TRANSGENOMIC INC
Form 10-Q
August 13, 2010
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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, 2010

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	**(I.R.S. Employer**
incorporation or organization)	**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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).) Yes ¨ No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller Reporting Company	x

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

As of August 13, 2010, the number of shares of common stock outstanding was 49,289,672.

TRANSGENOMIC, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TRANSGENOMIC, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)

	June 30, 2010 (unaudited)	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 5,416	$ 5,642
Accounts receivable (net of allowances for bad debts of $295 and $310, respectively)	3,827	4,522
Inventories (net of allowances for obsolescence of $536 and $507, respectively)	3,321	3,552
Prepaid expenses and other current assets	577	738
Total current assets	13,141	14,454
PROPERTY AND EQUIPMENT:		
Equipment	10,027	9,972
Furniture, fixtures & leasehold improvements	3,829	3,834
	13,856	13,806
Less: accumulated depreciation	(13,013)	(12,839)
	843	967
OTHER ASSETS:		
Other assets (net of accumulated amortization of $537 and $525, respectively)	462	583
	$ 14,446	$ 16,004
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 889	$ 1,013
Other accrued expenses	2,607	2,517
Accrued compensation	793	573
Total current liabilities	4,289	4,103
Other long-term liabilities	182	239
Total liabilities	4,471	4,342
STOCKHOLDERS EQUITY:		
Preferred stock, $.01 par value, 15,000,000 shares authorized, none outstanding		
Common stock, $.01 par value, 100,000,000 shares authorized, 49,289,672 and 49,189,672 shares outstanding, respectively	498	497

Additional paid-in capital	139,694	139,703
Accumulated other comprehensive income	1,435	1,645
Accumulated deficit	(131,652)	(130,183)
Total stockholders equity	9,975	11,662
	$ 14,446	$ 16,004

See notes to unaudited condensed consolidated financial statements.

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TRANSGENOMIC, INC. AND SUBSIDIARY

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands except per share data)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
NET SALES	$ 5,095	$ 5,473	$ 10,537	$ 10,463
COST OF GOODS SOLD	2,608	2,822	5,166	4,999
Gross profit	2,487	2,651	5,371	5,464
OPERATING EXPENSES:				
Selling, general and administrative	3,033	2,732	5,464	5,708
Research and development	512	686	1,339	1,530
	3,545	3,418	6,803	7,238
LOSS FROM OPERATIONS	(1,058)	(767)	(1,432)	(1,774)
OTHER INCOME (EXPENSE):				
Interest income	1	2	1	14
Other, net		(3)		(3)
	1	(1)	1	11
LOSS BEFORE INCOME TAXES	(1,057)	(768)	(1,431)	(1,763)
INCOME TAX EXPENSE (BENEFIT)	89	(38)	38	(80)
NET LOSS	$ (1,146)	$ (730)	$ (1,469)	$ (1,683)
BASIC AND DILUTED LOSS PER SHARE	$ (0.02)	$ (0.01)	$ (0.03)	$ (0.03)
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	49,206,339	49,189,672	49,198,005	49,189,672

See notes to unaudited condensed consolidated financial statements.

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TRANSGENOMIC, INC. AND SUBSIDIARY

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Six Months Ended June 30, 2010

(Dollars in thousands except per share data)

	Common Stock					
					Accumulated	
			Additional		Other	
	Outstanding Shares	Par Value	Paid-in Capital	Accumulated Deficit	Comprehensive Income (Loss)	Total
Balance, January 1, 2010	49,189,672	$ 497	$ 139,703	$ (130,183)	$ 1,645	$ 11,662
Net loss				(1,469)	(1,469)	(1,469)
Other comprehensive income (loss):						
Foreign currency translation adjustment, net of tax					(210)	(210)
Comprehensive loss					(1,679)	
Non-cash stock-based compensation			(50)			(50)
Issuance of shares for employee stock options	100,000	1	41			42
Balance, June 30, 2010	49,289,672	$ 498	$ 139,694	$ (131,652)	$ 1,435	$ 9,975

See notes to unaudited condensed consolidated financial statements.

