

TRANSGENOMIC INC
Form 10-Q
May 14, 2009
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2009

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)

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Delaware
(State or other jurisdiction of
incorporation or organization)

911789357
(I.R.S. Employer
Identification No.)

12325 Emmet Street, Omaha, Nebraska
(Address of principal executive offices)

68164
(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 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

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

As of May 14, 2009, the number of shares of common stock outstanding was 49,189,672.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****TRANSGENOMIC, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Dollars in thousands except per share data)**

	March 31, 2009 (unaudited)	December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 4,845	\$ 4,771
Accounts receivable (net of allowances for bad debts of \$356 and \$388, respectively)	4,376	5,385
Inventories	4,847	4,775
Prepaid expenses and other current assets	736	654
Total current assets	14,804	15,585
PROPERTY AND EQUIPMENT:		
Equipment	10,092	10,059
Furniture, fixtures & leasehold improvements	3,919	3,920
	14,011	13,979
Less: accumulated depreciation	(12,749)	(12,781)
	1,262	1,198
OTHER ASSETS:		
Other assets (net of accumulated amortization of \$437 and \$425, respectively)	741	773
	\$ 16,807	\$ 17,556
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 1,243	\$ 905
Other accrued expenses	2,653	2,810
Accrued compensation	535	520
Total current liabilities	4,431	4,235
Other long-term liabilities	118	116
Total liabilities	4,549	4,351
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Preferred stock, \$.01 par value, 15,000,000 shares authorized, none outstanding		
Common stock, \$.01 par value, 100,000,000 shares authorized, 49,189,672 shares outstanding	497	497
Additional paid-in capital	139,552	139,501

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Accumulated other comprehensive income	1,425	1,470
Accumulated deficit	(129,216)	(128,263)
Total stockholders' equity	12,258	13,205
	\$ 16,807	\$ 17,556

See notes to unaudited condensed consolidated financial statements.

Table of Contents**TRANSGENOMIC, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Dollars in thousands except per share data)

	Three Months Ended March 31,	
	2009	2008
NET SALES	\$ 4,989	\$ 6,254
COST OF GOODS SOLD	2,176	2,614
Gross profit	2,813	3,640
OPERATING EXPENSES:		
Selling, general and administrative	2,975	2,975
Research and development	844	572
	3,819	3,547
INCOME (LOSS) FROM OPERATIONS	(1,006)	93
OTHER INCOME (EXPENSE):		
Interest income, net of interest expense	12	33
Other, net		(1)
	12	32
INCOME (LOSS) BEFORE INCOME TAXES	(994)	125
INCOME TAX EXPENSE (BENEFIT)	(41)	3
NET INCOME (LOSS)	\$ (953)	\$ 122
BASIC AND DILUTED INCOME (LOSS) PER SHARE	\$ (0.02)	\$ 0.00
BASIC WEIGHTED AVERAGE SHARES OUTSTANDING	49,189,672	49,189,672
DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	49,189,672	49,192,571

See notes to unaudited condensed consolidated financial statements.

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TRANSGENOMIC, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Three Months Ended March 31, 2009

(Dollars in thousands except per share data)

	Common Stock				Accumulated	
	Outstanding Shares	Par Value	Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Income (Loss)	Total
Balance, January 1, 2009	49,189,672	\$ 497	\$ 139,501	\$ (128,263)	\$ 1,470	\$ 13,205
Net loss				(953)	(953)	(953)
Other comprehensive income (loss):						
Foreign currency translation adjustment, net of tax					(45)	(45)
Comprehensive loss					(998)	(998)
Non-cash stock-based compensation			51			51
Balance, March 31, 2009	49,189,672	\$ 497	\$ 139,552	\$ (129,216)	\$ 1,425	\$ 12,258

See notes to unaudited condensed consolidated financial statements.

Table of Contents**TRANSGENOMIC, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	Three Months Ended March 31,	
	2009	2008
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net income (loss)	\$ (953)	\$ 122
Adjustments to reconcile net income (loss) to net cash flows used in operating activities:		
Depreciation and amortization	209	197
Non-cash, stock based compensation	51	65
Loss on sale of investment and assets		(3)
Changes in operating assets and liabilities:		
Accounts receivable	968	(1,259)
Inventories	(133)	287
Prepaid expenses and other current assets	(87)	222
Accounts payable	344	(33)
Accrued expenses and accrued compensation	(110)	627
Other long term liabilities	4	
Long term deferred income taxes	6	
Net cash flows provided by operating activities	299	225
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Purchase of property and equipment	(209)	(43)
Change in other assets	(5)	(42)
Net cash flows used in investing activities	(214)	(85)
EFFECT OF FOREIGN CURRENCY EXCHANGE RATE CHANGES ON CASH	(11)	(59)
NET CHANGE IN CASH AND CASH EQUIVALENTS	74	81
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	4,771	5,723
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 4,845	\$ 5,804
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	\$	\$
Income taxes, net	2	13

See notes to unaudited condensed consolidated financial statements.

