OWENS & MINOR INC/VA/
Form 10-K405
March 08, 2002
Table of Contents

Form 10-K Annual Report

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the year ended December 31, 2001

[ ] 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 1-9810

OWENS & MINOR, INC.
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	54-01701843 (I.R.S. Employer Identification No.)
4800 Cox Road, Glen Allen, Virginia (Address of principal executive offices)	23060 (Zip Code)

Registrant s telephone number, including area code (804) 747-9794

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $2 par value	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange
8 1/2% Senior Subordinated Notes due 2011	Not Listed
$2.6875 Term Convertible Securities, Series A	Not Listed

Securities registered pursuant to Section 12(g) of the Act: None
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 (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes X No _
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]
The aggregate market value of Common Stock held by non-affiliates (based upon the closing sales price) was approximately $630,546,304 as of February 14, 2002.
The number of shares of the Company s Common Stock outstanding as of February 14, 2002 was 33,973,400 shares.

Documents Incorporated by Reference

The proxy statement for the annual meeting of security holders on April 25, 2002 is incorporated by reference for part III.

Table of Contents

Owens & Minor, Inc.
Statement of Differences Between Electronic Form 10-K and Printed Annual Report & Form 10-K

1. The printed Annual Report and Form 10-K document contains graphs and photographs not incorporated into the electronic Form 10-K.

2. Pages 1-15 and 17 of the printed document have not been included in the electronic document, as they do not contain items required by Form 10-K.

3. The 10-K cover sheet and index, presented on pages 57 and 58 of the printed document, have been repositioned to the front of the electronic document.

Table of Contents

Item Captions and Index
Form 10-K Annual Report

Item No.			Page
Part I			
1.		Business	19-23
2.		Properties	23
3.		Legal Proceedings	47
4.		Submission of Matters to a Vote of Security Holders	N/A
Part II			
5.		Market for Registrant s Common Equity and Related Stockholder Matters	56, 60
6.		Selected Financial Data	18
7.		Management s Discussion and Analysis of Financial Condition and Results of Operations	24-30
7A.		Quantitative and Qualitative Disclosures about Market Risk	29, 40
8.		Financial Statements and Supplementary Data	See Item 14
9.		Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	N/A
Part III			
10.		Directors and Executive Officers of the Registrant	(a), 16, 59
11.		Executive Compensation	(a)
12.		Security Ownership of Certain Beneficial Owners and Management	(a)
13.		Certain Relationships and Related Transactions	(a)
Part IV			
14.		Exhibits, Financial Statement Schedules, and Reports on Form 8-K	
	a.	Consolidated Statements of Income for the Years Ended Dec. 31, 2001, Dec. 31, 2000 and Dec. 31, 1999	31
		Consolidated Balance Sheets at Dec. 31, 2001 and Dec. 31, 2000	32
		Consolidated Statements of Cash Flows for the Years Ended Dec. 31, 2001, Dec. 31, 2000 and Dec. 31, 1999	33
		Consolidated Statements of Changes in Shareholders Equity for the Years Ended Dec. 31, 2001, Dec. 31, 2000 and Dec. 31, 1999	34
		Notes to Consolidated Financial Statements for the Years Ended Dec. 31, 2001, Dec. 31, 2000 and Dec. 31, 1999	35-54
		Report of Independent Auditors	55
	b.	Reports on Form 8-K:	None.
	c.	The index to exhibits has been filed as separate pages of 2001 Form 10-K and is available to shareholders on request from the Secretary of the company at the principal executive offices.	

(a) Part III will be incorporated by reference from the registrant s 2002 Proxy Statement pursuant to instructions G(1) and G(3) of the General Instructions to Form 10-K.

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 7th day of March, 2002.

OWENS & MINOR, INC.

/s/ G. Gilmer Minor, III

G. Gilmer Minor, III
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant on the 7th day of March 2002 and in the capacities indicated.

Signature	Title
/s/ G. Gilmer Minor, III G. Gilmer Minor, III	Chairman and Chief Executive Officer and Director (Principal Executive Officer)
/s/ Jeffrey Kaczka Jeffrey Kaczka	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ Olwen B. Cape Olwen B. Cape	Vice President and Controller (Principal Accounting Officer)
/s/ A. Marshall Acuff, Jr. A. Marshall Acuff, Jr.	Director
/s/ Henry A. Berling Henry A. Berling	Director
/s/ Josiah Bunting, III Josiah Bunting, III	Director
/s/ John T. Crotty John T. Crotty	Director
/s/ James B. Farinholt, Jr. James B. Farinholt, Jr.	Director
/s/ Vernard W. Henley Vernard W. Henley	Director
/s/ Peter S. Redding Peter S. Redding	Director
/s/ James E. Rogers James E. Rogers	Director
/s/ James E. Ukrop James E. Ukrop	Director
/s/ Anne Marie Whittemore Anne Marie Whittemore	Director

OWENS & MINOR 2001 ANNUAL REPORT

58

Table of Contents

[GRAPHICs]

Board of Directors

A. Marshall Acuff, Jr. (62) [2,4,5]
Retired Senior Vice President
& Managing Director,
Salomon Smith Barney, Inc.

Henry A. Berling (59) [1,4]
Executive Vice President,
Partnership Development,
Owens & Minor, Inc.

Josiah Bunting, III (62) [2,4,5]
Superintendent,
Virginia Military Institute

John T. Crotty (64) [2,3,4*]
Managing Partner,
CroBern Management Partnership
President, CroBern, Inc.

James B. Farinholt, Jr. (67) [1,2*,4]
Special Assistant to the President
for Economic Development,
Virginia Commonwealth University

Vernard W. Henley (72) [2,3,5]
Retired Chairman & CEO,
Consolidated Bank & Trust Company

G. Gilmer Minor, III (61) [1*,4]
Chairman & CEO,
Owens & Minor, Inc.

Peter S. Redding (63) [2,3,4]
Retired President & CEO,
Standard Register Company

James E. Rogers (56) [1,3*,4]
President, SCI Investors Inc.

James E. Ukrop (64) [3,4,5]
Chairman,
Ukrop s Super Markets, Inc.
Chairman, First Market Bank

Anne Marie Whittemore (55)[1,3,5*]
Partner,
McGuireWoods LLP

Board Committees: [1]Executive Committee, [2]Audit Committee, [3]Compensation & Benefits Committee, [4]Strategic Planning Committee, [5]Governance & Nominating Committee, [*]Denotes Chairperson

OWENS & MINOR 2001 ANNUAL REPORT

16

Table of Contents

S elected Financial Data[1]

(in thousands, except ratios and per share data)

	2001	2000	1999	1998	1997
Summary of Operations:					
Net sales	$ 3,814,994	$ 3,503,583	$ 3,194,134	$ 3,090,048	$ 3,124,062
Income before extraordinary item[2][3]	$ 30,103	$ 33,088	$ 27,979	$ 20,145	$ 24,320
Per Common Share:					
Income before extraordinary item basic	$ 0.90	$ 1.01	$ 0.86	$ 0.56	$ 0.60
Income before extraordinary item diluted	$ 0.85	$ 0.94	$ 0.82	$ 0.56	$ 0.60
Average number of shares outstanding basic	33,368	32,712	32,574	32,488	32,048
Average number of shares outstanding diluted	40,387	39,453	39,098	32,591	32,129
Cash dividends	$ 0.2725	$ 0.2475	$ 0.23	$ 0.20	$ 0.18
Stock price at year end	$ 18.50	$ 17.75	$ 8.94	$ 15.75	$ 14.50
Book value at year end	$ 6.97	$ 6.41	$ 5.58	$ 4.94	$ 4.48
Summary of Financial Position:					
Working capital	$ 311,778	$ 233,637	$ 219,448	$ 235,247	$ 233,789
Total assets	$ 953,853	$ 867,548	$ 865,000	$ 717,768	$ 712,563
Long-term debt	$ 203,449	$ 152,872	$ 174,553	$ 150,000	$ 182,550
Mandatorily redeemable preferred securities	$ 132,000	$ 132,000	$ 132,000	$ 132,000	$
Shareholders equity	$ 236,243	$ 212,772	$ 182,381	$ 161,126	$ 259,301
Selected Ratios:					
Gross margin as a percent of net sales	10.7%	10.7%	10.7%	10.8%	10.4%
Selling, general and administrative expenses as a percent of net sales	7.8%	7.7%	7.8%	8.0%	7.8%
Average receivable days sales outstanding[4]	33.1	33.3	34.9	33.5	32.4
Average inventory turnover	9.7	9.5	9.2	9.8	9.9
Return on average total equity before extraordinary item[5]	9.6%	11.2%	10.5%	8.2%	9.7%
Return on average total equity before extraordinary item[6]	13.4%	16.7%	16.3%	9.6%	9.7%
Current ratio	1.8	1.6	1.6	1.9	1.9
Capitalization ratio[4][5]	42.6%	40.4%	47.2%	43.4%	53.0%
Capitalization ratio[4][6]	63.2%	63.2%	69.4%	68.9%	53.0%

[1] *On July 30, 1999, the company acquired certain net assets of Medix, Inc. This acquisition was accounted for as a purchase.*

[2] *In 1998, the company incurred $11.2 million, or $6.6 million after taxes, of nonrecurring restructuring expenses which are included in income before extraordinary item. In 2001, 2000 and 1999, income before extraordinary item included reductions in the restructuring accrual of $1.5 million, $0.8 million and $1.0 million, or $0.8 million, $0.4 million and $0.6 million after taxes. See Note 3 to the Consolidated Financial Statements.*

[3] *In 2001, income before extraordinary item included an impairment loss of $1.1 million on an investment in marketable equity securities and a provision for disallowed income tax deductions of $7.2 million. See Notes 6 and 14 to the Consolidated Financial Statements.*

[4] *Assumes that receivables had not been sold under the company s off balance sheet receivables financing facility. See Note 9 to the Consolidated Financial Statements.*

(5) *Includes mandatorily redeemable preferred securities as equity.*

(6) *Includes mandatorily redeemable preferred securities as debt.*

Table of Contents

Business Description

The Company

Owens & Minor Inc. and subsidiaries (O&M or the company) is the leading distributor of national name brand medical and surgical supplies in the United States, distributing over 120,000 finished medical and surgical products produced by approximately 1,500 suppliers to approximately 4,000 customers from 44 distribution centers nationwide. The company s customers are primarily acute care hospitals and integrated healthcare networks (IHNs), which account for more than 90% of O&M s net sales. Many of these hospital customers are represented by national healthcare networks (Networks) or group purchasing organizations (GPOs) that offer discounted pricing with suppliers and contract distribution services with the company. Other customers include alternate care providers such as clinics, home healthcare organizations, nursing homes, physicians offices, rehabilitation facilities and surgery centers. The company typically provides its distribution services under contractual arrangements ranging from three to five years. Most of O&M s sales consist of consumable goods such as disposable gloves, dressings, endoscopic products, intravenous products, needles and syringes, sterile procedure trays, surgical products and gowns, urological products and wound closure products.

Founded in 1882 and incorporated in 1926 in Richmond, Virginia, as a wholesale drug company, the company refined its mission in 1992, selling the wholesale drug division to concentrate on medical and surgical distribution. O&M has significantly expanded and strengthened its national presence over the last ten years through internal growth and acquisitions, generating $3.8 billion of net sales in 2001.

The Industry

Distributors of medical and surgical supplies provide a wide variety of products and services to healthcare providers, including hospitals and hospital-based systems, IHNs and alternate care providers. The company contracts with these providers directly and through Networks and GPOs. The medical/surgical supply distribution industry has experienced growth in recent years due to the aging population and emerging medical technology resulting in new healthcare procedures and products. Over the years, healthcare providers have continued to change and model their health systems to meet the needs of the markets they serve. They have forged strategic relationships with national medical and surgical supply distributors to meet the challenges of managing the supply procurement and distribution needs of their entire network. The traditional role of distributors in warehousing and delivering medical and surgical supplies to customers is evolving into the role of assisting customers to manage the entire supply chain.

Historically, the medical/surgical supply distribution industry has been highly fragmented. During the past decade, the overall healthcare market has been characterized by the consolidation of healthcare providers into larger and more sophisticated entities seeking to lower their total costs. These providers have sought to lower total product costs through incremental value-added services from their medical and surgical supply distributors. These trends have driven a significant and ongoing consolidation within the medical/surgical supply distribution industry due to the competitive advantages enjoyed by larger distributors, which include, among other things, the ability to serve nationwide customers, buy inventory in large volume and develop technology platforms and decision support systems.

The Business

The company purchases a high volume of medical and surgical products from suppliers, inventories these items at its distribution centers and provides delivery services to its customers. O&M s 44 distribution centers are located throughout the United States and are situated close to its major customer facilities. These distribution centers generally serve hospitals and other customers within a 200-mile radius, delivering most medical and surgical supplies with a fleet of leased trucks. Almost all of O&M s delivery personnel are employees of the company, providing effective control of customer service. Contract carriers and parcel services are used to transport all other medical and surgical supplies. The company customizes its product pallets and truckloads according to the needs of its customers, thus enabling them to reduce labor on the receiving end. Furthermore, delivery times are adjusted to customers needs, allowing them to streamline receiving activities.

O&M strives to make the supply chain more efficient through the utilization of advanced warehousing, delivery and

Table of Contents

Business **Description** *(continued)*

purchasing techniques, enabling customers to order products using just-in-time and stockless services. A key component of this strategy is a significant investment in advanced information technology, which includes automated warehousing technology as well as electronic data interchange (EDI) and Internet-based technology for communicating with both customers and suppliers. O&M provides technology so that customers can analyze their own purchasing data to help them maintain contract compliance, create workflow efficiencies, raise employee productivity and cut costs.

Value-Added Services

The company offers its customers value-added services in the areas of supply chain management, logistics and information technology in order to help control healthcare costs, improve inventory management and increase profitability. Some of these services include:

CostTrack: This activity-based management program helps customers identify and track the cost drivers in their procurement and handling activities, giving them the information they need to drive workflow efficiencies, raise employee productivity and cut costs. With CostTrack, the pricing of services provided to customers is based on the variety of services that they choose, as compared to a traditional cost-plus pricing model. In 2001, almost 28% of the company s net sales were generated through the CostTrack program, up from 22% in 2000.

WISDOM: This Internet-accessed decision support tool connects customers, suppliers and GPOs to the company s data warehouse. WISDOM offers customers online access to a wide variety of reports, which summarize their purchase history, contract compliance, product usage and other related data. This timely information helps customers consolidate purchasing information across their healthcare systems and identify opportunities for product standardization, contract compliance and supplier consolidation. The company offers WISDOM on a subscription basis. WISDOM users represented net sales of approximately $1.5 billion for the year ended December 31, 2001.