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TRANSGENOMIC, INC. AND SUBSIDIARY

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net loss	$ (1,469)	$ (1,683)
Adjustments to reconcile net loss to net cash flows provided by (used in) operating activities:		
Depreciation, amortization and disposals	378	426
Non-cash, stock based compensation	(50)	99
Changes in operating assets and liabilities:		
Accounts receivable	567	1,369
Inventories	129	260
Prepaid expenses and other current assets	147	165
Accounts payable	(99)	(69)
Accrued expenses and accrued compensation	404	(393)
Other long term liabilities	(47)	10
Long term deferred income taxes	13	9
Net cash flows provided by (used in) operating activities	(27)	193
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of property and equipment	(108)	(219)
Change in other assets	(18)	(13)
Net cash flows used in investing activities	(126)	(232)
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES:		
Issuance of common stock	42	
Net cash flows provided by financing activities	42	
EFFECT OF FOREIGN CURRENCY EXCHANGE RATE CHANGES ON CASH	(115)	44
NET CHANGE IN CASH AND CASH EQUIVALENTS	(226)	5
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	5,642	4,771
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 5,416	$ 4,776
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$	$
Income taxes, net	2	6

See notes to unaudited condensed consolidated financial statements.

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Six Months Ended June 30, 2010 and 2009

A. BUSINESS DESCRIPTION

Business Description.

Transgenomic, Inc. provides innovative products for the purification and analysis of nucleic acids used in the life sciences industry for research focused on molecular genetics and diagnostics. We also provide genetic variation analytical services to the medical research, clinical and pharmaceutical markets. Net sales are categorized as Instrument Related Business and Laboratory Services.

Instrument Related Business:

Bioinstruments. Our flagship product is the WAVE® System which has broad applicability to genetic variation detection in both molecular genetic research and molecular diagnostics. There is a worldwide installed base of nearly 1,500 WAVE Systems as of June 30, 2010. We also distribute bioinstruments produced by other manufacturers (OEM Equipment) through our sales and distribution network. Service contracts to maintain installed systems are sold and supported by technical support personnel.

Bioconsumables. The installed WAVE base and some third-party installed platforms generate a demand for consumables that are required for the continued operation of the bioinstruments. We develop, manufacture and sell these consumable products. In addition, we manufacture and sell consumable products that can be used on multiple, independent platforms. These products include SURVEYOR® Nuclease and a range of HPLC separation columns.

Laboratory Services:

Molecular Clinical Reference Laboratory. The molecular clinical reference laboratory specializes in mitochondrial and molecular diagnostic testing including genetic testing for oncology, hematology and inherited disorders. Located in Omaha, Nebraska, the molecular clinical reference laboratory operates in a Good Laboratory Practices compliant environment and is certified under the Clinical Laboratory Improvement Amendment (CLIA) as a high complexity lab and is accredited by CAP (College of American Pathologists).

Pharmacogenomics Research Services. Pharmacogenomics research services are provided by our Contract Research Organization located in Omaha, Nebraska. It specializes in pharmocogenomic, biomarker and mutation discovery research serving the pharmaceutical and biomedical industries world-wide for disease research, drug and diagnostic development and clinical trial support.

Although we have experienced recurring net losses (resulting in an accumulated deficit of $131.7 million at June 30, 2010) management believes existing sources of liquidity, including cash and cash equivalents of $5.4 million, are sufficient to meet expected cash needs into 2011. We will need to increase net sales in order to meet our liquidity needs on a long-term basis. If we cannot increase net sales, further reductions to operating expenses will be needed. In future periods, there is no assurance that we will be able to increase net sales or further reduce expenses and, accordingly, we may not have sufficient sources of liquidity to continue operations indefinitely.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation.

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

Risks and Uncertainties.

Certain risks and uncertainties are inherent in our day-to-day operations and to the process of preparing our financial statements. The more significant of those risks are presented below and throughout the notes to the financial statements.

TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

1. 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 net sales and expenses during the reporting period. In addition, estimates and assumptions associated with the determination of the fair value of certain assets and related impairments require considerable judgment by management. Actual results could differ from the estimates and assumptions used in preparing these consolidated financial statements.