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TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended March 31, 2009 and 2008

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 over 1,450 WAVE Systems as of March 31, 2009. 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.

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

Management believes existing sources of liquidity, including cash and cash equivalents of \$4.8 million, are sufficient to meet expected cash needs during 2009. Our business consolidation efforts, recent reduction in force and cost containment management have helped control our operating costs, however, we have added sales and marketing costs over the last two years in an effort to drive increased sales. 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.

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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.

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.

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 financial statements.

Table of Contents**TRANSGENOMIC, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Three Months Ended March 31, 2009 and 2008****2. Concentration of Revenue Risk.**

No customer accounted for more than 10% of consolidated net sales during the three months ended March 31, 2009 and 2008. For the three months ended March 31, 2009 one customer made up more than 10% of the Laboratory Services net sales. This customer represented 17% of the Laboratory Services net sales.

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 March 31, 2009.

Basis of Presentation.

The consolidated balance sheet as of December 31, 2008 was derived from our audited balance sheet as of that date. The accompanying consolidated financial statements as of and for the three months ended March 31, 2009 and 2008 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, 2008 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 only temporary overnight investments.

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 months ended March 31, 2009 and 2008:

	Dollars in Thousands	
	Three Months Ended	
	March 31,	
	2009	2008
Beginning balance	\$ 388	\$ 703
Charges to income	(4)	36
Deductions from reserves	28	367
Ending balance	\$ 356	\$ 372

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 amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly 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. Cost is computed using standard costs for finished goods and average or latest actual cost for raw materials and work in process.

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TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended March 31, 2009 and 2008

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:

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

Depreciation and amortization during the three months ended March 31, 2009 and 2008, respectively, included \$0.2 million, for each period related to depreciation of property and equipment.

Other Assets.

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

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.

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.

Each of these assets is treated as long-lived assets for purposes of FAS No. 144, which provides that long-lived assets will be tested for impairment on an annual basis or when a significant event occurs which may impact impairment. We periodically review the carrying value of our long-lived assets to assess recoverability and impairment. We recorded no impairment in the three months ended March 31, 2009 or 2008.

Other Assets. Other assets include US security deposits and deferred tax assets.

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 March 31, 2009 had vesting periods of three years from date of grant. None of the stock options outstanding at March 31, 2009 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 three months ended March 31, 2009, we recorded compensation expense of \$0.1 million within the selling, general and administrative expense as a result of the vesting of options exercisable for the purchase of 1,715,000 shares. During the three months ended March 31, 2008, 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 1,410,000 shares. As of March 31, 2009, there was \$0.2 million of unrecognized compensation expense related to unvested stock options, which is expected to be recognized over a weighted

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average period of nearly three years.

The fair value of the options granted during the quarters ended March 31, 2009 and 2008 was estimated on their respective grant dates using the Black-Scholes option pricing model. The Black-Scholes model was used with the following assumptions: risk-free interest rates of 1.36% to 1.55%, based on the U.S. Treasury yield in effect at the time of grant; dividend yields of zero percent; expected lives of 2 to 10 years, based on historical exercise activity behavior; and volatility of 101.92% and 62.93% 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. Therefore, no forfeitures were assumed.

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TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended March 31, 2009 and 2008

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 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 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 and net sales associated with these contracts are deferred and recognized over the service period. At March 31, 2009 and March 31, 2008, deferred net sales, mainly associated with our service contracts, included in the balance sheet in other accrued expenses, was approximately \$1.4 million and \$2.0 million, respectively.

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 payment. There are no deferred net sales associated with our Molecular Clinical Reference Laboratory. In our Pharmacogenomics Research Services Group, we recognize net sales based on a proportionate performance measurement for each project. At March 31, 2009 and 2008, 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.

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 revaluation gains or losses resulting from changes in currency exchange rates are included in the determination of net income. Foreign currency revaluation adjustments increased operating expenses and net loss by \$0.2 million for the three months ended March 31, 2009, and decreased operating expenses and increased net income by \$0.2 million during the three months ended March 31, 2008.

Comprehensive Income.