WISDOM^2: The second generation of WISDOM, this Internet-based decision support tool provides customers access to purchasing information for all medical/surgical manufacturers and suppliers recorded in their materials management information systems. This timely information helps customers identify opportunities for product standardization, contract compliance, order optimization and efficiencies in their overall purchasing activity.

PANDAC Wound Closure Asset Management Program: This information-based program provides customers with an evaluation of their current and historical wound closure inventories and usage levels, helping them reduce their investment in high-cost wound management supplies and control their costs per operative case.

Focus On Consolidation, Utilization & Standardization (FOCUS): This supplier partnership program drives product standardization and consolidation, increasing the volume of purchases from the most efficient suppliers, which provides operational benefits and cost savings throughout the supply chain. FOCUS centers around both commodity and preference product standardization. O&M requires its FOCUS supplier partners to meet strict certification standards, such as exceeding minimum fill rates and offering a flexible returned goods policy.

Customers

The company currently provides its distribution services to approximately 4,000 healthcare providers, including hospitals, IHNs and alternative care providers, contracting with them directly and through Networks and GPOs.

Networks and GPOs

Networks and GPOs are entities that act on behalf of a group of healthcare providers to obtain pricing and other benefits that may be unavailable to individual members. Hospitals, physicians and other types of healthcare providers have joined Networks and GPOs to take advantage of improved economies of scale and to obtain services from medical and surgical supply

distributors ranging from discounted product pricing to logistical and clinical support. Networks and GPOs negotiate directly with medical and surgical product suppliers and distributors on behalf of their members, establishing exclusive or multi-supplier relationships. Networks and GPOs cannot ensure that members will purchase their supplies from a given distributor. O&M is a distributor for Novation, an organization that manages purchasing for more than 5,000 healthcare organizations. Novation was created in 1998 to serve member organizations of VHA, which O&M has served since 1985, and University HealthSystem Consortium (UHC), an alliance of academic health centers. Sales to Novation members represented approximately 51% of the company s net sales in 2001. The company is also a distributor for Broadlane, a GPO providing national contracting for more than 300 acute care hospitals and more than 1,400 sub-acute care facilities, including Tenet Healthcare Corporation, one of the largest for profit hospital chains in the nation. Sales to Broadlane members represented approximately 11% of O&M s net sales in 2001.

IHNs

IHNs are typically networks of different types of healthcare providers that seek to offer a broad spectrum of healthcare services and comprehensive geographic coverage to a particular local market. IHNs have become increasingly important because of their expanding role in healthcare delivery and cost containment and their reliance upon the hospital as a key component of their organizations. Individual healthcare providers within a multiple-entity IHN may be able to contract individually for distribution services; however, the providers shared economic interests create strong incentives for participation in distribution contracts established at the system level. Because IHNs frequently rely on cost containment as a competitive advantage, IHNs have become an important source of demand for O&M s enhanced inventory management and other value-added services.

Individual Providers

In addition to contracting with healthcare providers at the IHN level, and through Networks and GPOs, O&M contracts directly with individual healthcare providers. In 2001, not-for-profit hospitals represented a majority of these facilities.

Sales and Marketing

O&M s sales and marketing function is organized to support its decentralized field sales teams of approximately 220 people. Based from the company s distribution centers nationwide, the company s local sales teams are positioned to respond to customer needs quickly and efficiently. National account directors work closely with Networks and GPOs to meet their needs and coordinate activities with their individual member facilities. In addition, O&M has a national field organization, the Medical Specialties Group, which is focused on assisting customers in the clinical environment. The company s integrated sales and marketing strategy offers customers value-added services in logistics, information management, asset management and product mix management. O&M provides special training and support tools to its sales team to help promote these programs and services.

Contracts and Pricing

Industry practice is for healthcare providers or their GPOs to negotiate product pricing directly with suppliers and then negotiate distribution pricing terms with distributors. Distribution contracts in the medical/surgical supply industry establish the price at which products will be distributed and, in many cases, specify a minimum volume of product to be purchased and are terminable by the customer upon short notice.

The majority of O&M s arrangements compensate the company on a cost-plus percentage basis under which a negotiated percentage distributor fee is added to the product cost agreed to by the customer and the supplier. This negotiated distributor fee is calculated either on a fixed cost-plus percentage basis or a variable cost-plus percentage basis that varies according to the services rendered and the dollar volume of purchases. Under this variable pricing method, as the company s sales to an institution grow, the cost-plus percentage charged to the customer generally decreases. Additionally, O&M has arrangements that charge incremental fees for additional distribution and enhanced inventory management services, such as more frequent deliveries and distribution of products in small units of measure. Although the company s marketing and sales personnel based in the distribution centers can negotiate local arrangements and pricing levels with customers, corporate management has established minimum pricing levels and a contract review process.

Table of Contents

Business Description *(continued)*

Pricing under O&M s CostTrack model differs from pricing under a traditional cost-plus model. With CostTrack, the pricing of services provided to customers is based on the variety of services that they choose, as compared to a traditional cost-plus pricing model. As a result, this pricing model more accurately aligns the distribution fees charged to the customer with the costs of the individual services provided.

Suppliers

O&M believes that its size, strength and long-standing relationships enable it to obtain attractive terms from suppliers, including discounts for prompt payment and volume incentives. The company has well-established relationships with virtually all major suppliers of medical and surgical supplies, and uses cross-functional teams to work with its largest suppliers to create operating efficiencies in the supply chain.

Approximately 16% of O&M s net sales in 2001 were sales of Johnson & Johnson Hospital Services, Inc. products. Approximately 15% of O&M s 2001 net sales were sales of products of the subsidiaries of Tyco International, which include Kendall Healthcare Products, United States Surgical Corporation and Mallinckrodt.

Information Technology

To support its strategic efforts, the company has developed information systems to manage all aspects of its operations, including warehouse and inventory management, asset management and electronic commerce. O&M believes that its investment in and use of technology in the management of its operations provides the company with a significant competitive advantage. In 2001, the company ranked number one on the *InformationWeek* 500 listing of the most innovative users of technology in the nation.

In 1998, O&M signed a 10-year agreement with Perot Systems Corporation to outsource its information technology (IT) operations and to procure strategic application development services. This partnership has allowed the company to provide resources to major IT initiatives, which support internal operations and enhance services to customers and suppliers. The company has focused its technology expenditures on electronic commerce, data warehouse and decision support, supply chain management and warehousing systems, sales and marketing programs and services and infrastructure enhancements. In 2001, O&M s capital expenditures included approximately $9.8 million for computer hardware and software.

Owens & Minor is an industry leader in the use of electronic commerce to conduct business transactions with customers and suppliers, using OM Direct, an Internet-based product catalog and direct ordering system, to supplement existing EDI technologies.

The company also provides distribution services for several Internet-based medical and surgical supply companies. O&M is committed to an ongoing investment in an open, Internet-based electronic commerce platform to support the company s supply chain management initiatives and to enable expansion into new market segments for medical and surgical products.

Asset Management

O&M aims to provide the highest quality of service in the medical/surgical supply distribution industry by focusing on providing suppliers and customers with local sales and service support and the most responsive, efficient and cost-effective distribution of medical and surgical products. The company draws on technology to provide a broad range of value-added services to control inventory and accounts receivable.

Inventory

Due to O&M s significant investment in inventory to meet the rapid delivery requirements of customers, efficient asset management is essential to the company s profitability. The significant and ongoing emphasis on cost control in the healthcare industry puts pressure on suppliers, distributors and healthcare providers to create more efficient inventory management systems. O&M has responded to these ongoing challenges by developing inventory forecasting capabilities, a client/server warehouse management system, a product standardization and consolidation initiative, and a vendor-managed inventory process. This vendor-managed inventory process allows some of the company s major suppliers to monitor daily sales, inventory levels and product forecasts electronically so they can automatically and accurately replenish O&M s inventory.

Accounts Receivable

The company s credit practices are consistent with those of other medical and surgical supply distributors. O&M actively manages its accounts receivable to minimize credit risk and does not believe that the risk of loss associated with accounts receivable poses a significant risk to its results of operations.

Competition

The medical/surgical supply distribution industry in the United States is highly competitive and consists of three major nationwide distributors: O&M; Allegiance Corp., a subsidiary of Cardinal Health, Inc.; and McKesson General Medical Corp., a subsidiary of McKesson HBOC, Inc. The industry also includes smaller national distributors of medical and surgical supplies and a number of regional and local distributors.

Competitive factors within the medical/surgical supply distribution industry include total delivered product cost, product availability, the ability to fill and invoice orders accurately, delivery time, services provided, inventory management, information technology, electronic commerce capabilities and the ability to meet special customer requirements. O&M believes its emphasis on technology, combined with its customer-focused approach to distribution and value-added services, enables it to compete effectively with both larger and smaller distributors by being located near the customer and offering a high level of customer service.

Other Matters

Regulation

The medical/surgical supply distribution industry is subject to regulation by federal, state and local government agencies. Each of O&M s distribution centers is licensed to distribute medical and surgical supplies as well as certain pharmaceutical and related products. The company must comply with regulations, including operating and security standards for each of its distribution centers, of the Food and Drug Administration, the Occupational Safety and Health Administration, state boards of pharmacy and, in certain areas, state boards of health. O&M believes it is in material compliance with all statutes and regulations applicable to distributors of medical and surgical supply products and pharmaceutical and related products, as well as other general employee health and safety laws and regulations.

Employees

At the end of 2001, the company had 2,937 full-time and part-time employees. O&M believes that ongoing employee training is critical to performance, so the company emphasizes quality and technology in training programs to increase employee efficiency by sharpening overall customer service skills and by focusing on functional best practices. Management believes that relations with employees are good.

Properties

O&M s corporate headquarters are located in western Henrico County, in a suburb of Richmond, Virginia, in facilities leased from unaffiliated third parties. The company owns two undeveloped parcels of land adjacent to its corporate headquarters. In March 2001, the company purchased an undeveloped parcel of land in nearby Hanover County to be used for its future corporate headquarters. The company leases offices and warehouses for 42 of its distribution centers across the United States from unaffiliated third parties. In addition, the company has a distribution center located at a customer facility in Columbia, South Carolina, and has a warehousing arrangement in Honolulu, Hawaii. In the normal course of business, the company regularly assesses its business needs and makes changes to the capacity and location of its distribution centers. The company believes that its facilities are adequate to carry on its business as currently conducted. A number of leases are scheduled to terminate within the next several years. The company believes that, if necessary, it could find facilities to replace these leased premises without suffering a material adverse effect on its business.

Table of Contents

Management Discussion & Analysis *(continued)*

2001 Financial Results

In 2001, O&M earned net income of $23.0 million, or $0.68 per diluted common share, compared with $33.1 million, or $0.94 per diluted common share in 2000, and $28.0 million, or $0.82 per diluted common share in 1999. Results from 2001 included a $1.1 million impairment loss on an investment, a $7.2 million additional tax provision related principally to disallowed interest deductions for corporate-owned life insurance for the years 1995 through 1998, and a $7.1 million after-tax extraordinary loss on the early retirement of debt. Net income in 2001, 2000 and 1999 included reductions in a restructuring reserve, originally established in 1998, of $0.8 million, $0.4 million, and $0.6 million, net of tax. Excluding these unusual items, net income for 2001 increased to $37.5 million, or $1.03 per diluted common share, from $32.7 million, or $0.93 per diluted common share, for 2000 and $27.4 million, or $0.80 per diluted common share for 1999. The increase from 2000 to 2001 was primarily due to the increase in sales, a reduction of financing costs, and a lower effective tax rate for ongoing operations. The increase from 1999 to 2000 resulted from higher sales and success in controlling operating expenses through productivity improvements.

The following tables reconcile net income as reported under generally accepted accounting principles to income excluding unusual items for the years ended December 31, 2001, 2000 and 1999:

(in thousands, except per share data)

	Year ended December 31, 2001		
	As reported	Unusual items	Excluding unusual items
Income before income taxes and extraordinary item	$ 64,577	$ 405	$ 64,172
Income tax provision	34,474	7,817	26,657
Income before extraordinary item	30,103	(7,412)	37,515
Extraordinary loss on early retirement of debt	(7,068)	(7,068)	
Net income	$ 23,035	$ (14,480)	$ 37,515
Per common share diluted:			
Income before extraordinary item	$ 0.85	$ (0.18)	$ 1.03
Extraordinary loss on early retirement of debt	(0.17)	(0.17)	
Net income	$ 0.68	$ (0.35)	$ 1.03

	Year ended December 31, 2000		
	As reported	Unusual items	Excluding unusual items
	$ 60,160	$ 750	$ 59,410

Income before income taxes			
Income tax provision	27,072	338	26,734
Net income	$ 33,088	$ 412	$ 32,676
Net income per diluted common share	$ 0.94	$ 0.01	$ 0.93

	Year ended December 31, 1999		
	As reported	Unusual items	Excluding unusual items
Income before income taxes	$ 50,058	$ 1,000	$ 49,058
Income tax provision	22,079	441	21,638
Net income	$ 27,979	$ 559	$ 27,420
Net income per diluted common share	$ 0.82	$ 0.02	$ 0.80

Table of Contents

Results of Operations

The following table presents the company s consolidated statements of income on a percentage of net sales basis:

Year ended December 31,	2001	2000	1999
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	89.3	89.3	89.3
Gross margin	10.7	10.7	10.7
Selling, general and administrative expenses	7.8	7.7	7.8
Depreciation and amortization	0.6	0.6	0.6
Interest expense, net	0.3	0.3	0.4
Discount on accounts receivable securitization	0.1	0.2	0.1
Impairment loss on investment	0.0		
Distributions on mandatorily redeemable preferred securities	0.2	0.2	0.2
Restructuring credit	(0.0)	(0.0)	(0.0)
Total expenses	9.0	9.0	9.1
Income before income taxes and extraordinary item	1.7	1.7	1.6
Income tax provision	0.9	0.8	0.7
Income before extraordinary item	0.8	0.9	0.9
Extraordinary loss on early retirement of debt	(0.2)		
Net income	0.6%	0.9%	0.9%

Acquisition. On July 30, 1999, the company acquired certain net assets of Medix, Inc. (Medix), a distributor of medical/surgical supplies, for approximately $83 million. The company paid cash of approximately $68 million and assumed debt of approximately $15 million, which was paid off as part of the closing transaction. The excess of the purchase price over the fair value of the identifiable net assets acquired of approximately $58 million was recorded as goodwill and has been amortized on a straight-line basis over 40 years. As the acquisition was accounted for as a purchase, the operating results of Medix have been included in the company s consolidated financial statements since July 30, 1999.