2. Concentration of Revenue Risk.

One customer accounted for more than 10% of consolidated net sales during the three months ended June 30, 2010. This was an instrument sale that will be nonrecurring. No customer accounted for more than 10% of consolidated net sales during the three months ended June 30, 2009 or the six months ended June 30, 2010 and 2009. For the three and six months ended June 30, 2010 two customers accounted for more than 10% of the Laboratory Services net sales. These customers represented 25% of the Laboratory Services net sales for each of the three and six months ended June 30, 2010. For the three and six months ended June 30, 2009 one customer accounted for more than 10% of the Laboratory Services net sales. We have additional risk due to the global economic crisis. Our existing and future customers may not have the ability to obtain adequate financing or fulfill their financial obligations.

Fair Value.

Unless otherwise specified, book value approximates fair market value.

Concentrations of Cash.

From time to time, we may maintain a cash position with financial institutions in amounts that exceed federally insured limits. We have not experienced any losses on such accounts as of June 30, 2010.

Basis of Presentation.

The condensed consolidated balance sheet as of December 31, 2009 was derived from our audited balance sheet as of that date. The accompanying consolidated financial statements as of and for the three and six months ended June 30, 2010 and 2009 are unaudited and reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. These unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2009 contained in our Annual Report on Form 10-K. The results of operations for the interim periods presented are not necessarily indicative of the results for the entire year.

Cash and Cash Equivalents.

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

Accounts Receivable.

The following is a summary of activity for the allowance for doubtful accounts during the three and six months ended June 30, 2010 and 2009:

	Dollars in Thousands			
	Beginning Balance	Provision	Write Offs	Ending Balance
Three Months Ended June 30, 2010	$ 279	$ 16	$	$ 295
Three Months Ended June 30, 2009	$ 356	$ 36	$ (34)	$ 358
Six Months Ended June 30, 2010	$ 310	$ (11)	$ (4)	$ 295
Six Months Ended June 30, 2009	$ 388	$ 32	$ (62)	$ 358

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

While payment terms are generally 30 days, we have also provided extended payment terms of up to 90 days in certain cases. We operate globally and some of the international payment terms may be greater than 90 days. Accounts receivable are carried at original invoice and shown net of allowance for doubtful accounts. The estimate made for doubtful accounts is based on a review of all outstanding amounts on a quarterly basis. We determine the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer s financial condition, credit history and current economic conditions. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Inventories.

Inventories are stated at the lower of cost or market net of allowance for obsolete inventory. Cost is computed using standard costs for finished goods and average or latest actual cost for raw materials and work in process, which approximates the first-in, first-out (FIFO) method.

The following is a summary of activity for the allowance for obsolete inventory during the three and six months ended June 30, 2010 and 2009:

	Dollars in Thousands			
	Beginning Balance	Provision	Write Offs	Ending Balance
Three Months Ended June 30, 2010	$ 478	$ 67	$ (9)	$ 536
Three Months Ended June 30, 2009	$ 117	$ 30	$ (24)	$ 123
Six Months Ended June 30, 2010	$ 507	$ 65	$ (36)	$ 536
Six Months Ended June 30, 2009	$ 108	$ 41	$ (26)	$ 123

We determine the allowance for obsolete inventory by evaluating quarterly the inventory for items deemed to be slow moving or obsolete. Included in our provision is the foreign currency impact of the consolidation of our subsidiary.

Property and Equipment.

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

Leasehold improvements	1 to 10 years
Furniture and fixtures	3 to 7 years
Production equipment	3 to 7 years
Computer equipment	3 to 7 years
Research and development equipment	2 to 7 years

Other Assets.

Other assets include intellectual property, patents and other long-term assets.

1. Intellectual Property.
Initial costs paid to license intellectual property from independent 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.

2. Patents.
We capitalize legal costs, filing fees and other expenses associated with obtaining patents on new discoveries and amortize these costs using the straight-line method over the shorter of the legal life of the patent or its economic life beginning on the date the patent is issued.

