments.

The carrying amount of the Company s cash and cash equivalents, receivables, accounts payable and accrued expenses approximate fair value because of the short maturity of those instruments. The Company derives the fair value of its investments based on quoted market prices.

Earnings (Loss) Per Share.

Basic earnings (loss) per share is calculated based on the weighted-average number of common shares outstanding during each period. Diluted earnings (loss) per share include shares issuable upon exercise of outstanding stock options and warrants or conversion of convertible notes, where dilutive. Potentially dilutive securities totaling 13,538,841 and 13,625,675 at June 30, 2006 and December 31, 2005, respectively, have been excluded from the computation of diluted earnings per share as they have an antidilutive effect.

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No.153, Exchanges of Nonmonetary Assets. This statement addresses the prospective measurement for nonmonetary exchanges of nonmonetary assets. It specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 will be effective for the Company beginning July 1, 2006. The Company is assessing the final impact of this standard on its financial position, results of operations or cash flows.

In July 2006, the FASB issued Interpretation (FIN) No. 48, Uncertainty in Income Taxes. FIN 48 applies to all tax positions within the scope of Statement 109 and clarifies when and how to recognize tax benefits in the financial statements with a two-step approach of recognition and measurement. FIN 48 will become effective in the first quarter of 2007. Management continues to evaluate the effect that adoption of FIN 48 will have on the Company s consolidated results of operations and financial position.

Use of Estimates.

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. In addition, estimates and assumptions associated with the determination of fair value of certain assets and related impairments, and the determination of goodwill impairments require considerable judgment by management. Actual results could differ from the estimates and assumptions used in preparing these financial statements.

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

B. DISCONTINUED OPERATIONS AND DIVESTITURES

In the fourth quarter of 2005, the Company implemented a plan to exit the Nucleic Acids operating segment. Accordingly, the Company now reflects the related results as discontinued operations for all periods presented. Expenses that are not directly identified to the Nucleic Acids operating segment or that are considered corporate overhead have not been allocated in arriving at loss from discontinued operations. Summary results of operations of the former Nucleic Acids operating segment were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
NET SALES	$ 581	$ 744	$ 1,135	$ 1,190
COST OF GOODS SOLD	463	1,048	843	1,920
Gross profit(loss)	118	(304)	292	(730)
OPERATING EXPENSES:				
Selling, general and administrative	244	231	433	537
LOSS FROM OPERATIONS	(126)	(535)	(141)	(1,267)
OTHER INCOME	1	10	2	12
LOSS BEFORE INCOME TAXES	(125)	(525)	(139)	(1,255)
INCOME TAX				
LOSS FROM DISCONTINUED OPERATIONS	$ (125)	$ (525)	$ (139)	$ (1,255)

At June 30, 2006 and December 31, 2005, the Company had accrued expenses of $208 and $715 related to statutory payments to affected employees and other costs specifically attributable to closure of the Glasgow facility. The Company expects to incur additional period costs attributable to closure of the facility that will be recorded in discontinued operations during the remainder of 2006.

The assets and liabilities of the former Nucleic Acids operating segment were as follows:

	June 30, 2006	December 31, 2005
Accounts receivable (net of allowances for bad debts of $116 and $393, respectively)	$ 98	$ 51
Inventories		86
Prepaid expenses and other current assets	99	60
Current assets of discontinued operations	$ 197	$ 197
Property, plant and equipment, net	$ 3,061	$ 2,933
Non-current assets of discontinued operations	$ 3,061	$ 2,933

Accounts payable	$ 363	$ 434
Other accrued expenses	657	863
Accrued compensation	26	625
Current liabilities of discontinued operations	$ 1,046	$ 1,922

Restructuring plans were implemented during 2004 and 2002 to better align the cost structure of the former Nucleic Acids operating segment with anticipated revenues. In conjunction with these plans, the Company accrued expenses associated with the former Nucleic Acids operating segment of $107 and $221 at June 30, 2006 and December 31, 2005, respectively, related to net rents on leased but unoccupied facilities. The future net lease payments required under these leases are approximately $82 for the remainder of 2006 and $13 in 2007.

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

C. INVENTORIES

Inventories consisted of the following:

	June 30, 2006	December 31, 2005
Finished goods	$ 1,576	$ 2,062
Raw materials and work in process	486	653
Demonstration inventory	341	275
	$ 2,403	$ 2,990

D. OTHER ASSETS

Finite lived intangible assets and other assets consisted of the following:

	June 30, 2006			December 31, 2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Intellectual property	765	671	94	765	534	231
Patents	664	148	516	636	135	501
Other	862	572	290	838	496	342
Total	$ 2,291	$ 1,391	$ 900	$ 2,239	$ 1,165	$ 1,074

Amortization expense for intangible assets was $133 and $245 during the three months ended June 30, 2006 and 2005, and $150 and $495 for the six months ended June 30, 2006 and 2005, respectively. Amortization expense for intangible assets is expected to be approximately $21 for the remainder of 2006, $40 in each of the next four years and $37 in 2011.

E. DEBT

The Company had no debt at June 30, 2006 or December 31, 2005.

In December 2003, the Company entered into a $7,500 line of credit (the Credit Line) with Laurus Master Fund, Ltd. (Laurus). The term of the Credit Line was three years carrying an interest rate of 2.0% over the prime rate or a minimum of 6.0%. The Credit Line was secured by most of the Company s assets. In February 2004, the Company entered into a separate $2,750 convertible note with Laurus (the Term Note). The Term Note carried an interest rate of 2.0% over the prime rate or a minimum of 6.0%. The Company issued warrants covering 1,136,484 common shares of the Company in conjunction with the Credit Line and Term Note (collectively, the Laurus Loans). Principal and interest on the Laurus Loans could be converted into common stock of the Company at a fixed conversion price of $1.00 per share.