In connection with the acquisition, management adopted a plan for integration of the businesses that included closure of some Medix facilities and consolidation of certain administrative functions. An accrual of $2.7 million, included in the allocation of the purchase price, was established to provide for certain costs related to this plan. In 2001, 2000, and 1999 amounts of $0.3 million, $1.0 million, and $0.1 million were charged against the accrual, principally for lease payments on closed facilities and employee separations. The integration of the Medix business was completed in 2001, and the integration accrual was re-evaluated, resulting in a reduction in the accrual of $0.6 million. This adjustment was recorded as a reduction in goodwill. The remaining accrual consists primarily of losses on lease commitments for vacated warehouse space on leases through 2003. Management subleases the vacant space when practicable to reduce these losses.

Net sales. Net sales increased by 9% to $3.81 billion for 2001, from $3.50 billion for 2000. This increase resulted from further penetration of existing accounts, as well as new business, including the addition of several large customers. In April 2001, the company signed a new distribution agreement with Novation, the supply company of VHA, Inc. and University HealthSystem Consortium, continuing its long-standing

relationship with these organizations. Under the new three-year agreement, the company is one of two national medical and surgical supply distributors authorized to serve members in all areas of the country. Sales to Novation members represented approximately 51% of the company s net sales in 2001.

Net sales increased by 10% to $3.50 billion for 2000, from $3.19 billion in 1999. Excluding the sales generated by customers acquired through the Medix acquisition, net sales increased 6%. Most of this increase resulted from increased penetration of existing accounts, most significantly Broadlane, whose distribution contract began in February 1999.

The company anticipates sales growth for 2002 to be in the 6 to 8 percent range.

[Graphic]

Table of Contents

Management Discussion & Analysis *(continued)*

Gross margin. Gross margin as a percentage of net sales for 2001 remained unchanged from 2000 and 1999 at 10.7%. From 1999 to 2000 and from 2000 to 2001, customer margins decreased slightly due to competitive pressures and changes in the company s customer mix. These decreases, however, were offset by increased margins from supplier incentives and inventory buying opportunities.

For 2002, management anticipates continued competitive pressure, as well as potential lessening of supplier incentives. The company will continue to pursue opportunities for margin improvement, including an emphasis on providing value-added services to customers and converting more business to CostTrack, which better aligns the fees charged to customers with the services provided. The company will also continue to actively pursue buying opportunities in order to reduce the cost of goods sold. As a result, management anticipates that, in 2002, gross margin as a percentage of net sales will remain consistent with 2001.

[GRAPHIC]

Selling, general and administrative expenses. Selling, general and administrative (SG&A) expenses as a percentage of net sales were 7.8% in 2001 compared with 7.7% in 2000 and 7.8% in 1999. The increase from 2000 to 2001 was primarily the result of higher personnel, warehouse and employee benefits costs driven by customer and business transitions, including:

- higher than normal activity levels related to customer sign-ups as a result of the Novation contract renewal,
- the addition of several large new customer accounts, and
- changes in the levels of service provided to certain customers, such as low unit-of-measure delivery.

The decreases from 1999 to 2000 as a percentage of net sales were attributable to economies of scale achieved as a result of a higher sales base without a significant increase in fixed costs, operating efficiencies driven by improved warehouse technology, and continued management of administrative costs, including consolidation of certain administrative functions.

Management anticipates that in 2002, SG&A expenses as a percentage of net sales will improve by a minimum of 10 basis points as compared to 2001, as the volume of customer transitions is expected to be lower and the company is focusing on further standardization of processes. Increased demand for low unit-of-measure delivery and other increases in levels of service as a result of customer needs could affect the company s ability to decrease SG&A expenses as a percentage of net sales, but increased fees for these services should enable the company to preserve or enhance operating margins.

Depreciation and amortization. Depreciation and amortization increased by 4% in 2001 to $22.5 million, compared with $21.5 million in 2000 and $19.4 million in 1999. Excluding goodwill amortization of $6.0 million in 2001 and 2000 and $5.1 million in 1999, depreciation and amortization increased by 6% from 2000 to 2001 and by 9% from 1999 to 2000 as a result of continued capital spending associated with information technology initiatives. O&M anticipates similar increases in depreciation in 2002 as the company continues to invest in information technology. In 2002, the company will adopt Statement of Financial Accounting Standards No. (SFAS) 142, *Goodwill and Other Intangible Assets,* and as a result, the company will no longer amortize goodwill.

Net interest expense and discount on accounts receivable securitization (financing costs). Net financing costs totaled $17.7 million in 2001, compared with $19.4 million in 2000 and $17.1 million in 1999. Net financing costs included collections of customer finance charges of $4.5 million in 2001, compared with $5.3 million in 2000 and $4.6 million in 1999. Excluding the collection of customer finance charges, financing costs decreased to $22.2 million in 2001 from $24.8 million in 2000, and increased

[Graphic]

from $21.7 million in 1999. The decrease in financing costs from 2000 to 2001 was primarily driven by lower effective interest rates resulting from both the refinancing of the company s long-term debt and from decreases in short-term interest rates. The increase in financing costs from 1999 to 2000 was due to a combination of higher interest rates due to external market forces and an increase in outstanding financing resulting from the Medix acquisition. O&M expects to continue to manage its financing costs by managing working capital levels. Future financing costs will be affected primarily by changes in short-term interest rates, as well as working capital requirements.

Impairment loss on investment. The company owns equity securities of a provider of business-to-business e-commerce services in the healthcare industry. The market value of these securities fell significantly below the company s original cost basis and, as management believed that recovery in the near term was unlikely, the company recorded an impairment charge of $1.1 million in the third quarter of 2001.

Restructuring credits. As a result of the cancellation of a significant customer contract in 1998, the company recorded a nonrecurring restructuring charge of $6.6 million, after taxes, to downsize operations. The company periodically re-evaluates its restructuring reserve, and since the actions under this plan have resulted in lower projected total costs than originally anticipated, the company has recorded reductions in the reserve in 2001, 2000 and 1999 of $1.5 million, $0.8 million and $1.0 million. These reductions in the reserve have increased net income for 2001, 2000 and 1999 by $0.8 million, $0.4 million and $0.6 million. In 2001, 2000 and 1999, amounts of $0.3 million, $1.8 million and $2.1 million were charged against this liability. The remaining accrual consists primarily of losses on lease commitments for vacated office space on leases through 2006, as well as anticipated asset write-offs. Management subleases the vacant space when practicable to reduce the cost of the restructuring plan.

Income taxes. The provision for income taxes was $34.5 million in 2001, including a $7.2 million provision for estimated tax liabilities related principally to interest deductions for corporate-owned life insurance claimed on the company s tax returns for the years 1995 through 1998. Excluding this charge, the impairment loss on investment, and the reduction of the restructuring reserve, O&M s effective tax rate was 41.5% in 2001, compared with 45.0% in 2000 and 44.1% in 1999. The reduction in rate from 2000 to 2001 resulted primarily from lower effective state income tax rates and decreases in the effect of certain nondeductible items. The increase in the effective tax rate from 1999 to 2000 resulted primarily from increases in certain nondeductible expenses. The effective tax rate is expected to decrease in 2002 as a result of the elimination of goodwill amortization expense, of which only a small part was deductible for income tax purposes.

Financial Condition, Liquidity and Capital Resources

Liquidity. Combined outstanding debt and off balance sheet accounts receivable securitization increased by $39.9 million from December 31, 2000 to $273.4 million at December 31, 2001. This increase in financing levels was primarily a result of an increased investment in inventory to support growing sales volume and to ensure high service levels during customer transitions. Excluding sales of accounts receivable, and their subsequent collections, under the company s off balance sheet receivables financing facility (Receivables Financing Facility), $11.6 million of cash was provided by operating activities in 2001, compared with $68.8 million in 2000 and $61.7 million in 1999. This decrease in operating cash flow resulted largely from increased purchases of inventory.

Table of Contents

Management Discussion & Analysis *(continued)*

In July 1999, the company acquired certain net assets of Medix for approximately $83 million. This acquisition was funded by cash flow from operations and an increase in outstanding financing under the Receivables Financing Facility.

During 2000, the company replaced its revolving credit facility and Receivables Financing Facility with new facilities expiring in April 2003 and July 2001. The new revolving credit facility allows the company to borrow up to $225 million, unchanged from the prior facility. Under the new Receivables Financing Facility, the company can sell up to $225 million of accounts receivable, an increase of $75 million from the prior facility. In July 2001, the company extended the expiration of its Receivables Financing Facility to July 11, 2002. The company expects to renew or replace both its Receivables Financing Facility and its revolving credit facility in 2002.

On July 2, 2001, the company issued $200 million of 8 1/2% Senior Subordinated Notes which will mature in July 2011. The proceeds from these notes were used to retire the company s $150 million of 10 7/8% Senior Subordinated Notes and to reduce the amount of outstanding financing under the Receivables Financing Facility. The retirement of the 10 7/8% Notes resulted in an extraordinary loss on the early retirement of debt of $7.1 million, net of income tax benefit. In conjunction with the new notes, the company entered into interest rate swap agreements through 2011 under which the company pays counterparties a variable rate based on London Interbank Offered Rate (LIBOR) and the counterparties pay the company a fixed interest rate of 8 1/2% on a notional amount of $100 million.

The company expects that its available financing will be sufficient to fund its working capital needs and long-term strategic growth, although this cannot be assured. At December 31, 2001, O&M had $213.6 million of unused credit under its revolving credit facility and the ability to sell an additional $155.0 million of accounts receivable under the Receivables Financing Facility.

The following is a summary of the company s significant contractual obligations:

(in millions)

	Payments due by period				
Contractual obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt	$ 200.0	$	$	$	$ 200.0
Mandatorily redeemable preferred securities	132.0				132.0
Leases and other commitments	76.9	23.2	35.2	15.2	3.3
Total contractual obligations	$ 408.9	$ 23.2	$ 35.2	$ 15.2	$ 335.3

In addition, the company has two commitments to outsource information technology operations that are cancelable upon payment of termination fees. These commitments are more fully described in Note 18 to the Consolidated Financial Statements.

Working Capital Management. The company s working capital increased by $78.1 million from December 31, 2000, to $311.8 million at December 31, 2001, as a result of increased levels of inventory. Inventory turnover improved to 9.7 times for the year ended December 31, 2001, from 9.5 times for the year ended December 31, 2000, as a result of increased sales. Accounts receivable, assuming they had not been sold under the company s Receivables Financing Facility, decreased by $7.7 million to $334.2 million at December 31, 2001.

Capital Expenditures. Capital expenditures were approximately $16.8 million in 2001, including $3.3 million for the purchase of land to be used for the company s future headquarters. The company spent $9.8 million to purchase computer hardware and software. The company expects to continue supporting strategic initiatives and improving operational efficiency through investments in technology, including system upgrades.

Table of Contents

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued the following new accounting pronouncements: SFAS 141, *Business Combinations,* SFAS 142, *Goodwill and Other Intangible Assets,* and SFAS 143, *Accounting for Asset Retirement Obligations.*

The provisions of SFAS 141 require that all business combinations initiated after June 30, 2001 be accounted for using the purchase method and also specify criteria that intangible assets acquired in a business combination must meet to be recognized and reported apart from goodwill. The adoption of this standard will affect the company s accounting for future acquisitions.

The provisions of SFAS 142 state that goodwill should not be amortized but should be tested for impairment upon adoption of the standard, and at least annually, at the reporting unit level. The company is required to adopt the provisions of this standard beginning on January 1, 2002. As a result, the company will no longer record goodwill amortization expense. Amortization expense related to goodwill for 2001, 2000 and 1999 was $6.0 million, $6.0 million and $5.1 million. Had SFAS 142 been in effect in 2001, 2000 and 1999, net income would have been increased by $5.3 million, $5.3 million and $4.8 million, or $0.13, $0.13 and $0.12 per diluted common share. Management expects that implementation of SFAS 142 will increase net income by approximately $5.3 million, or $0.13 per diluted common share, in 2002.

The provisions of SFAS 142 require the company to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. Any such transitional impairment loss would be recognized as the cumulative effect of a change in accounting principle in the company s consolidated statement of income. Management does not expect to incur a transitional impairment loss upon adoption of this standard.

The provisions of SFAS 142 also require the company to evaluate its existing intangible assets and goodwill that were acquired in purchase business combinations, and to make any necessary reclassifications in order to conform with the new classification criteria in SFAS 141 for recognition separate from goodwill. At December 31, 2001, the company had no separately identifiable intangible assets from purchase business combinations that were recorded either separately or within goodwill.

The provisions of SFAS 143 address financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The company will be required to adopt the provisions of this standard beginning on January 1, 2003. Management believes that adoption of this standard will not have a material effect on the company s financial condition or results of operations.

In August 2001, the FASB issued SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The provisions of SFAS 144 will modify the accounting treatment for impairments of long-lived assets and discontinued operations. The company will be required to adopt the provisions of this standard beginning on January 1, 2002. Management believes that adoption of this standard will not have a material effect on the company s financial condition or results of operations.

Customer Risk

The company is subject to risks associated with changes in the medical industry, including continued efforts to control costs, which place pressure on operating margin, and changes in the way medical and surgical services are delivered to patients. The loss of one of the company s larger customers could have a significant effect on its business. However, management believes that the company s competitive position in the marketplace and its ability to control costs would enable it to continue profitable operations and attract new customers in the event of such a loss.

Market Risk

O&M provides credit, in the normal course of business, to its customers. The company performs ongoing credit evaluations of its customers and maintains reserves for credit losses.

The company is exposed to market risk relating to changes in interest rates. To manage this risk, O&M uses interest rate swaps to modify the company s exposure to interest rate movements and reduce borrowing costs. The company is exposed to

Table of Contents

Management Discussion & Analysis *(continued)*

certain losses in the event of nonperformance by the counterparties to these swap agreements. However, O&M s exposure is not significant and, since the counterparties are investment grade financial institutions, nonperformance is not anticipated.

The company is exposed to market risk from both changes in interest rates related to its interest rate swaps and changes in discount rates related to its Receivables Financing Facility. Interest expense and discount on accounts receivable securitization are subject to change as a result of movements in interest rates. As of December 31, 2001, O&M had $100 million of interest rate swaps on which the company pays a variable rate based on LIBOR and receives a fixed rate, as well as $70 million of receivables sold under the Receivables Financing Facility. Assuming similar levels of financing under the Receivables Financing Facility, a hypothetical increase in interest rates of 100 basis points would result in a potential reduction in future pre-tax earnings of approximately $1.7 million per year in connection with the swaps and the accounts receivable securitization.