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

Each of these assets is treated as long-lived assets. Long-lived assets will be tested for impairment on an annual basis or when a significant event occurs which may impact impairment. We recorded no impairment in the three or six months ended June 30, 2010 or 2009.

3. Other Long-Term Assets.
Other long-term assets include US security deposits and deferred tax assets, net of applicable valuation allowances.

Stock Based Compensation.

All stock options awarded to date have exercise prices equal to the market price of our common stock on the date of grant and have ten-year contractual terms. Unvested options as of June 30, 2010 had vesting periods of three years from date of grant. None of the stock options outstanding at June 30, 2010 are subject to performance or market-based vesting conditions.

We measure and recognize compensation expense for all stock-based awards made to employees and directors, including stock options. Compensation expense is based on the calculated fair value of the awards as measured at the grant date and is expensed ratably over the service period of the awards (generally the vesting period).

During the six months ended June 30, 2010, we recorded compensation expense recovery of less than $0.1 million within the selling, general and administrative expense. Two executive officers departed during the second quarter of 2010. All stock options that were unvested were forfeited at the time of their departure as their requisite service period was not completed. The vesting of options exercisable for the purchase of 1.3 million shares was offset by the expense recovery for stock options which were forfeited due to the requisite service not being rendered. During the six months ended June 30, 2009, we recorded compensation expenses of $0.1 million within selling, general and administrative expense as a result of the vesting of options exercisable for the purchase of 1.7 million shares. As of June 30, 2010, there was less than $0.1 million of unrecognized compensation expense related to unvested stock options, which is expected to be recognized over a weighted average period of nearly three years.

The fair value of the options granted during the quarters ended June 30, 2010 and 2009 was estimated on their respective grant dates using the Black-Scholes option pricing model. There were 75,000 stock options granted during the quarter ended June 30, 2010. The Black-Scholes model was used with the following assumptions: risk-free interest rates of 1.98% based on the U.S. Treasury yield in effect at the time of grant; dividend yields of zero percent; expected life of five years, based on historical exercise activity behavior; and volatility of 102.69% based on the historical volatility of our stock over a time that is consistent with the expected life of the option. A small group of senior executives hold the majority of the stock options and are expected to hold the options until they are vested. Forfeitures have been assumed in the calculation.

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.

Net Sales Recognition.

Net sales of products are 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 under a purchase order. Our sales terms do not provide for the right of return unless the product is damaged or defective. Net sales from certain services associated with the 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. We also enter into various service contracts that cover installed instruments. These contracts cover specific time periods. Net sales associated with these contracts are deferred and recognized ratably over the service period. At June 30, 2010 and June 30, 2009, deferred net sales, mainly associated with our service contracts, included in the balance sheet in other accrued expenses, was approximately $1.4 million for each of the periods.

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

Net sales from our Molecular Clinical Reference Laboratory Services are recognized on an individual test basis and takes place when the test report is completed, reviewed and sent to the client less the reserve for insurance, Medicare and Medicaid expected reimbursement. There are no deferred net sales associated with our Molecular Clinical Reference Laboratory. Adjustments to the allowances, based on actual receipts from third party payers, are recorded upon settlement. In our Pharmacogenomics Research Services Group, we perform services on a project by project basis. When we get payment in advance we recognize revenue when we deliver the service. These projects typically do not extend beyond one year. At June 30, 2010 and 2009, deferred net sales associated with the pharmacogenomics research projects included in the balance sheet in other accrued expenses, was less than $0.1 million for each period.

Taxes collected from customers and remitted to government agencies for specific net sales producing transactions are recorded net with no effect on the income statement.

Research and Development.

Research and development and various collaboration costs are charged to expense when incurred.

Translation of Foreign Currency.

Our foreign subsidiary uses the local currency of the country in which they are located as their functional currency. Their assets and liabilities are translated into U.S. dollars at the exchange rates in effect at the balance sheet date. Cumulative translation losses of $0.2 million are reported as accumulated other comprehensive income on the accompanying consolidated balance sheets as of June 30, 2010. Revenues and expenses are translated at the average exchange rates during the period. For transactions that are not denominated in the functional currency, we recognized net losses of $0.5 million and $0.4 million as foreign currency transaction losses in the determination of net income for the 6 months ending June 30, 2010 and 2009, respectively.