Accumulated other comprehensive income at March 31, 2009 and December 31, 2008 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.

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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. At March 31, 2009, there were outstanding options, warrants and conversion rights pertaining to 11,500,720 shares of our common stock all of which were excluded from the

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TRANSGENOMIC, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended March 31, 2009 and 2008

computation of diluted earnings per share because the effect would be anti-dilutive due to the net loss from continuing operations in that period. At March 31, 2008 there were outstanding options, warrants and conversion rights pertaining to 12,223,879 shares of our common stock of which options to acquire 33,334 shares were included in the calculation of diluted earnings per share.

Recently Issued Accounting Pronouncements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurement* (FAS 157). While this Statement does not require new fair value measurements, it provides guidance on applying fair value and expands required disclosures. FAS 157 is effective as of January 1, 2008 for financial assets and financial liabilities within its scope. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2 Effective Date of FASB Statement No. 157 (FSP FAS 157-2), which defers the effective date of FAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), for fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for items within the scope of FSP FAS 157-2. We have implemented FAS 157 and FSP FAS 157-2 with no impact to our financial statements.

In December 2007, the FASB issued FAS No. 141(R) *Business Combinations* (FAS 141(R)). FAS 141(R) changes several underlying principles in applying the purchase method of accounting. Among the significant changes, FAS 141(R) requires a redefining of the measurement date of a business combination, expensing direct transaction costs as incurred, capitalizing in-process research and development costs as an intangible asset and recording a liability for contingent consideration at the measurement date with subsequent re-measurements recorded in the results of operations. FAS 141(R) also requires that costs for business restructuring and exit activities related to the acquired company will be included in the post-combination financial results of operations and also provides new guidance for the recognition and measurement of contingent assets and liabilities in a business combination. In addition, FAS 141(R) requires several new disclosures, including the reasons for the business combination, the factors that contribute to the recognition of goodwill, the amount of acquisition related third-party expenses incurred, the nature and amount of contingent consideration, and a discussion of pre-existing relationships between the parties. FAS 141(R) is effective as of January 1, 2009. We currently do not have any plans for a business combination, therefore FAS No. 141 (R) has no impact on our consolidated financial statements.

In December 2007, the FASB issued FAS No. 160 *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51* , (FAS 160). FAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. FAS 160 requires noncontrolling interests in subsidiaries initially to be measured at fair value and classified as a separate component of equity. FAS 160 also requires a new presentation on the face of the consolidated financial statements to separately report the amounts attributable to controlling and non-controlling interests. FAS 160 was effective as of January 1, 2009. We currently do not have a noncontrolling interest in a subsidiary nor have we deconsolidated a subsidiary, therefore, FAS 160 is not applicable at this time.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP No. FAS 142-3). FSP No. FAS 142-3 requires companies estimating the useful life of a recognized intangible asset to consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, to consider assumptions that market participants would use about renewal or extension as adjusted for FAS No. 142 s, *Goodwill and Other Intangible Assets*, entity-specific factors. FSP No. FAS 142-3 was adopted on January 1, 2009 and had no impact on our financial statements.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (FAS 162). This Standard identified the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. FAS 162 directs the hierarchy to the entity, rather than the independent auditors, as the entity is responsible for selecting accounting principles for financial statements that are presented in conformity with generally accepted accounting principles. FAS 162 was effective November 15, 2008 and did not have an impact on our financial statements.

In June 2008 the FASB issued Abstract Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock* (EITF 07-5). EITF 07-5 clarifies the exceptions that are allowable under FAS 133, *Accounting for Derivative Instruments and*

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Hedging Activities in paragraph 11A. Under FAS 133 most derivatives are recorded as assets or liabilities with changes in their fair value being recorded through earnings. One of the exceptions outlined in paragraph 11A of

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FAS 133 states that if a derivative is indexed to the entity's own stock and is classified in shareholder's equity, the derivative accounting is avoided. EITF 07-5 clarifies whether or not a derivative is indexed to an entity's own stock. EITF 07-5 was adopted on January 1, 2009. We have assessed our warrants and determined the fair value is \$0 so there is no impact to our financial statements.