Forward-Looking Statements

Certain statements in this discussion constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Although O&M believes its expectations with respect to the forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of its business and operations, all forward-looking statements involve risks and uncertainties and, as a result, actual results could differ materially from those projected, anticipated or implied by these statements. Such forward-looking statements involve known and unknown risks, including, but not limited to, general economic and business conditions; dependence on sales to certain customers; dependence on suppliers; competition; changing trends in customer profiles; the ability of the company to meet customer demand for additional value added services; the ability to convert customers to CostTrack; the availability of supplier incentives; the ability to capitalize on buying opportunities; the ability to manage operating expenses; the ability of the company to manage financing costs and interest rate risk; the risk that a decline in business volume or profitability could result in an impairment of goodwill; the ability to timely or adequately respond to technological advances in the medical supply industry; the ability to successfully identify, manage or integrate possible future acquisitions; the outcome of outstanding litigation; and changes in government regulations. The company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future results, or otherwise.

Table of Contents

Consolidated Statements of Income

(in thousands, except per share data)

Year ended December 31,	2001	2000	1999
Net sales	$ 3,814,994	$ 3,503,583	$ 3,194,134
Cost of goods sold	3,406,758	3,127,911	2,851,556
Gross margin	408,236	375,672	342,578
Selling, general and administrative expenses	296,807	268,205	249,960
Depreciation and amortization	22,469	21,515	19,365
Interest expense, net	13,363	12,566	11,860
Discount on accounts receivable securitization	4,330	6,881	5,240
Impairment loss on investment	1,071		
Distributions on mandatorily redeemable preferred securities	7,095	7,095	7,095
Restructuring credit	(1,476)	(750)	(1,000)
Total expenses	343,659	315,512	292,520
Income before income taxes and extraordinary item	64,577	60,160	50,058
Income tax provision	34,474	27,072	22,079
Income before extraordinary item	30,103	33,088	27,979
Extraordinary loss on early retirement of debt, net of tax benefit	(7,068)		
Net income	$ 23,035	$ 33,088	$ 27,979
Per common share basic:			
Income before extraordinary item	$ 0.90	$ 1.01	$ 0.86
Extraordinary loss, net of tax benefit	(0.21)		
Net income	$ 0.69	$ 1.01	$ 0.86
Per common share diluted:			
Income before extraordinary item	$ 0.85	$ 0.94	$ 0.82
Extraordinary loss, net of tax benefit	(0.17)		
Net income	$ 0.68	$ 0.94	$ 0.82
Cash dividends per common share	$ 0.2725	$ 0.2475	$ 0.23

See accompanying notes to consolidated financial statements.

Table of Contents

Consolidated Balance Sheets

(in thousands, except per share data)

December 31,	2001	2000
Assets		
Current assets		
Cash and cash equivalents	$ 953	$ 626
Accounts and notes receivable, net	264,235	261,905
Merchandise inventories	389,504	315,570
Other current assets	24,760	16,190
Total current assets	679,452	594,291
Property and equipment, net	25,257	24,239
Goodwill, net	198,324	204,849
Other assets, net	50,820	44,169
Total assets	$ 953,853	$ 867,548
Liabilities and shareholders equity		
Current liabilities		
Accounts payable	$ 286,656	$ 291,507
Accrued payroll and related liabilities	12,669	9,940
Deferred income taxes	27,154	16,502
Other accrued liabilities	41,195	42,705
Total current liabilities	367,674	360,654
Long-term debt	203,449	152,872
Accrued pension and retirement plans	14,123	8,879
Deferred income taxes	364	371
Total liabilities	585,610	522,776
Company-obligated mandatorily redeemable preferred securities of subsidiary trust, holding solely convertible debentures of Owens & Minor, Inc.	132,000	132,000
Shareholders equity		
Preferred stock, par value $100 per share; authorized 10,000 shares Series A; Participating Cumulative Preferred Stock; none issued		
Common stock, par value $2 per share; authorized 200,000 shares; issued and outstanding 33,885 shares and 33,180 shares	67,770	66,360
Paid-in capital	27,181	18,039
Retained earnings	142,854	129,001
Accumulated other comprehensive loss	(1,562)	(628)
Total shareholders equity	236,243	212,772
Commitments and contingencies		
Total liabilities and shareholders equity	$ 953,853	$ 867,548

See accompanying notes to consolidated financial statements.

Table of Contents

Consolidated Statements of Cash Flows

(in thousands)

Year ended December 31,	2001	2000	1999
Operating activities			
Income before extraordinary item	$ 30,103	$ 33,088	$ 27,979
Adjustments to reconcile income before extraordinary item to cash provided by operating activities:			
Depreciation and amortization	22,469	21,515	19,365
Restructuring credit	(1,476)	(750)	(1,000)
Impairment loss on investment	1,071		
Deferred income taxes	11,268	(1,293)	8,236
Provision for LIFO reserve	4,264	2,973	1,741
Provision for losses on accounts and notes receivable	782	227	559
Sales of (collections of sold) accounts receivable, net	(10,000)	(25,612)	30,612
Changes in operating assets and liabilities:			
Accounts and notes receivable	6,888	(9,593)	(30,131)
Merchandise inventories	(78,198)	23,935	(42,397)
Accounts payable	10,049	(14,783)	86,871
Net change in other current assets and current liabilities	48	8,926	(11,232)
Other, net	4,373	4,522	1,686
Cash provided by operating activities	1,641	43,155	92,289
Investing activities			
Net cash paid for acquisition of business			(82,699)
Additions to property and equipment	(10,147)	(8,005)	(8,933)
Additions to computer software	(6,686)	(11,622)	(13,172)
Other, net	(858)	(152)	(2,359)
Cash used for investing activities	(17,691)	(19,779)	(107,163)
Financing activities			
Net proceeds from issuance of long-term debt	194,331		
Payments to retire long-term debt	(158,594)		
Additions (reductions) to other debt, net	(3,533)	(21,645)	25,178
Cash dividends paid	(9,182)	(8,156)	(7,520)
Proceeds from exercise of stock options	8,255	4,837	80
Other, net	(14,900)	1,545	(2,741)
Cash provided by (used for) financing activities	16,377	(23,419)	14,997
Net increase (decrease) in cash and cash equivalents	327	(43)	123
Cash and cash equivalents at beginning of year	626	669	546
Cash and cash equivalents at end of year	$ 953	$ 626	$ 669

See accompanying notes to consolidated financial statements.

33

Table of Contents

Consolidated Statements of Changes in Shareholders Equity

(in thousands, except per share data)

	Common Shares Outstanding	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance December 31, 1998	32,618	$ 65,236	$ 12,280	$ 83,610	$	$ 161,126
Net income				27,979		27,979
Comprehensive income						27,979
Issuance of restricted stock, net of forfeitures	74	148	893			1,041
Unearned compensation			(454)			(454)
Cash dividends				(7,520)		(7,520)
Exercise of stock options	6	12	71			83
Other	13	26	100			126
Balance December 31, 1999	32,711	65,422	12,890	104,069		182,381
Net income				33,088		33,088
Other comprehensive income, net of tax:						
Unrealized loss on investment					(628)	(628)
Comprehensive income						32,460
Issuance of restricted stock, net of forfeitures	102	204	622			826
Unearned compensation			(139)			(139)
Cash dividends				(8,156)		(8,156)
Exercise of stock options	355	710	4,541			5,251
Other	12	24	125			149
Balance December 31, 2000	33,180	66,360	18,039	129,001	(628)	212,772
Net income				23,035		23,035
Other comprehensive income, net of tax:						
Unrealized gain on investment					272	272
Reclassification of unrealized loss to net income					642	642
Minimum pension liability adjustment					(1,848)	(1,848)
Comprehensive income						22,101
Issuance of restricted stock, net of forfeitures	55	110	813			923

Unearned compensation			(173)				(173)
Cash dividends				(9,182)			(9,182)
Exercise of stock options	696	1,392	9,237				10,629
Other	(46)	(92)	(735)				(827)
Balance December 31, 2001	33,885	$ 67,770	$ 27,181	$ 142,854	$	(1,562)	$ 236,243

See accompanying notes to consolidated financial statements.

Table of Contents

Notes to Consolidated Financial Statements

Note 1 Summary of Significant Accounting Policies

Basis of Presentation. Owens & Minor, Inc. is the leading distributor of national name brand medical and surgical supplies in the United States. The consolidated financial statements include the accounts of Owens & Minor, Inc. and its wholly owned subsidiaries (the company). All significant intercompany accounts and transactions have been eliminated.

Use of Estimates. The preparation of the consolidated financial statements in accordance with generally accepted accounting principles requires management to make assumptions and estimates that affect amounts reported. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, inventory valuation allowances, collectibility of rebates receivable, depreciation and amortization, tax liabilities, and other contingencies. Actual results may differ from these estimates.

Cash and Cash Equivalents. Cash and cash equivalents include cash and marketable securities with an original maturity or maturity at acquisition of three months or less. Cash and cash equivalents are stated at cost, which approximates market value.

Accounts Receivable. The company maintains an allowance for doubtful accounts based upon the expected collectibility of accounts receivable. Allowances for doubtful accounts of $5.3 million and $6.4 million have been applied as reductions of accounts receivable at December 31, 2001 and 2000.

Merchandise Inventories. The company s merchandise inventories are valued on a last-in, first-out (LIFO) basis.

Property and Equipment. Property and equipment are stated at cost or, if acquired under capital leases, at the lower of the present value of minimum lease payments or fair market value at the inception of the lease. Normal maintenance and repairs are expensed as incurred, and renovations and betterments are capitalized. Depreciation and amortization are provided for financial reporting purposes using the straight-line method over the estimated useful lives of the assets or, for capital leases and leasehold improvements, over the terms of the lease, if shorter. In general, the estimated useful lives for computing depreciation and amortization are four to eight years for warehouse equipment and three to eight years for computer, office and other equipment. Straight-line and accelerated methods of depreciation are used for income tax purposes.

Goodwill. Goodwill is amortized on a straight-line basis over 40 years from the dates of acquisition. As of December 31, 2001 and 2000, goodwill was $238.3 and $238.8 million and the related accumulated amortization was $40.0 million and $34.0 million. Based upon management s assessment of undiscounted future cash flows, the carrying value of goodwill at December 31, 2001 has not been impaired in accordance with the provisions of Statement of Financial Accounting Standards No. (SFAS) 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of.*

Amortization expense related to goodwill for 2001, 2000 and 1999 was $6.0 million, $6.0 million and $5.1 million. Effective January 1, 2002, the company will be required to adopt the provisions of SFAS 142, *Goodwill and Other Intangible Assets*.

The provisions of SFAS 142 state that goodwill should not be amortized but should be tested for impairment upon adoption of the standard, and at least annually, at the reporting unit level. As a result, the company will no longer record goodwill amortization expense. The company will be required to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. Any such transitional impairment loss would be recognized as the cumulative effect of a change in accounting principle in the company s consolidated statement of income.

The provisions of SFAS 142 also require the company to evaluate its existing intangible assets and goodwill that were acquired in purchase business combinations, and to make any necessary reclassifications in order to conform with the new classification criteria in SFAS No. 141 for recognition separate from goodwill. At December 31, 2001, the company had no separately identifiable intangible assets from purchase business combinations that are recorded either separately or within goodwill.

Computer Software. The company develops and purchases software for internal use. Software development costs incurred during the application development stage are capitalized. Once the software has been installed and tested and is ready for use, additional costs incurred in connection with the software are expensed as incurred. Capitalized computer software

costs are amortized over the estimated useful life of the software, usually between 3 and 5 years. Computer software costs are included in other assets, net in the consolidated balance sheets. Unamortized software at December 31, 2001 and 2000 was $22.8 million and $23.7 million. Depreciation and amortization expense includes $7.6 million, $6.1 million and $4.9 million of software amortization for the years ended December 31, 2001, 2000 and 1999.

Investment. The company owns equity securities that are classified as available-for-sale, in accordance with SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, and are included in other assets, net in the consolidated balance sheets at fair value, with unrealized gains and losses, net of tax, reported as accumulated other comprehensive income or loss. Other than temporary declines in market value from original cost are reclassified to net income.

Revenue Recognition. The company recognizes product revenue when product has been shipped, fees are determinable, and collectibility is probable. Service revenue is recognized ratably over the period during which services are provided. In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) 101, *Revenue Recognition in Financial Statements*, which clarifies the application of generally accepted accounting principles to revenue recognition in financial statements. The company adopted the provisions of SAB 101 in the fourth quarter 2000.

Stock-based Compensation. The company uses the intrinsic value method as defined by Accounting Principles Board Opinion No. 25 to account for stock-based compensation. This method requires compensation expense to be recognized for the excess of the quoted market price of the stock at the grant date or the measurement date over the amount an employee must pay to acquire the stock. The disclosures required by SFAS 123 are included in Note 12 to the Consolidated Financial Statements.

Derivative Financial Instruments. On January 1, 2001, the company adopted the provisions of SFAS 133*, Accounting for Derivative Instruments and Hedging Activities,* as amended. SFAS 133 requires that an entity recognize all derivatives as either assets or liabilities measured at fair value. The accounting treatment for changes in the fair value of a derivative depends upon the intended use of the derivative and the resulting designation. The adoption of this Standard did not have a material impact on the company s results of operations or financial position.

The company enters into interest rate swaps as part of its interest rate risk management strategy. The purpose of these swaps is to maintain the company s desired mix of fixed to floating rate financing in order to manage interest rate risk. These swaps are recognized on the balance sheet at their fair value, based on estimates of the prices obtained from a dealer. All of the company s interest rate swaps since the implementation of SFAS 133 have been designated as hedges of the fair value of a portion of the company s long-term debt and, accordingly, the changes in the fair value of the swaps and the changes in the fair value of the hedged item attributable to the hedged risk are recognized as a charge or credit to interest expense. The company assesses, both at the hedge s inception and on an ongoing basis, whether the swaps are highly effective in offsetting changes in the fair values of the hedged items. If it is determined that an interest rate swap has ceased to be a highly effective hedge, the company discontinues hedge accounting prospectively.

Prior to the adoption of the provisions of SFAS 133, the company entered into interest rate swaps as part of its interest rate risk management strategy. The instruments were designated as hedges of interest-bearing liabilities and anticipated cash flows associated with off balance sheet financing. Net payments or receipts were accrued as interest payable or receivable and as interest expense or income. Fees related to these instruments were amortized over the life of the instrument. If the outstanding balance of the underlying liability were to drop below the notional amount of the swap, the excess portion of the swap was marked to market, and the resulting gain or loss included in net income.