Comprehensive Income.

Accumulated other comprehensive income at June 30, 2010 and December 31, 2009 consisted of foreign currency translation adjustments, net of applicable tax of zero. We deem our foreign investments to be permanent in nature and do not provide for taxes on currency translation adjustments arising from converting investments in a foreign currency to U.S. dollars.

Earnings Per Share.

Basic earnings per share is calculated based on the weighted average number of common shares outstanding during each period. Diluted earnings per share include shares issuable upon exercise of outstanding stock options, warrants or conversion rights that have exercise or conversion prices below the market value of our common stock. Options, warrants and conversion rights pertaining to 10,763,324 and 11,514,720 shares of our common stock have been excluded from the computation of diluted earnings per share at June 30, 2010 and 2009, respectively. The options, warrants and conversion rights that were exercisable in 2010 and 2009 were not included because the effect would be anti-dilutive due to the net loss. As a result, none of our outstanding options, warrants or conversion rights affect the calculation of diluted earnings per share.

Recently Issued Accounting Pronouncements.

In October 2009, the FASB issued ASU No. 2009-13, *Revenue Recognition (ASC 605): Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force)*; effective for years beginning after June 15, 2010. This standard update will be effective for us on January 1, 2011. Vendors often provide multiple products and/or services to their customers as part of a single arrangement. These deliverables may be provided at different points in time or over different time periods. The existing guidance regarding how and whether to separate these deliverables and how to allocate the overall arrangement consideration to each was originally captured in EITF Issue 00-21, *Revenue Arrangements with Multiple Deliverables*, which is now codified at ASC 605-25, *Revenue Recognition Multiple-Element Arrangements*. The issuance of ASU 2009-13 amends ASC 605-25 and represents a significant shift from the existing guidance that was considered abuse-preventative and heavily geared toward ensuring that revenue recognition was not accelerated. The application of this new guidance is expected to result in accounting for multiple-deliverable revenue arrangements that better reflects their economics as more arrangements will be separated into individual units of accounting. We are currently evaluating the impact of adopting ASU 2009-13.

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

In October 2009, the FASB issued ASU No. 2009-14, *Software (ASC 985): Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force)*; effective for years beginning after June 15, 2010. This standard update will be effective for us on January 1, 2011. ASU 2009-14 modifies the existing scope guidance in ASC 985-605, *Software Revenue Recognition*, for revenue arrangements with tangible products that include software elements. This modification was made primarily due to the changes in ASC 605-25 noted previously, which further differentiated the separation and allocation guidance applicable to non-software arrangements as compared to software arrangements. Prior to the modification of ASC 605-25, the separation and allocation guidance for software and non-software arrangements was more similar. Under ASC 985-605, which was originally issued as AICPA Statement of position 97-2, *Software Revenue Recognition*, an arrangement to sell a tangible product along with software was considered to be in its scope if the software was more than incidental to the product as a whole. We are currently evaluating the impact of adopting ASU 2009-14.

C. INVENTORIES

Inventories (net of allowances for obsolescence) consisted of the following:

	Dollars in Thousands	
	June 30, 2010	**December 31, 2009**
Finished goods	$ 1,897	$ 2,322
Raw materials and work in process	1,545	1,588
Demonstration inventory	415	149
	$ 3,857	$ 4,059
Less allowance for obsolescence	(536)	(507)
Total	$ 3,321	$ 3,552

D. OTHER ASSETS

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

	Dollars in Thousands					
	June 30, 2010			**December 31, 2009**		
	Cost	**Accumulated Amortization**	**Net Book Value**	**Cost**	**Accumulated Amortization**	**Net Book Value**
Intellectual property	$ 310	$ 293	$ 17	$ 310	$ 284	$ 26
Patents	525	244	281	598	241	357
Other	164		164	200		200
Total	$ 999	$ 537	$ 462	$ 1,108	$ 525	$ 583

Other assets include US security deposits and deferred tax assets.