Certain features of the Laurus Loans required the Company to separately account for the value of certain amounts related to the warrants issued and the conversion feature of the Laurus Loans. Specifically, Emerging Issues Task Force (EITF) No. 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments,* required the Company to separately value the warrants issued and the beneficial conversion premium related to the Laurus Loans. The values of the warrants and the beneficial conversion premium were recorded on the balance sheet as a debt discount and an increase to additional paid in capital. The debt discount recorded for these items was amortized as expense to the income statement over the terms of the Laurus Loans or as the debt was converted into common stock thereby increasing the effective interest rate on the Laurus Loans.

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

On March 18, 2005, the Company agreed to allow Laurus to convert $1,872 of the outstanding principal balance under the Credit Line into 3,600,000 shares of its common stock. In addition, on March 24, 2005, the Company agreed to allow Laurus to convert $650 of the outstanding principal balance of the Term Note into 1,250,000 shares of common stock. The closing market price of the Company s common stock the day before each of these conversions was $0.58 per share. No other provisions of the Credit Line or Term Note were modified, including the $1.00 conversion price for remaining debt. In conjunction with these conversions the Company accelerated amortization of $0.41 million of related debt premiums and discounts and recorded a charge to interest expense of $1.37 million related to the fair value of incremental shares received by Laurus.

The Company had no interest expense for the three and six months ended June 30, 2006. Interest expense during the three and six months ended June 30, 2005 consisted of the following:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Interest paid or accrued on outstanding debt	$ 134	$ 305
Amortization of debt premiums	(124)	(692)
Amortization of debt discounts warrants	9	20
Amortization of debt discount beneficial conversion feature	15	644
Fair value of incremental shares received by Laurus		1,365
Other	49	98
	$ 83	$ 1,740

Contemporaneously with the closing of a private placement of the Company s common stock on October 31, 2005 (the 2005 Private Placement), the Company repaid all outstanding principal and accrued interest on the Laurus Loans which have been cancelled and are no longer available to the Company.

F. COMMITMENTS AND CONTINGENCIES

The Company is subject to a number of claims of various amounts, which arise out of the normal course of business. In the opinion of management, the disposition of pending claims will not have a material adverse effect on the Company s financial position, results of operations or cash flows.

The Company leases certain equipment, vehicles and operating facilities under non-cancellable operating leases that expire on various dates through 2010. The future minimum lease payments required under these leases are approximately $610 for the remainder of 2006, $605 in 2007, $294 in 2008, $281 in 2009, and $252 in 2010 and $88 thereafter. Rent expense for continuing operations related to all operating leases for the three months ended June 30, 2006 and 2005 was approximately $302 and $290, respectively, and for the six months ended June 30, 2006 and 2005 was $596 and $632, respectively.

At June 30, 2006 and December 31, 2005, firm commitments to vendors to purchase components used in WAVE® systems and instruments manufactured by others totaled $1,043 and $879, respectively. The Company expects to satisfy the majority of these purchase commitments during 2006 and 2007.

G. INCOME TAXES

Income tax expense during the three and six months ended June 30, 2006 and 2005 relates to income taxes in states, foreign countries and other local jurisdictions offset by refunds received.

Due to the Company s cumulative losses, expected losses in future years and inability to utilize any additional losses as carrybacks, no income tax benefit has been provided during the three and six months ended June 30, 2006 or 2005 based on a determination that it was more likely than not that such benefits would not be realized.

The Company will continue to assess the recoverability of deferred tax assets and the related valuation allowance. To the extent the Company begins to generate taxable income in future periods and a determination is made that such valuation allowance is no longer required, the tax benefit of the remaining deferred tax assets will be recognized at such time. As of June 30, 2006 and December 31, 2005, deferred tax assets totaled $42,837 and $42,561, respectively, that were fully offset by valuation allowances.

TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Six Months Ended June 30, 2006 and 2005

(Dollars in thousands except per share data)

H. EMPLOYEE BENEFIT PLAN

The Company maintains an employee 401(k) retirement savings plan that allows for voluntary contributions into designated investment funds by eligible employees. The Company matches the employees contributions at the rate of 50% on the first 6% of contributions. The Company may, at the discretion of its Board of Directors, make additional contributions on behalf of the Plan s participants. Company contributions to the 401(k) plan were $41 and $45 for the three months ended June 30, 2006 and 2005, respectively, and $83 and $90 for the six months ended June 30, 2006 and 2005, respectively.

I. STOCKHOLDERS EQUITY

Common Stock.

During the three and six months ended June 30, 2006, the Company issued zero and 7,551 shares of common stock, respectively, under the Transgenomic, Inc. 2001 Employee Stock Purchase Plan. During the three and six months ended June 30, 2005, the Company issued, 6,359 and 10,407, shares of common stock, respectively, under the Transgenomic, Inc. 2001 Employee Stock Purchase Plan. No additional stock will be issued under this plan as it was terminated in December 2005.

During the three and six months ended June 30, 2005, the Company issued 4,900,000 shares of common stock in conjunction with conversions under the Laurus Loans as follows:

Date	Price	Shares Issued	Net Proceeds	Facility	Applied To
January 2005	$ 1.00	50,000	$ 50	Term Note	Principal
March 2005	$ 0.52	3,600,000	1,835	Credit Note	Principal
March 2005	$ 0.52	1,250,000	650	Term Note	Principal
Total 2005					