Operating Segments. As defined in SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*, the company has eight operating segments, representing various geographic areas within the United States. As each of these segments is substantially identical to the others in each of the five aggregation characteristics identified in the statement, they

Table of Contents

are considered one operating segment for purposes of financial statement disclosure.

Note 2 Acquisition

On July 30, 1999, the company acquired certain net assets of Medix, Inc. (Medix), a distributor of medical and surgical supplies, for approximately $83 million. Medix customers, located primarily in the Midwest, included acute care hospitals, long-term care facilities and clinics. The acquisition has been accounted for by the purchase method and, accordingly, the operating results of Medix have been included in the company s consolidated financial statements since the date of acquisition. Assuming the acquisition had been made at the beginning of 1999, consolidated net sales on a pro forma basis would have been approximately $3.31 billion for the year ended December 31, 1999. Consolidated net income and net income per share on a pro forma basis would not have been materially different from the results reported.

The company paid cash of approximately $68 million and assumed debt of approximately $15 million, which was paid off as part of the closing transaction. The excess of the purchase price over the fair value of the identifiable net assets acquired of approximately $58 million was recorded as goodwill and is being amortized on a straight-line basis over 40 years.

In connection with the acquisition, management adopted a plan for integration of the businesses that included closure of some Medix facilities and consolidation of certain administrative functions. An accrual was established to provide for certain costs of this plan. The integration accrual was re-evaluated in the fourth quarter of 2001, resulting in a reduction in the accrual of $0.6 million. The accrual adjustment was recorded as a reduction in goodwill, as it reduced the purchase price of the Medix acquisition. The following table sets forth the major components of the accrual and activity through December 31, 2001:

(in thousands)

	Exit Plan Provision	Charges	Adjustments	Balance at December 31, 2001
Losses under lease commitments	$ 1,643	$ 610	$ (296)	$ 737
Employee separations	395	350	(45)	
Other	685	410	(210)	65
Total	$ 2,723	$ 1,370	$ (551)	$ 802

The employee separations relate to severance costs for employees in operations and activities that were exited. Approximately 40 employees were terminated. While the integration of the Medix business has been completed, the company continues to make payments under lease commitments and other obligations.

Note 3 Restructuring

In 1998, the company recorded a nonrecurring restructuring charge of $11.2 million as a result of the cancellation of a significant medical/surgical distribution contract. The restructuring plan included reductions in warehouse space and in the number of employees in those facilities that had the highest volume of business under that contract. The company periodically re-evaluates its estimate of the remaining costs to be incurred and, as a result, has reduced the accrual by $1.5 million in 2001, $0.8 million in 2000 and $1.0 million in 1999. Approximately 130 employees were terminated in connection with the restructuring plan.

Table of Contents

The following table sets forth the activity in the restructuring accrual through December 31, 2001:

(in thousands)

	Restructuring Provision	Charges	Adjustments	Balance at December 31, 2001
Losses under lease commitments	$ 4,194	$ 3,351	$ 78	$ 921
Asset write-offs	3,968	1,466	(1,653)	849
Employee separations	2,497	1,288	(1,209)	
Other	541	99	(442)	
Total	$ 11,200	$ 6,204	$ (3,226)	$ 1,770

Note 4 Merchandise Inventories

The company s merchandise inventories are valued on a LIFO basis. If LIFO inventories had been valued on a current cost or first-in, first-out (FIFO) basis, they would have been greater by $35.8 million and $31.6 million as of December 31, 2001 and 2000.

Note 5 Property And Equipment

The company s investment in property and equipment consists of the following:

(in thousands)

December 31,	2001	2000
Warehouse equipment	$ 24,906	$ 24,012
Computer equipment	36,449	34,137
Office equipment and other	12,991	12,683
Leasehold improvements	11,440	10,540
Land and improvements	5,065	1,743
	90,851	83,115
Accumulated depreciation and amortization	(65,594)	(58,876)
Property and equipment, net	$ 25,257	$ 24,239

Depreciation and amortization expense for property and equipment in 2001, 2000 and 1999 was $8.9 million, $9.4 million and $9.3 million.

Note 6 Investment

The company owns equity securities of a provider of business-to-business e-commerce services in the healthcare industry. Net income for the year ended December 31, 2001 included an impairment charge of $1.1 million, as the market value of these securities fell significantly below the company s original cost basis and management believed that recovery in the near term was unlikely. The following table summarizes the fair value (based on the quoted market price), gross unrealized gains and losses, and adjusted cost basis of the investment as of December 31, 2001 and 2000:

(in thousands)

December 31,	2001	2000

Fair value	$ 627	$ 175
Gross unrealized gain (loss)	476	(1,047)
Adjusted cost basis	151	1,222

Note 7 Accounts Payable

Accounts payable balances were $286.7 million and $291.5 million as of December 31, 2001 and 2000, of which $259.7 million and $249.6 million were trade accounts payable and $27.0 million and $41.9 million, were drafts payable. Drafts payable are checks written in excess of bank balances to be funded upon clearing the bank.

Table of Contents

Note 8 Debt

The company s long-term debt consists of the following:

(in thousands)

December 31,	2001		2000	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
8.5% Senior Subordinated Notes, $200 million par value, mature July 2011	$ 203,449	$ 210,000	$	$
10.875% Senior Subordinated Notes, $150 million par value, retired in 2001			150,000	156,375
Revolving Credit Facility with interest based on London Interbank Offered Rate (LIBOR) or Prime Rate, expires April 2003, credit limit of $225,000			2,200	2,200
Obligation under software financing agreement			1,333	1,333
Total debt	203,449	210,000	153,533	159,908
Less current maturities			(661)	(661)
Long-term debt	$ 203,449	$ 210,000	$ 152,872	$ 159,247

(1) No stock options were granted in the year ended December 31, 2011.

The following are the assumptions for the periods in which we granted stock options:

Expected Dividend: We do not anticipate any dividends.

Expected Life: The expected life represents the period that we expect our stock-based awards to be outstanding. We determine life based on historical experience and vesting schedules of similar awards.

Expected Volatility: Our expected volatility represents the weighted average historical volatility of the shares of our common stock for the most recent four-year and five-year periods.

Risk-Free Interest Rate: We base the risk-free interest rate used on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term. Where the expected term of our stock-based awards does not correspond with the terms for which interest rates are quoted, we perform a straight-line interpolation to determine the rate from the available term maturities.

Forfeiture Rate: We apply an estimated forfeiture rate that is derived from historical forfeited shares. If the actual number of forfeitures differs from our estimates, we may record additional adjustments to compensation expense in future periods.

Warrant Liability

We account for warrants with anti-dilution (down-round) provisions under the guidance of ASC 815, Accounting for Derivative Instruments, and Hedging Activities and Emerging Issue Task Force Statement 07-5: Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock, which require the warrants to be recorded as a liability and adjusted to fair value in each reporting period. We estimate the fair values of these securities using a Black Scholes valuation model.

Accounting for Income Taxes

Our income tax policy records the estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in the accompanying balance sheets, as well as operating loss and tax credit carry-forwards. We have recorded a full valuation allowance to reduce our deferred tax

49

TABLE OF CONTENTS

assets, as based on available objective evidence; it is more likely than not that the deferred tax assets will not be realized. In the event that we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax assets would increase net income in the period such determination was made.

Recent Accounting Pronouncements

In September 2011, the FASB issued Accounting Standards Update (ASU) no. 2011-08, Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment that simplifies how public and nonpublic entities test goodwill for impairment. The amendments permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in FASB Accounting Standards Codification Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50%. The guidance also includes examples of the types of events and circumstances to consider in conducting the qualitative assessment. The amendments will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We elected to early adopt this standard and used these new guidelines in assessing goodwill impairment for the consolidated financial statements.

On May 16, 2013, the FASB issued a proposed Accounting Standards Update, Leases (Topic 842): a revision of the 2010 proposed Accounting Standards Update, Leases (Topic 840). The proposal affects operating leases, especially with properties, and requires lessees to recognize assets and liabilities arising from those leases. The draft also proposes changes in accounting for purchase options and contingent rentals, which would affect the measurement of assets and liabilities for capital leases. An entity will be required to recognize all outstanding leases within the scope of the draft as of the date of initial application using a simplified retroactive approach. The exposure draft proposes that lessee and lessors should apply a right-of-use model in accounting for all leases, with few exceptions. An entity has a right to use an asset if it has control over the asset which is fulfilled if one of the three conditions outlined in the document are met. For leases within the scope of the draft, a lessee would recognize a right of use asset representing its right to use and the liability to make lease payments. A lessor would recognize an asset representing its right to receive lease payments using a performance obligation approach or a derecognition approach depending on its exposure to risks. There are numerous disclosures that would also be required such as a reconciliation of the opening and closing balances for the leased asset and liabilities. This proposed guidance could impact all companies that participate in leasing activities. We do not believe this proposed accounting standard will have a significant impact on the Company s future financial reporting.

JOBS Act

In April 2012, the JOBS Act was signed into law. The JOBS Act contains provisions that, among other things, reduce certain reporting requirements for an emerging growth company. As an emerging growth company, we are electing not to take advantage of the extended transition period afforded by the JOBS Act for the implementation of new or revised accounting standards, and as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision not to take advantage of the extended transition period is irrevocable. In addition, we are in the process of evaluating the benefits of relying on the other exemptions and reduced reporting requirements provided by the JOBS Act. Subject to certain conditions set forth in the JOBS Act, if as an emerging growth company we choose to rely on such exemptions, we may not be required to, among other things, (i) provide an auditor s attestation report on our system of internal controls over financial reporting pursuant to Section 404, (ii) provide all of the compensation disclosure that may be required of non-emerging growth public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act, (iii) comply with any requirement that may be adopted by the

Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor s report providing additional information about the audit and the financial statements (auditor discussion and analysis) and (iv) disclose certain executive compensation-related items such as the correlation between executive compensation and performance and comparisons of the Chief Executive Officer s compensation to median employee compensation. These exemptions will apply for a period of five

50

TABLE OF CONTENTS

years following the completion of our initial public offering or until we no longer meet the requirements of being an emerging growth company, whichever is earlier.

Results of Operations

Comparison of the Years Ended December 31, 2012 and 2011

Revenue

For the years ended December 31, 2012 and 2011, we recognized $0.7 million and $0.1 million in revenue, respectively. For the years ended December 31, 2012 and 2011, we earned $0.6 million and $0.1 million of revenue through sublicensing agreements involving our former gene therapy program.

For the years ended December 31, 2012 and 2011, we also earned $0.1 million and $20,000 in grant revenue, respectively.

Research and Development

Research and development expenses were $1.5 million for the year ended December 31, 2012, compared to $0.7 million for the year ended December 31, 2011. The $0.8 million increase in expenses is due to an increase in consulting and development expenses.

Research and development expenses are expected to increase in 2013 compared to 2012 as we plan to continue devoting substantial resources to research and development in future periods as we start clinical trials and continue our discovery efforts.

General and Administrative

General and administrative expenses were $3.2 million for 2012, compared to $3.3 million for 2011. The $0.1 million decrease is due to lower administrative staffing and facilities expenses, partially offset by higher legal expenses related to the acquisition of SPH.

We currently expect our general and administrative expenses to increase in 2013 compared to 2012 due to the costs associated with preparing this registration statement and being a public company.

Discontinued Operations

In June 2012, we sold certain assets used in our gene therapy business including process development, quality control, quality assurance, manufacturing and bioanalytical functions for $3.1 million. In addition to this cash consideration, we may receive a long-term royalty of 1.75% on all product sales. This royalty may be completely canceled at any time by a one-time payment of $1.8 million.

Tax Refund

As of December 31, 2012, we had a United Kingdom research and development tax refund of $0.1 million (£0.1 million) for the losses in the subsidiary based in the United Kingdom, compared to $0.3 million for 2011. The decrease in the refund was due to reduced staffing in 2012 compared to 2011.

Interest Income (Expense)

Interest expense in 2012 was $0.3 million, compared to $0.1 million for 2011. The increase was due to interest accrued for convertible notes. During 2012 and 2011, we issued $1.0 million and $2.7 million in convertible notes, respectively. Interest on the unpaid principal balance of these notes accrues at the rate of ten percent (10%) per annum.

Income Taxes

We incurred net operating losses for the years ended December 31, 2012 and 2011 and, accordingly, we did not pay any federal or state income taxes. As of December 31, 2012, we had accumulated approximately $170.4 million in U.S. and UK operating loss carry-forwards and research tax credit carry-forwards of approximately $4.3 million. The carry-forwards began to expire in 2012. Our net operating loss carry-forwards are subject to certain limitations on annual utilization as a result of changes in ownership of us, as defined by federal and state tax laws.

51

TABLE OF CONTENTS

Net Operating Losses

We have not recorded a benefit from our net operating loss or research credit carry-forwards because we believe that it is uncertain that we will have sufficient income from future operations to realize the carry-forwards prior to their expiration. Accordingly, we have established a valuation allowance against the deferred tax asset arising from the carry-forwards.

Liquidity and Capital Resources

We have incurred net losses since inception through December 31, 2012 of $320.4 million, of which $315.5 million was incurred in the Company s prior focus of gene therapy in 2010 and years earlier. We have not generated any product revenues and do not expect to generate revenue from the sale of product candidates in the near term.

We had cash of $0.9 million and $1.1 million at December 31, 2012 and 2011, respectively.

Net cash used in operating activities for the years ended December 31, 2012 and 2011 was $4.3 million and $4.7 million, respectively. For the year ended December 31, 2012, cash used in operations was attributable to the net loss for the year after adding back non-cash charges for stock-based compensation expense, depreciation expenses and loss on disposal of equipment, offset by a decrease in accrued liabilities and an increase in receivables. For the year ended December 31, 2011, cash used in operations was attributable to the net loss for the year after adding back non-cash charges for stock-based compensation expense and depreciation expenses, offset by a decrease in accrued liabilities and an increase in receivables. Net cash provided by investing activities for the year ended December 31, 2012 was $3.1 million, due to the sale of assets from discontinued operations slightly offset by purchases of property and equipment. Net cash used in investing activities for the year ended December 31, 2011 was $0.1 million, due to purchases of property and equipment. Net cash provided by financing activities was $1.0 million for the year ended December 31, 2012, due to proceeds from convertible notes. Net cash provided by financing activities was $2.5 million for the year ended December 31, 2011, due to proceeds from convertible notes. We expect 2013 cash requirements to be in the range of $9.0 million to $10.0 million. We believe that our cash as of December 31, 2012, in addition to convertible loan note revenue received in February through May 2013 and the recent $7.0 million in financing, will be sufficient to fund our projected operating requirements into the first quarter of 2014.