Amortization expense for intangible assets was less than $0.1 million during the three and six months ended June 30, 2010 and 2009, respectively. Amortization expense for intangible assets is expected to be less than $0.1 million for each of the years 2010 and thereafter. During the six months ended June 30, 2010 we abandoned patents of $0.1 million.

E. COMMITMENTS AND CONTINGENCIES

We are 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 our financial position, results of operations or cash flows.

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

We lease certain equipment, vehicles and operating facilities under non-cancellable operating leases that expire on various dates through 2014. The future minimum lease payments required under these leases are approximately $0.5 million in 2010, $0.6 million in 2011, $0.2 million in 2012, less than $0.1 million in 2013 and less than $0.1 million in 2014. Rent expense for each of the three months ended June 30, 2010 and 2009 was $0.2 million. Rent expense for each of the six months ended June 30, 2010 and 2009 was $0.4 million.

We have entered into an employment agreement with Craig J. Tuttle, our President and Chief Executive Officer. The current term of Mr. Tuttle s employment agreement ends on July 12, 2011. The employment agreement provides that Mr. Tuttle will be entitled to receive severance payments from the Company if his employment is terminated involuntarily except if such termination is based on just cause , as that term is defined in the employment agreement. The severance payment payable in the event of involuntary termination without just cause is equal to his annual base salary at the time of termination and will be paid over a twelve-month period. The employment agreement provides that the severance payment provisions will be honored if the Company is acquired by, or merged into, another company and his position is eliminated as a result of such acquisition or merger. In addition we have one employee who is entitled to a severance payment of less than $0.1 million if the employee s position is eliminated prior to July 2012.

At June 30, 2010, firm commitments to vendors to purchase components used in WAVE Systems and instruments manufactured by others totaled $0.5 million.

F. INCOME TAXES

We file income tax returns in the U.S. federal jurisdiction, various U.S. state jurisdictions and various foreign jurisdictions. We have statutes of limitation open for Federal income tax returns related to tax years 2007 through 2009. We have state income tax returns subject to examination primarily for tax years 2006 through 2009. Open tax years related to foreign jurisdictions remain subject to examination. Our primary foreign jurisdiction is the United Kingdom which has open tax years for 2006 through 2009.

Income tax expense for the six months ended June 30, 2010 was less than $0.1 million. This is the result of the change in deferred tax assets and liabilities reported in financial statements of our subsidiary outside the U.S. This tax expense includes state and franchise taxes as well as reserves for uncertain income taxes. Income tax benefit for the six months ended June 30, 2009 was less than $0.1 million. The effective tax rate for the six months ended June 30, 2010 is (2.65)% which is primarily the result of valuation allowances against the net operating losses for the U.S. partially adjusted by permanent differences related to intercompany foreign currency exchange of our subsidiary outside the U.S. The effective tax rate for the six months ended June 30, 2009 was 4.6%.

During the three and six months ended June 30, 2010, there were no material changes to the liability for uncertain tax positions.

G. EMPLOYEE BENEFIT PLAN

We maintain an employee 401(k) retirement savings plan that allows for voluntary contributions into designated investment funds by eligible employees. We currently match the employee s contributions at the rate of 50% on the first 6% of contributions. We may, at the discretion of our Board of Directors, make additional contributions on behalf of the Plan s participants. Contributions to the 401(k) plan were less than $0.1 million for each of the three and six months ended June 30, 2010 and 2009.

H. STOCKHOLDERS EQUITY

Common Stock.

The Company s Board of Directors is authorized to issue up to 100,000,000 shares of common stock, from time to time, as provided in a resolution or resolutions adopted by the Board of Directors.

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

Common Stock Warrants.

No common stock warrants were issued or exercised during the three and six months ended June 30, 2010 or 2009. At June 30, 2010, there were warrants outstanding which were exercisable to purchase 7,978,156 shares of common stock.