C. INVENTORIES

Inventories consisted of the following:

	Dollars in Thousands	
	March 31, 2009	December 31, 2008
Finished goods	\$ 3,131	\$ 2,911
Raw materials and work in process	1,683	1,658
Demonstration inventory	33	206
	\$ 4,847	\$ 4,775

D. OTHER ASSETS

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

	Dollars in Thousands					
	March 31, 2009			December 31, 2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Intellectual property	\$ 310	\$ 205	\$ 105	\$ 310	\$ 195	\$ 115
Patents	670	232	438	679	230	449
Other	198		198	209		209
Total	\$ 1,178	\$ 437	\$ 741	\$ 1,198	\$ 425	\$ 773

Amortization expense for intangible assets was less than \$0.1 million during the three months ended March 31, 2009 and 2008, respectively. Amortization expense for intangible assets is expected to be approximately \$0.1 million for each of the years 2009 through 2013.

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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We lease certain equipment, vehicles and operating facilities under non-cancellable operating leases that expire on various dates through 2014. Some of our leases have early termination clauses. The future minimum lease payments required under these leases are approximately \$0.7 million for the remainder of 2009, \$0.9 million in 2010, \$0.6 million in 2011, \$0.3 million in 2012, and \$0.1 million thereafter. Rent expense for continuing operations relating to operating leases for the three months ended March 31, 2009 and 2008 was approximately \$0.2 million and \$0.2 million, respectively.

At March 31, 2009, firm commitments to vendors to purchase components used in WAVE Systems and instruments manufactured by others totaled \$0.4 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 2005 and 2007. We have state income tax returns subject to examination primarily for tax years 2005 through 2007. 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 2005 through 2007.

During the three months ended March 31, 2009, there were no material changes to the liability for uncertain tax positions.

Table of Contents**TRANSGENOMIC, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Three Months Ended March 31, 2009 and 2008****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. The Transgenomic, Inc. Savings and Retirement Plan was modified to state that the employer may make a discretionary matching contribution equal to a uniform percentage or dollar amount of the employee's elective payroll deferral. Each year we will determine the formula for the discretionary matching contribution. We may, at the discretion of our Board of Directors, make additional contributions on behalf of the Plan's participants. Effective June 1, 2009, Transgenomic will not match employee 401(k) contributions. Contributions to the 401(k) plan were less than \$0.1 million for each of the three months ended March 31, 2009 and 2008.

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.

Common Stock Warrants.

No common stock warrants were issued or exercised during the three months ended March 31, 2009 or 2008. At March 31, 2009, there were warrants outstanding which were exercisable to purchase 7,978,156 shares of common stock.

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

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

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

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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.

Table of Contents**TRANSGENOMIC, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Three Months Ended March 31, 2009 and 2008****I. STOCK OPTIONS**

The following table summarizes stock option activity during the three months ended March 31, 2009:

	Number of Options	Weighted Average Exercise Price
Balance at January 1, 2009:	3,531,064	\$ 2.54
Granted	25,000	.36
Exercised		
Forfeited/Expired	33,500	1.53
Balance at March 31, 2009:	3,522,564	\$ 2.53
Exercisable at March 31, 2009:	2,399,370	\$ 3.42

During the three months ended March 31, 2009, we granted 25,000 stock options at a weighted average exercise price of \$0.36 under our 2006 Equity Incentive Plan. The weighted average fair value per share on grant date of options granted during the three months ended March 31, 2009 was \$0.28.

J. OPERATING SEGMENT AND GEOGRAPHIC INFORMATION

Our company's chief decision-maker as defined in FAS 131, Disclosures about Segments of an Enterprise and Related Information, is the Chief Executive Officer, who regularly evaluates our performance based on net sales and gross profit. The preparation of this segment analysis required 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 March 31, 2009 and 2008 is as follows:

	Dollars in Thousands					
	2009			2008		
	Instrument Business	Lab Services	Total	Instrument Business	Lab Services	Total
Net Sales	\$ 3,733	\$ 1,256	\$ 4,989	\$ 5,281	\$ 973	\$ 6,254
Gross Profit	2,202	611	2,813	3,250	390	3,640
Net Income/(Loss) before Taxes	(433)	(561)	(994)	327	(201)	125
Income Tax Expense (Benefit)	(41)		(41)	3		3

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Net Income/(Loss)	\$ (392)	\$ (561)	\$ (953)	\$ 324	\$ (201)	\$ 122
Depreciation/Amortization	130	60	190	139	51	190
Interest Income, Net	9	3	12	28	5	33

		3/31/2009		12/31/08		
Total Assets	\$ 9,682	\$ 7,125	\$ 16,807	\$ 10,226	\$ 7,330	\$ 17,556

Table of Contents**TRANSGENOMIC, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Three Months Ended March 31, 2009 and 2008**

Net sales by product were as follows:

	Dollars in Thousands	
	Three Months Ended	
	March 31,	
	2009	2008
Instrument Related Business:		
Bioinstruments	\$ 1,912	\$ 3,028
Bioconsumables	1,821	2,253
	3,733	\$ 5,281
Laboratory Services:		
Molecular Clinical Reference Laboratory	953	506
Pharmacogenomics Research Services	303	467
	1,256	973
Total Net Sales	\$ 4,989	\$ 6,254

Net cost of goods sold was as follows:

	Dollars in Thousands	
	Three Months Ended	
	March 31,	
	2009	2008
Instrument Related Business:		
Bioinstruments	\$ 658	\$ 1,029
Bioconsumables	873	1,002
	\$ 1,531	\$ 2,031
Laboratory Services:		
Molecular Clinical Reference Laboratory	486	347
Pharmacogenomics Research Services	159	236
	645	583
Total Cost of Goods Sold	\$ 2,176	\$ 2,614

Net sales for the three months ended March 31, 2009 by country were as follows:

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	3/31/2009
	(Dollars in Thousands)
United States	\$ 2,183
Italy	841
China	309
Germany	293
France	283
United Kingdom	242
All Other Countries	838
Total	\$ 4,989

No other country accounted for more than 5% of total net sales.

No customer accounted for more than 10% of consolidated net sales during the three months ended March 31, 2009 and 2008. For the three months ended March 31, 2009 one customer made up more than 10% of the Laboratory Services net sales. This customer represented 17% of the Laboratory Services net sales.

80% of our long-lived assets are within the United States. Substantially all of the remaining long-lived assets are within Europe.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations **Overview**

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 over 1,450 WAVE Systems as of March 31, 2009. 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.

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

Executive Summary

Net sales for the three months ended March 31, 2009 decreased by \$1.3 million or 20% compared to the same period in 2008. Net sales in our Instrument Related Business were down 29% or \$1.5 million for the three months ended March 31, 2009 compared to the same period in 2008. Net sales from bioinstruments were down 37% and net sales of consumables were down 19% for the comparable three month periods. During the three months ended March 31, 2009, net sales from Laboratory Services grew 29%, or \$0.3 million, compared to the same three month period in 2008. The Clinical Reference Laboratory showed revenue growth of 88% and net sales from Pharmacogenomics Research Services decreased by 35%. Our gross profit margin decreased from 58% for the three months ended March 31, 2008 to 56% for the same period in 2009. Laboratory Services gross margin improved from 40% gross profit in the three months ended March 31, 2008 to 49% for the same period in 2009. Net loss was \$1.0 million for the three months ended March 31, 2009 compared to net income of \$0.1 million for the three months ended March 31, 2008.

As of March 31, 2009, we had cash and cash equivalents of \$4.8 million.

Outlook

We continue to work toward our objective of generating income from continuing operations and positive cash flows from continuing operations. To accomplish these goals, we must generate sequential growth in net sales and continue to control manufacturing and other operating expenses. As a result of the current economic outlook in 2009 and our first quarter sales performance, we initiated a cost cutting initiative in April 2009. This was necessary to ensure that we remain financially strong and try to maintain cash in 2009. The cost cutting initiative included a reduction

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in force, a freeze on new hires and backfills, no merits or other bonuses, effective June 1, 2009 there will be no 401(k) company match, reduction in travel and elimination of our investor relations firm.

Table of Contents**Uncertainties**

The uncertainty of the current general economic conditions could negatively impact our business in the future.

We have historically operated at a loss until recently and have not consistently generated sufficient cash from operating activities to cover our operating and other cash expenses. While we have been able to historically finance our operating losses through borrowings or from the issuance of additional equity, we may not be able to obtain such funding due to the tightened credit markets. At March 31, 2009 we had cash and cash equivalents of \$4.8 million. We believe that existing sources of liquidity are sufficient to meet expected cash needs during 2009.

There are many factors that affect the market demand for our products and services that we cannot control. Demand for our Instrument Related Business is affected by the needs and budgetary resources of research institutions, universities and hospitals. The instrument purchase represents a significant expenditure by these types of customers and often requires a long sales cycle. These customers may not have the funding available to purchase our instruments.

Results of Continuing Operations**Three Months Ended March 31, 2009 and 2008**

Net Sales. Net sales consisted of the following:

	Dollars in Thousands			
	Three Months Ended		Change	
	March 31, 2009	2008	\$	%
Instrument Related Business:				
Bioinstruments	\$ 1,912	\$ 3,028	\$ (1,116)	(37)%
Bioconsumables	1,821	2,253	(432)	(19)%
		3,733		