We expect to need to raise additional capital or incur indebtedness to continue to fund our future operations. We may seek to raise capital through a variety of sources, including:

- the public equity market;
- private equity financing;
- collaborative arrangements;
- licensing arrangements; and/or
- public or private debt.

Our ability to raise additional funds will depend on our clinical and regulatory events, our ability to identify promising in-licensing opportunities and factors related to financial, economic and market conditions, many of which are beyond our control. We cannot be certain that sufficient funds will be available to us when required or on satisfactory terms. If adequate funds are not available, we may be required to significantly reduce or refocus our operations or to obtain funds through arrangements that may require us to relinquish rights to certain of our products, technologies or potential markets, any of which could delay or require that we curtail our development programs or otherwise have a material adverse effect on our business, financial condition and results of operations. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of such securities would result in

ownership dilution to our existing stockholders.

If we are unable to secure additional financing on a timely basis or on terms favorable to us, we may be required to cease or reduce certain research and development projects, to sell some or all of our technology or

52

assets or to merge all or a portion of our business with another entity. Insufficient funds may require us to delay, scale back or eliminate some or all of our activities, and if we are unable to obtain additional funding, there is uncertainty regarding our continued existence.

Contractual Obligations and Commitments

In February 2011, we entered into an agreement with Virginia Biotechnology Research Partnership Authority for Richmond, Virginia laboratory space. This agreement has a contractual expiration date of February 29, 2012, at which time it converted to a rolling three-month lease. At September 30, 2013, our minimum payment commitment for our Richmond, Virginia laboratory space was $4,800.

In December 2011, we entered into an agreement with Nevis Limited and Charter Limited for laboratory space in Bedfordshire, United Kingdom. This agreement had a minimum period of three years and a contractual expiration date of December 8, 2016. At September 30, 2013, our minimum payment commitment for the Bedfordshire laboratory space was $0.2 million.

In February 2013, we entered into an agreement with Office Suites Plus (now Regus Management Group, LLC) for office space in Glen Allen, Virginia. The agreement has a minimum period of one year ending February 28, 2014, with a monthly cost of $2,075. At September 30, 2013, our minimum payment commitment for the Glen Allen space was $10,375.

Off-Balance Sheet Arrangements

As of December 31, 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. Therefore, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

Comparison of the Nine Months Ended September 30, 2013 and 2012

Revenue

For the nine-month periods ended September 30, 2013 and 2012, we recognized $0.3 million and $3.8 million in revenue, respectively. In May 2013, we received a $0.3 million sublicense fee from Celladon Corporation. In addition to the June 2012 sale of certain assets used in our gene therapy business to Celladon Corporation for $3.5 million, we earned $0.2 million of revenue under the AMT license for the nine-month period ended September 30, 2012. We received $23,000 in grant revenue for the nine-month period ended September 30, 2013 compared to $0.2 million for the nine-month period ended September 30, 2012.

Research and Development

Research and development expenses were $5.4 million for the nine-month period ended September 30, 2013 compared to $0.9 million for the nine-month period ended September 30, 2012. $3.0 million of the $4.5 million increase in expenses was due to a one-time non-cash technology access fee paid to Intrexon as part of the Exclusive Channel Collaboration Agreement, which we refer to as the ECC. The remaining increase is due to the addition of staff and facility expense for our new Australian subsidiary, stock option expense and an increase in consulting expense.

General and Administrative

General and administrative expenses were $4.0 million for the nine-month period ended September 30, 2013 compared to $2.3 million for the nine-month period ended September 30, 2012. The $1.7 million increase was due primarily to $1.2 million in stock option expense and a placement agent commission of $0.3 million for the private placement of convertible preferred stock.

Loss from Change in Fair Value of Warrant Liability

In connection with the private placement of Series B Convertible Preferred Stock, which occurred through two closings on June 26, 2013 and July 15, 2013, we issued an aggregate of warrants to purchase

53

TABLE OF CONTENTS

30,040,194 shares of common stock at an exercise price of $0.14 per share. These warrants expire June 2018. These warrants contain provisions that protect holders from a decline in the issue price of the Company s common stock (down-round provision) and contain net settlement provisions. Due to these provisions, we account for these warrants as liabilities instead of equity. We measured the fair value of these warrants on June 26, 2013 and July 15, 2013 and recorded the initial liability as part of the private placement proceeds. We re-measured the fair value of these warrants and recorded a $10.0 million charge to record the liabilities associated with these warrants at their estimated fair values totaling $14.9 million as of September 30, 2013. We estimated the fair values of these securities using a Black Scholes valuation model.

Interest Expense

Interest expense was $0.2 million for the nine-month period ended September 30, 2013, compared to $0.2 million for the nine-month period ended September 20, 2012. During the nine-month periods ended September 30, 2013 and 2012, we issued $2.0 million and $1.0 million in convertible notes, respectively. Interest on the unpaid principal balance of these notes accrues at the rate of ten percent (10%) per annum.

Net Cash Used in Operating Activities

For the nine months ended September 30, 2013, net cash flow used in operating activities was $4.8 million, compared to net cash flow provided by operating activities of $0.4 million for the nine months ended September 30, 2012. Net cash flow used in operating activities during the nine months ended September 30, 2013 consisted primarily of a net loss of $19.4 million, increased by $10.0 million for the non-cash expense recorded as the change in fair value of warrants and $3.0 million for the Intrexon technology access fee paid by stock, $1.2 million for stock option expense, $0.5 million for the receipt of tax refund, $0.2 million for accrued interest on convertible loans and $0.3 million for accrued dividends payable on Series B Preferred Stock. Net cash flow provided by operating activities during the nine months ended September 30, 2012, consisted primarily of net income of $0.3 million, increased by $0.1 million for the receipt of an AMT license fee receivable and $0.2 million for accrued interest on convertible notes, and decreased by $0.2 million for accounts payable and accrued liabilities.

Net Cash from Financing Activities

During the nine months ended September 30, 2013, net cash flow provided from financing activities was $8.9 million, compared to net cash flow provided from financing activities of $1.0 million for the nine months ended September 30, 2012. Net cash flow provided from financing activities during the nine months ended September 30, 2013 consisted of $7.0 million received through the Series B Convertible Preferred Stock issuance and $2.0 million received through the issuance of convertible notes. Net cash flow provided from financing activities during the nine months ended September 30, 2012, consisted of $1.0 million received through the issuance of convertible notes.

Recent Financings

On June 26, 2013, we completed a private placement of convertible preferred stock and warrants to purchase common stock with gross proceeds of $7.0 million through the sale of shares of our newly-created Series B Convertible Preferred Stock. As part of the same transaction, approximately $5.5 million in outstanding convertible notes were converted into shares of Series B Convertible Preferred Stock and warrants to purchase common stock. On July 15, 2013, we completed a second closing in which we converted approximately $0.8 million of outstanding convertible notes into Series B Convertible Preferred Stock and warrants to purchase common stock. The financing was led by life-sciences investors RA Capital Management and Third Security, LLC, with participation from BioScience

Managers Pty Ltd.

Under the terms of the financing, we issued an aggregate amount of approximately 10.0 million shares of the Series B Convertible Preferred Stock for an aggregate purchase price of approximately $13.3 million (including the conversion of approximately $6.3 million of outstanding convertible notes). Each share of Series B Convertible Preferred Stock is convertible into 10 shares of common stock. Additionally, we issued warrants to purchase an aggregate of up to approximately 25.0 million shares of common stock at an exercise price of $0.14 per share. As a result of the completion of this private placement, as of July 15, 2013, all previously issued convertible notes have been converted and there are no convertible notes outstanding.

54

TABLE OF CONTENTS

On December 16, 2013, we entered into subscription agreements to issue an aggregate amount of 72,007,000 shares of common stock for an aggregate purchase price of approximately $18 million as part of a private placement. This transaction was completed in two closings, which occurred on December 19, 2013 and December 24, 2013.

55

TABLE OF CONTENTS

Item 3. Properties.

Our principal offices occupy approximately 314 square feet of leased office space pursuant to a lease agreement that expires in February 2014 and is located at 4870 Sadler Road, Suite 300, Glen Allen, VA 23060. We also lease approximately 708 square feet of lab space in Richmond (Virginia), approximately 153 square feet of office space in Carlsbad (California), approximately 5,000 square feet of lab space in Brookvale (Australia) and approximately 2,672 square feet of lab space in Bedford (United Kingdom). We believe our facilities are adequate for our current and near-term needs.

Item 4. Security Ownership of Certain Beneficial Owners and Management.

The following table sets forth certain information with respect to the beneficial ownership of our common stock as of January 10, 2014, for:

- each person known by us to beneficially own more than 5% of our outstanding shares of common stock,
- each of our directors,
- each of our named executive officers, and
- all such directors, nominees for director and executive officers as a group.

The percentage of ownership depicted below is based on 271,135,285 shares of common stock outstanding on January 10, 2014, which consists of 182,535,505 shares of common stock outstanding as of January 10, 2014, and 88,599,780 shares of common stock issuable upon conversion of all outstanding shares of Series B Convertible Preferred Stock as of January 10, 2014 (assuming a conversion ratio equal to ten (10) common shares for each share of Series B Convertible Preferred Stock).

We have determined beneficial ownership in accordance with the rules of the SEC. These rules generally attribute beneficial ownership of securities to persons who possess sole or share voting power or investment power with respect to those securities. In addition, the rules include shares of common stock issuable pursuant to the exercise of stock options or warrants or pursuant to the conversion of our Series B Convertible Stock that are either immediately exercisable or convertible or exercisable or convertible within 60 days of January 10, 2014. Shares underlying such options, warrants and Series B Convertible Preferred Stock, however, are only considered outstanding for the purpose of computing the percentage ownership of that person and are not considered outstanding when computing the percentage ownership of any other person.

Name of Beneficial Owner[(1)]	Shares Beneficially Owned	Percentage Total Voting Power
5% Stockholders		
Anthony M. Smithyman	26,679,305 [(2)]	9.84 %
Randal J. Kirk	70,785,712 [(3)]	25.60 %
RA Capital Healthcare Fund, LP	21,428,570 [(4)]	7.75 %
Pendinas Limited	47,343,649 [(5)]	16.54 %
Broadfin Healthcare Master Fund, Ltd	14,000,000	5.16 %
Phillip Asset Management Ltd	14,928,562 [(6)]	5.47 %
Named Executive Officers and Directors		
Philip J. Young	7,777,334 [(7)]	2.79 %
Kelley A. Wendt	156,250 [(8)]	*
David Harper, Ph.D.	1,204,352 [(9)]	*
Jeremy Curnock Cook	300,500 [(10)]	*

Louis Drapeau	37,500 (11)	*
Michael S. Perry, Ph.D.	166,125 (12)	*
Anthony M. Smithyman	26,679,305 (2)	9.84 %
Julian P. Kirk	0	*
Baxter F. Phillips III	300,000 (13)	*
All officers and directors as a group (9 persons)	36,321,366	13.43 %

56

TABLE OF CONTENTS

* Less than 1%.

(1) Unless otherwise indicated, the address of such stockholder is c/o AmpliPhi Biosciences Corporation, 4870 Sadler Road, Suite 300, Glen Allen, VA 23060.

(2) Includes 12,000,000 shares of common stock held in escrow pending fulfillment of certain contractual terms of the SPH acquisition and options to purchase 15,625 shares of common stock.

(3) Consists of 46,785,712 shares held by NRM VII Holdings I, LLC, which we refer to as NRM VII Holdings (20,000,000 shares of common stock, 21,428,570 shares of common stock issuable upon conversion of Series B Convertible Preferred Stock (assuming a conversion ratio equal to ten (10) common shares for each share of Series B Convertible Preferred Stock) and 5,357,142 shares of common stock issuable upon exercise of warrants) and 24,000,000 shares held by Intrexon Corporation. Randal J. Kirk controls NRM VII Holdings. Shares held by this entity may be deemed to be indirectly beneficially owned (as defined under Rule 13d-3 promulgated under the Exchange Act) by Mr. Kirk. Mr. Kirk disclaims beneficial ownership of such shares, except to the extent of any pecuniary interest therein. Randal J. Kirk, directly and through certain affiliates, has voting and dispositive power over a majority of the outstanding capital stock of Intrexon Corporation. Mr. Kirk may therefore be deemed to have voting and dispositive power over the shares of the issuer owned by Intrexon Corporation. Shares held by Intrexon Corporation may be deemed to be indirectly beneficially owned (as defined under Rule 13d-3 promulgated under the Exchange Act) by Mr. Kirk. Mr. Kirk disclaims beneficial ownership of such shares, except to the extent of any pecuniary interest therein.

(4) Consists of an aggregate of 21,428,570 of common stock issuable upon conversion of Series B Convertible Preferred Stock (assuming a conversion ratio equal to ten (10) common shares for each share of Series B Convertible Preferred Stock) and an aggregate of 5,357,142 shares of common stock issuable upon the exercise of warrants held by two of its funds, RA Capital Healthcare Fund, LP and Blackwell Partners, LLC. The address of such stockholder is 20 Park Plaza, Suite 1200, Boston, MA 02116.

(5) Consists of 32,250,610 shares of common stock issuable upon conversion of Series B Convertible Preferred Stock and 15,093,039 shares of common stock issuable upon exercise of warrants. The address of such stockholder is Ballacarrick, Pooilvaaish Road, Isle of Man, IM9 4PJ.

(6) Phillip Asset Management Ltd holds all shares in its capacity as trustee for Bioscience Managers Pty Ltd. Jeremy Curnock Cook, the Chairman of the Company s Board of Directors, is a Managing Director and holds an ownership interest in Bioscience Managers Pty Ltd.

(7) Consists of options to purchase 7,777,334 shares of common stock.

(8) Consists of options to purchase 156,250 shares of common stock.

(9) Includes options to purchase 375,000 shares of common stock.

(10) Includes options to purchase 235,500 shares of common stock.

(11) Consists of options to purchase 37,500 shares of common stock.

(12) Includes options to purchase 121,125 shares of common stock.

(13) Consists of 300,000 shares of common stock purchased by Mr. Phillips in the December 2013 private placement.

57

TABLE OF CONTENTS

Item 5. Directors and Executive Officers.

The following table sets forth certain information about our executive officers, key employees and directors as of the date of this registration statement.