Warrant Holder	Issue Year	Expiration	Underlying Shares	Exercise Price
Various Institutional Holders (1)	2005	Oct. 2010	6,903,156	$ 1.20
Laurus Master Fund, Ltd. (2)	2003	Dec. 2010	200,000	$ 1.92
Laurus Master Fund, Ltd. (2)	2003	Dec. 2010	200,000	$ 2.07
Laurus Master Fund, Ltd. (2)	2003	Dec. 2010	150,000	$ 2.35
Laurus Master Fund, Ltd. (2)	2004	Feb. 2011	125,000	$ 2.57
Laurus Master Fund, Ltd. (2)	2004	Aug. 2011	400,000	$ 1.18
Total			7,978,156	

We are released from the liability when the stock warrants expire.

(1) These warrants were issued in conjunction with a private placement of common stock in October 2005.

(2) These warrants were issued in conjunction with two loans that had been made to us by Laurus Master Fund, Ltd. (the Laurus Loans), and subsequent modifications of these loans. In conjunction with the 2005 private placement, the exercise prices of these warrants were adjusted according to repricing provisions contained in the original warrant agreements. While the Laurus Loans have been terminated, the warrants remain outstanding. Due to the repricing provision, these warrants are considered liabilities for financial reporting purposes. We have assessed and determined the fair value is $0.

Preferred Stock.

The Company s Board of Directors is authorized to issue up to 15,000,000 shares of preferred stock in one or more series, from time to time, with such designations, powers, preferences and rights and such qualifications, limitations and restrictions as may be provided in a resolution or resolutions adopted by the Board of Directors. The authority of the Board of Directors includes, but is not limited to, the determination or fixing of the following with respect to shares of such class or any series thereof: (i) the number of shares; (ii) the dividend rate, whether dividends shall be cumulative and, if so, from which date; (iii) whether shares are to be redeemable and, if so, the terms and amount of any sinking fund providing for the purchase or redemption of such shares; (iv) whether shares shall be convertible and, if so, the terms and provisions thereof; (v) what restrictions are to apply, if any, on the issue or reissue of any additional preferred stock; and (vi) whether shares have voting rights. The preferred stock may be issued with a preference over the common stock as to the payment of dividends. The Company has no current plans to issue any series of preferred stock. Classes of stock such as the preferred stock may be used, in certain circumstances, to create voting impediments on extraordinary corporate transactions or to frustrate persons seeking to effect a merger or otherwise to gain control of the Company. For the foregoing reasons, any preferred stock issued by the Company could have an adverse effect on the rights of the holders of the common stock.

I. STOCK OPTIONS

The following table summarizes stock option activity during the six months ended June 30, 2010:

	Number of Options	Weighted Average Exercise Price
Balance at January 1, 2010:	3,331,731	$ 2.39
Granted	75,000	.58
Exercised	(100,000)	(.42)
Forfeited	(388,332)	(.65)
Expired	(133,231)	(12.50)
Balance at June 30, 2010:	2,785,168	$ 2.17
Exercisable at June 30, 2010:	2,392,105	$ 2.42

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TRANSGENOMIC, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2010 and 2009

During the six months ended June 30, 2010, we granted options exercisable to purchase 75,000 shares of common stock at a weighted average exercise price of $0.58 under our 2006 Equity Incentive Plan.

J. OPERATING SEGMENT AND GEOGRAPHIC INFORMATION

Our company s chief operating decision-maker is the Chief Executive Officer, who regularly evaluates our performance based on net sales and gross profit. The preparation of this segment analysis requires management to make estimates and assumptions around expense below the gross profit level. While we believe the segment information to be directionally correct, actual results could differ from the estimates and assumptions used in preparing this information.

The accounting policies of the segments are the same as the policies discussed in Footnote B Summary of Significant Accounting Policies.

We have two reportable operating segments.

Segment information for the three months ended June 30, 2010 and 2009 is as follows:

	Dollars in Thousands					
	2010			2009		
	Instrument Business	Lab Services	Total	Instrument Business	Lab Services	Total
Net Sales	$ 3,854	$ 1,241	$ 5,095	$ 4,209	$ 1,264	$ 5,473
Gross Profit	2,069	418	2,487	2,262	389	2,651
Net Loss before Taxes	(551)	(506)	(1,057)	(88)	(680)	(768)
Income Tax Expense (Benefit)	89		89	(38		