Name	Age	Position
Philip J. Young	56	President, Chief Executive Officer and Director
Kelley A. Wendt	39	Chief Financial Officer
Baxter F. Phillips III	38	Vice President of Corporate Strategy and Business Development
David Harper, Ph.D.	53	Chief Scientific Officer
Jeremy Curnock Cook(1)(2)(3)	63	Chairman of the Board
Louis Drapeau(1)(2)(3)	68	Director
Michael S. Perry, Ph.D.(1)(2)(3)	53	Director
Anthony Smithyman, Ph.D.	64	Director
Julian P. Kirk	39	Director

(1) Member of the audit committee.
(2) Member of the compensation committee.
(3) Member of the nominating and corporate governance committee.

No events listed in Item 401(f) of Regulation S-K have occurred during the past 10 years that are material to the evaluation of the ability or integrity of any of our directors or executive officers.

The following is a brief biography of the business experience during the past five years (and, in some instances, for prior years) of each director and executive officer of the Company, with each director biography including information regarding the experiences, qualifications, attributes or skills that caused our board of directors to determine that such member of our board of directors should serve as a director as of the date of this registration statement.

Executive Officers and Significant Employees

Philip J. Young has served as our President, Chief Executive Officer and Director since November 2011. Mr. Young is a U.S.-based long-time executive in the biopharmaceuticals industry. He is the former President and CEO of Osteologix, Inc., a global biopharmaceutical company, which is currently based in Ireland. Prior to joining Osteologix, Mr. Young served as an Executive Vice President and Chief Business Officer for Insmed Inc., a publicly traded biotechnology company, from 2004 to 2007. Prior to Insmed Inc., Mr. Young held executive positions at Elan Corporation, Neurex Corporation, and Pharmacia Corporation. Mr. Young started his career in the biopharmaceuticals industry at Genentech, Inc. Mr. Young received a B.S. in Sociology with minors in Business and Psychology from James Madison University.

Kelley A. Wendt has served as our Chief Financial Officer since December 2011. Prior to joining AmpliPhi, she served as the Chief Financial Officer for Osteologix, Inc., a global biopharmaceutical company, which is currently based in Ireland. Prior to joining Osteologix, Ms. Wendt served as the Chief Financial Officer for Crop Life America, a global chemical industry trade organization, from 2006 to 2008. She is the former Controller for Sheltering Arms Hospitals, a rehabilitation hospital company with nine facilities across the Richmond, Virginia region. Her pre-executive experience consists of several regional and national public accounting firms, primarily in audit and consulting roles. Ms. Wendt received a B.S. in Business, Accounting, from Wright State University.

Baxter F. Phillips III has served as our Vice President, Corporate Strategy and Business Development since October 2013. Prior to joining AmpliPhi, Mr. Phillips served as Director, Business Development at Depomed, Inc., a commercially engaged specialty pharmaceutical company developing and commercializing products to treat pain and other central nervous system conditions, from 2011 to 2013. Prior to Depomed, Mr. Phillips served as Senior Director, Corporate Development at Osteologix, Inc., a global biopharmaceutical company, from 2007 to 2011. Prior to Osteologix, Mr. Phillips served in a number of senior research, corporate and sales and marketing positions at Insmed Inc., a publically traded biotechnology company, from

58

TABLE OF CONTENTS

1998 to 2007. Mr. Phillips has a B.S. in Biology from Hampden-Sydney College and an MBA from The Mason School of Business at the College of William and Mary.

David Harper, Ph.D. has served as our Chief Scientific Officer since the January 2011 acquisition of Biocontrol Ltd. by Targeted Genetics Corporation. Prior to joining AmpliPhi, Dr. Harper served as Chief Scientific Officer of Biocontrol, which he founded in 1997, from 2002 to 2011. He previously served as leader of the herpes virus research group in the Department of Virology at St. Bartholomew s Medical School, joining the faculty in 1991 as a Lecturer in Molecular Virology. Dr. Harper received his B.Sc. in microbiology and virology at the University of Warwick and his Ph.D. at the University of Newcastle-upon-Tyne, studying viral genetics. He carried out post-doctoral work at St. Bartholomew s Medical School in London and at the University of Iowa.

Non-Employee Directors

Jeremy Curnock Cook has served as a member of our board of directors since July 1995 and as chairman of the board of directors since February 1998. Mr. Curnock Cook has served as Chairman of International Bioscience Managers Limited, a corporate and investment advisory firm since 2000, and also currently serves as Managing Director of Bioscience Managers Pty Ltd, a medical sciences fund manager. From 1987 to 2000, Mr. Curnock Cook was a director of Rothschild Asset Management Limited, a corporate and investment advisory company, and was responsible for the Rothschild Bioscience Unit. Mr. Curnock Cook founded the International Biochemicals Group in 1975, which was sold in 1985 to Royal Dutch Shell, where he served as managing director until 1987. Mr. Curnock Cook holds an M.A. in natural sciences from Trinity College, Dublin. He also serves as a member of the board of Avita Medical Ltd, Nexus6 Ltd and SeaDragon Ltd. Mr. Curnock Cook brings to the board significant experience as an investor in and board member of multiple biotechnology companies.

Louis Drapeau has served as a member of our board of directors since March 2011. Mr. Drapeau currently serves as Vice President and Chief Financial officer of InSite Vision, an ophthalmology drug development company, a position he has held since October 2007. From November 2008 until December 2010, he was also CEO of InSite Vision. Prior to InSite Vision, he served as Chief Financial Officer, Senior Vice President, Finance, at Nektar Therapeutics, a biopharmaceutical company, from January 2006 to August 2007. Prior to Nektar, he served as Acting Chief Executive Officer from August 2004 to May 2005 and as Senior Vice President and Chief Financial Officer from August 2002 to August 2005 for BioMarin Pharmaceutical Inc. Previously, Mr. Drapeau spent 30 years at Arthur Andersen, including 19 years as an Audit Partner in Arthur Andersen s Northern California Audit and Business Consulting practice, which included 12 years as Managing Partner. Mr. Drapeau received both his undergraduate degree in mechanical engineering and an M.B.A. from Stanford University. He also serves as a member of the board of Bio-Rad Laboratories and InterMune, Inc. Mr. Drapeau is able to provide valuable input with respect to accounting and financial matters as a result of his experience.

Michael S. Perry, D.V.M., Ph.D. has served as a member of our board of directors since November 2005. Dr. Perry is currently Global Head of Stem Cell Therapy and Vice President of the Integrated Hospital Care Franchise for Novartis Pharmaceuticals Corporation. Prior to joining Novartis in 2012, he was a Venture Partner with Bay City Capital, a venture capital firm, from 2005 to 2012. While serving in this capacity, he concurrently served as President and Chief Medical Officer at Poniard Pharmaceuticals, Inc., a publicly held drug development company, from 2009 to 2011 and also previously served as Chief Development Officer of VIA Pharmaceuticals, Inc., another publicly held biotechnology company, from 2005 to 2009. Dr. Perry served as chairman and Chief Executive Officer of Extropy Pharmaceuticals, Inc., a privately held pediatric specialty pharmaceutical company, from 2003 to 2005. From 2002 to 2003, Dr. Perry served as President and Chief Executive Officer of Pharsight Corporation, a publicly held software and consulting services firm. From 2000 to 2002, Dr. Perry served as Global Head of Research and Development for

Baxter Healthcare. From 1997 to 2000, Dr. Perry was President and Chief Executive Officer of both SyStemix Inc. and Genetic Therapy Inc., two wholly owned subsidiaries of Novartis Pharma; he was Vice President of Regulatory Affairs for Novartis from 1994 to 1997. Prior to 1994, Dr. Perry held various management positions with Syntex Corporation, Schering-Plough Corporation and BioResearch Laboratories, Inc. Dr. Perry holds a Doctor of Veterinary Medicine, a Ph.D. in Biomedical Science-CardioPulmonary Pharmacology and a B.S. in Physics from the University of Guelph. He also serves

59

as a member of the board of Arrowhead Research Corporation and of Avita Medical Ltd. Dr. Perry brings to the board substantial scientific and medical knowledge, as well as operational and investing experience.

Anthony Smithyman, Ph.D. joined our board of directors in November 2012 following the merger with Special Phage Services Pty Ltd of Sydney, Australia. Born in Malawi, Central Africa, Dr. Smithyman was educated in Scotland and obtained a B.Sc. from the University of St. Andrews, followed by a Ph.D. in Bacteriology and Immunology from Glasgow University. After completing a two-year post-doctoral Fellowship at the Sloan-Kettering Cancer Center in New York in 1978, he joined ICI Pharmaceuticals Ltd in Alderley Edge, Cheshire, England as Laboratory Head in the Immunology Department before moving to Australia in 1982. Dr. Smithyman has been involved with the Australian biotechnology industry for over 30 years, including as the current Managing Director of Cellabs Pty Ltd., a longstanding Australian biotechnology company. In 2004, Dr. Smithyman established Special Phage Services Pty Ltd to develop novel phage therapeutics for the human health, veterinary and aquaculture industries. Dr. Smithyman s experience in the biotechnology industry, and with phage therapeutics specifically, bring a valuable perspective to our board.

Julian P. Kirk has served as a member of our board of directors since June 2013. Mr. Kirk is a Managing Director of Third Security, LLC, where he has worked since the firm s inception with several portfolio companies of its managed investment funds. He is also involved with oversight of Third Security, LLC s internal operations. Since October 2012, he has served on the board of directors of Fibrocell Science, Inc. Since August 2010, he has served on the board of the New River Valley Economic Development Alliance. From October 2006 until December 2011, he served as member of the board of directors of IntelliMat, Inc. and as co-chairman of the board between September 2008 and December 2011. From September 2005 until December 2011, Mr. Kirk served as President of Harvest Pharmaceuticals Inc. Mr. Kirk also served as chairman of the board of managers of ECDS, LLC from June 2008 until March 2010. Mr. Kirk graduated as an Echols Scholar from the University of Virginia. Mr. Kirk brings to our board significant financial and operations expertise within our industry.

Item 6. Executive Compensation.

Summary Compensation Table

The following table provides information regarding the compensation paid during the last two fiscal years to our principal executive officer, and our two most highly compensated executive officers other than our principal executive officer who were serving as executive officers at the end of the last completed fiscal year, who are collectively referred to as named executive officers elsewhere in this registration statement.

Name and Principal Position	Year	Salary	Bonus	Option Awards[(1)]	All Other Compensation	Total
Philip J. Young	2013	$400,000	$	$1,856,000	$ 105,396	$2,361,396
President, Chief Executive and Director	2012	$325,000	$	$1,680,000	$	$2,005,000
David Harper, Ph.D.	2013	$225,541	$	$	$	$225,541
Chief Scientific Officer	2012	$228,672	$	$240,000	$	$468,672
Kelley A. Wendt,	2013	$155,938	$	$	$ 18,575	$174,513
Chief Financial Officer[(2)]	2012	$	$	$100,000	$ 120,247	$220,247

(1) Represents the aggregate grant date fair value computed in accordance with FASB ASC Topic 718.

(2)

Ms. Wendt became Chief Financial Officer on January 1, 2013. Prior to this date, Ms. Wendt was engaged as an accounting consultant and all compensation paid during the year ended December 31, 2012 was for her services in that capacity.

Executive Employment Agreement

We entered into an employment agreement with Philip J. Young on October 19, 2011. The employment agreement provides for at-will employment, base salary, incentive bonuses, standard employee benefit plan participation and recommendations for initial stock option grants. The employment agreement was subject to execution of a standard proprietary information and invention agreement and proof of identity and work eligibility in the United States.

60

TABLE OF CONTENTS

Mr. Young is entitled to severance and change in control benefits pursuant to his employment, the terms of which are described below under Potential Payments upon Termination or Change in Control. We believe that these severance and change in control benefits help us from a retention standpoint and they are particularly necessary in an industry, such as ours, where there has been market consolidation. We believe that they help executive officers maintain continued focus and dedication to their assigned duties to maximize shareholder value if there is a change of control. We believe that these severance and change in control benefits are an essential element of our overall executive compensation package.

Pursuant to the terms of his employment agreement, as amended, Mr. Young was granted options to purchase 8,400,000 shares of our common stock on October 23, 2012 and options to purchase 11,600,000 of our common stock on June 25, 2013.

Potential Payments upon Termination or Change in Control

Regardless of the manner in which a named executive officer s employment terminates, the named executive officer is entitled to receive amounts earned during his term of employment, including salary and unused vacation pay. In addition, each of our named executive officers that are currently employed by us is entitled to severance and change in control benefits described below.

On October 19, 2011, the Company entered into an employment agreement with Mr. Young, the Company s President, Chief Executive Officer and member of the board of directors, which provides if the Company terminates Mr. Young without cause or he resigns for good reason, he will be entitled to: (i) severance payments on a monthly basis at a rate equal to his base salary then in effect for a period ranging from at least six months up to one year and (ii) accelerated vesting of his stock option shares with respect to the number of shares that would have vested if Mr. Young had remained employed by the Company during the period in which he is to receive severance payments.

If Mr. Young s employment is terminated by the Company, with or without cause, or by Mr. Young for changed circumstances in connection with or following a change in control, he will be entitled to: (i) severance payments on a monthly basis at a rate equal to his base salary then in effect for a period of one year, (ii) accelerated vesting of his stock option shares with respect to the number of shares that would have vested if Mr. Young had remained employed by the Company during the period in which he is to receive severance payments, and (iii) the pro rata portion of any eligible bonus compensation as of the date of termination.

The following table sets forth potential payments payable to our named executive officers upon a termination of employment without cause or resignation for good reason or termination of employment with or without cause or resignation following a change in control. The table below reflects amounts payable to our executive officers assuming their employment was terminated on December 31, 2013 and, if applicable, a change in control also occurred on such date.

	Upon Termination without Cause or Resignation for Good Reason No Change in Control			Upon Termination with or without Cause or Resignation Change in Control		
Name	Cash Severance	Value of Accelerated Vesting[(1)]	Total	Cash Severance	Value of Accelerated Vesting[(1)]	Total
Philip J. Young	$1,950,000	$420,000	$2,370,000	$3,900,000	$420,000	$4,320,000

David Harper, Ph.D.	$	$	$	$	$	$
Kelley A. Wendt	$	$	$	$	$	$

(1) The value of accelerated vesting is equal to 2,100,000 stock option shares vesting at $0.20 per share.

61

Potential Payments upon Termination or Change in Control

TABLE OF CONTENTS

Grants of Plan-Based Awards

The following table sets forth certain information regarding grants of plan-based awards to our named executive officers for 2013.

Name	Grant Date	All other option awards: number of securities underlying options (#)	Exercise or base price of option awards ($/share)[(1)]	Grant date fair value of option awards ($)[(2)]
Philip J. Young	6/25/2013	11,600,000	$ 0.16	$ 1,856,000
David Harper, Ph.D.			$	$
Kelley A. Wendt			$	$

(1) Represents the per share fair market value of our common stock, as determined in good faith by our board of directors on the grant date.

(2) Amounts listed represent the aggregate fair value amount computed as of the grant date of each option and award during 2013 in accordance with FASB ASC Topic 718. Assumptions used in the calculation of these amounts are included in Note 6, Stock Options and Warrants, of the Notes to the Financial Statements. As required by SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. Our named executive officers will only realize compensation to the extent the trading price of our common stock is greater than the exercise price of such stock options.

Outstanding Equity Awards at Fiscal Year-End

The following table sets forth certain information regarding all outstanding equity awards held by our named executive officers as of December 31, 2013.

Name	Number of Securities Underlying Unexercised Options (# Exercisable)	Number of Securities Underlying Unexercised Options (# Unexercisable)	Option Exercise Price ($)	Option Expiration Date
Philip J. Young	2,100,000 (1)	6,300,000	$ 0.20	10/23/2022
	5,152,334 (2)	6,447,666	$ 0.16	6/25/2023
David Harper, Ph.D.	300,000 (3)	800,000	$ 0.20	10/23/2022
Kelley A. Wendt	125,000 (4)	375,000	$ 0.20	10/23/2022

(1) 6.25% of the total shares underlying this option vested and became exercisable on January 23, 2013. 6.25% of the total shares underlying this option vests and becomes exercisable on the first business day of each three (3) month period thereafter, subject to continued service through each vesting date. This option may be subject to accelerated

vesting as described above. As of December 31, 2013, 2,100,000 of the total shares underlying this option are vested and exercisable.

(2) 3,862,800 of the total shares underlying this option vested and became exercisable on the grant date, which was June 26, 2013. 1/36 of the remaining unvested shares underlying this option vests and becomes exercisable on each one month anniversary of the grant date thereafter, subject to continued service through each vesting date. This option may be subject to accelerated vesting as described above. As of December 31, 2013, 5,152,334 of the total shares underlying this option are vested and exercisable.

(3) 6.25% of the total shares underlying this option vested and became exercisable on January 23, 2013. 6.25% of the total shares underlying this option vests and becomes exercisable on the first business day of each three (3) month period thereafter, subject to continued service through each vesting date. This option may be subject to accelerated vesting as described below. As of December 31, 2013, 300,000 of the total shares underlying this option are vested and exercisable.

(4) 6.25% of the total shares underlying this option vested and became exercisable on January 23, 2013. 6.25% of the total shares underlying this option vests and becomes exercisable on the first business day of each three (3) month period thereafter, subject to continued service through each vesting date. This

62

TABLE OF CONTENTS

option may be subject to accelerated vesting as described below. As of December 31, 2013, 125,000 of the total shares underlying this option are vested and exercisable.

Option Exercises and Stock Vested

Our named executive officers did not exercise any stock option awards during the year ended December 31, 2013.

Pension Benefits

None of our named executive officers participate in or have account balances in qualified or non-qualified defined benefit plans sponsored by us.

Non-Qualified Deferred Compensation

None of our named executive officers participate in or have account balances in qualified or non-qualified defined contribution plans or other non-qualified compensation plans sponsored by us.

Equity Incentive Plans

The purpose of all of our equity incentive plans is to promote the long-term success of the Company and the creation of shareholder value by offering key service providers an opportunity to share in such long-term success by acquiring a proprietary interest in the Company and to attract and retain the best available personnel for positions of substantial responsibility, and to provide additional incentive to employees, consultants and directors.

Our equity incentive plans seek to achieve these purposes by providing for discretionary long-term incentive awards in the form of options (which may constitute incentive stock options or nonstatutory stock options), stock appreciation rights, stock grants and stock units. Our equity incentive plans are administered by the board or a committee appointed by the board, which we refer to as the plan administrator and have a term of 10 years from the date they were adopted by the board of directors.

2009 Targeted Genetics Stock Incentive Plan and 2012 Stock Incentive Plan

Our board of directors and shareholders adopted our 2009 Targeted Genetics Stock Incentive Plan, which we refer to as the 2009 Plan, in March 2009. Our board of directors adopted our 2012 Stock Incentive Plan, which we refer to as the 2012 Plan, in October 2012. As of December 6, 2013, there are 1,304,760 shares of common stock and 9,353,323 shares of common stock remaining for future awards under the 2009 Plan and the 2012 Plan, respectively. We refer to the 2009 Plan and the 2012 Plan together as the Existing Plans.

The number of shares authorized under each of the Existing Plans is subject to adjustment in the event of a stock split, stock dividend or other change in our capitalization. The shares we issue under the Existing Plans may be authorized but unissued shares or shares we reacquire. The shares of common stock underlying any equity awards that are forfeited, canceled, repurchased, expired or are otherwise terminated (other than by exercise) under the Existing Plans are currently added back to the shares of common stock available for issuance under the Existing Plans.

The Existing Plans permit us to make grants of incentive stock options to employees and grants of non-qualified stock options and restricted stock to employees, officers, directors and consultants. The Existing Plans are administered by

our board of directors. Our board of directors has the authority to select the individuals to whom awards will be granted, to make any combination of awards to participants, to accelerate the exercisability or vesting of any award and to determine the specific terms and conditions of each award, subject to the provisions of the Existing Plans.

The Existing Plans permit the grant of (1) options to purchase common stock intended to qualify as incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended, or the Code, and (2) options that do not so qualify. The option exercise price of each option will be determined by our board of directors but may not be less than 100% of the fair market value of the common stock on the date of grant. The term of each option will be fixed by our board of directors and may not exceed 10 years from the date of grant. All stock option awards that are granted pursuant to the Existing Plans are covered by an option agreement.

The Existing Plans also permit the award of stock grants, stock appreciation rights and stock units to participants, subject to such terms, conditions and restrictions as our board of directors may determine. All stock grants, stock appreciation rights and stock units that are granted pursuant to the Existing Plans are covered by a written agreement.

The Existing Plans provide that upon the effectiveness of a corporate transaction, as defined in each of the Existing Plans, in the event that all awards are not assumed or continued or substituted by the successor entity, all awards granted under the Existing Plans shall terminate. In addition, in connection with a corporate transaction, the plan administrator may provide the full automatic vesting and exercisability of one or more outstanding unvested awards under the Existing Plans in connection with a corporate transaction, on such terms and conditions as the plan administrator may specify. Furthermore, in connection with a change in control, as defined in each of the Existing Plans, the Existing Plans provide for the full automatic vesting and exercisability of any outstanding unvested awards held by certain key service providers, which under the terms of the Existing Plans, is defined as any employee, director or consultant who has been designated as a key service provider by the plan administrator, in the event that any such awards are not assumed or continued or substituted by the successor entity, or otherwise fully automatically vested by the plan administrator in connection with such change in control.

Our board of directors may amend, alter, suspend or terminate the Existing Plans at any time, subject to stockholder approval where such approval is required by applicable law. Our board of directors may also amend, modify or terminate any outstanding award, provided that no amendment to an award may materially impair any of the rights of a participant under any awards previously granted without his or her written consent. No awards may be granted under the 2009 Plan and 2012 Plan after March 3, 2019 and October 19, 2022, respectively.

TABLE OF CONTENTS

2013 Stock Incentive Plan

Our 2013 Stock Incentive Plan, which we refer to as the 2013 Plan, was approved by our board of directors in December 2013 and will be considered for adoption by our shareholders in February 2014. The 2013 Plan will replace the 2009 Plan and the 2012 Plan.

The 2013 Plan allows the plan administrator, to make equity-based incentive awards to our officers, employees, directors and other key persons (including consultants).

We have initially reserved 40,000,000 shares of our common stock for the issuance of awards under the 2013 Plan. This number is subject to adjustment in the event of a stock split, stock dividend or other change in our capitalization.

The shares issuable pursuant to awards granted under the 2013 Plan will be authorized but unissued shares or shares that we reacquire. The shares of common stock underlying any awards from the 2013 Plan that are forfeited, cancelled, held back upon exercise or settlement of an award to satisfy the exercise price or tax withholding, reacquired by us prior to vesting, satisfied without any issuance of common stock, expire or are otherwise terminated (other than by exercise) under the 2013 Plan will be added back to the shares of common stock available for issuance under the 2013 Plan.

The 2013 Plan will be administered by the plan administrator. The plan administrator has full power to select, from among the individuals eligible for awards, the individuals to whom awards will be granted, to make any combination of awards to participants, and to determine the specific terms and conditions of each award, subject to the provisions of the 2013 Plan. Persons eligible to participate in the 2013 Plan will be those full or part-time officers, employees, non-employee directors and other key persons (including consultants) as selected from time to time by our plan administrator in its discretion. The plan administrator may reprice options or stock appreciation rights without stockholder approval.

The 2013 Plan permits the granting of both options to purchase common stock intended to qualify as incentive stock options under Section 422 of the Code and options that do not so qualify. The exercise price of each stock option will be determined by our plan administrator but may not be less than 100% of the fair market value of our common stock on the date of grant or, in the case of an incentive stock option granted to a 10% owner, less than 110% of the fair market value of our common stock on the date of grant. The term of each stock option will be fixed by the plan administrator and may not exceed 10 years from the date of grant. The plan administrator will determine at what time or times each option may be exercised.

The plan administrator may also award stock appreciation rights subject to such conditions and restrictions as it may determine. Stock appreciation rights entitle the recipient to shares of common stock, or cash, equal to the value of the appreciation in our stock price over the exercise price. The exercise price may not be less than 100% of the fair market value of the common stock on the date of grant.

The plan administrator may also award restricted stock or restricted stock units to participants subject to such conditions and restrictions as it may determine. These conditions and restrictions may include the achievement of certain performance goals or continued employment with us through a specified vesting period. The plan administrator may also grant shares of common stock that are free from any restrictions under the 2013 Plan.

The plan administrator may grant cash bonuses under the 2013 Plan to participants, subject to the achievement of certain performance goals.

The plan administrator may grant performance-based awards to participants in the form of restricted stock, restricted stock units or cash-based awards upon the achievement of certain performance goals and such other conditions as the plan administrator shall determine. The plan administrator may grant such performance-based awards under the 2013 Plan that are intended to qualify as performance-based compensation under Section 162(m) of the Code. Those awards would only vest or become payable upon the attainment of performance goals that are established by our plan administrator and related to one or more performance criteria. The performance criteria that could be used with respect to any such awards include: net earnings or net income (before or after taxes); earnings per share; revenues or sales (including net sales or revenue growth); net operating profit; return measures (including return on assets, net assets, capital, invested

65

TABLE OF CONTENTS

capital, equity, sales, or revenue); cash flow (including operating cash flow, free cash flow, cash flow return on equity, and cash flow return on investment); earnings before or after taxes, interest, depreciation, and/or amortization; gross or operating margins; productivity ratios; share price (including growth measures and total stockholder return); expense targets; margins; operating efficiency; market share; working capital targets and change in working capital; economic value added or net operating income, any of which may be measured either in absolute terms or as compared to any incremental increase or as compared to results of a peer group. From and after the time that we become subject to Section 162(m) of the Code, the maximum award that is intended to qualify as performance-based compensation under Section 162(m) of the Code that may be made to any one employee during any one calendar year period with respect to options and stock appreciation rights is 18,000,000 shares for existing employees and 5,000,000 shares in the case of new hires. The 12-month limit with respect to restricted stock and restricted stock units is 10,000,000 shares in the case of either existing or new employees. From and after the time that we become subject to Section 162(m) of the Code, the maximum cash-based award that is intended to qualify as performance-based compensation is limited to $10,000,000 in any 12-month period, which is pro-rated in the case of a partial performance period. The share limits are subject to adjustments in the event of a stock split, stock dividend or other change in our capitalization.

The 2013 Plan provides that upon the effectiveness of a corporate transaction, as defined in the 2013 Plan, in the event that all awards are not assumed or continued or substituted by the successor entity, all awards granted under the 2013 Plan shall terminate. In addition, in connection with a corporate transaction, the plan administrator may provide the full or partial automatic vesting and exercisability of one or more outstanding unvested awards under the 2013 Plan and the release from restrictions on transfer or forfeiture rights of such awards in connection with a corporate transaction, on such terms and conditions as the plan administrator may specify.

Our board of directors may amend or discontinue the 2013 Plan and our plan administrator may amend or cancel outstanding awards for purposes of satisfying changes in law or any other lawful purpose, but no such action may adversely affect rights under an award without the holder s consent. Certain amendments to the 2013 Plan require the approval of our stockholders.

No awards may be granted under the 2013 Plan after the date that is 10 years from the earlier of the date of adoption by our board of directors or the date of stockholder approval of the 2013 Plan. No awards under the 2013 Plan have been made prior to the date of this registration statement.

Non-Executive Director Compensation

The following table and related footnotes show the compensation paid during the year ended December 31, 2013 to our non-executive directors.

Name	Fees Earned or Paid in Cash	Option Awards	All Other Compensation	Total
Jeremy Curnock Cook[(1)]	$ 70,875	$	$	$ 70,875
Louis Drapeau[(2)]	$ 41,250	$	$	$ 41,250
Anthony Peter Gellert[(3)]	$ 11,666	$	$	$ 11,666
Michael S. Perry, Ph.D.[(4)]	$ 39,750	$	$	$ 39,750
Anthony Smithyman, Ph.D.[(5)]	$ 13,333	$	$	$ 13,333
Caroline A. Williams[(6)]	$ 50,750	$	$	$ 50,750

Julian P. Kirk[7]	$	$	$	$

(1) As of December 31, 2013, Mr. Cook holds stock options for an aggregate of 440,000 shares, of which 110,000 shares are vested and exercisable.

(2) As of December 31, 2013, Mr. Drapeau holds stock options for an aggregate of 120,000 shares, of which 30,000 shares are vested and exercisable.

(3) On June 26, 2013, Mr. Gellert resigned from our board of directors. As of June 26, 2013, Mr. Gellert held stock options for an aggregate of 50,000, of which 6,250 shares were vested and exercisable. Pursuant to the terms of his resignation, vesting will continue until December 31, 2015 as if that was his resignation date, at which time all unvested shares will have vested and will be exercisable pursuant to

66

TABLE OF CONTENTS

the standard post-termination exercise terms of the applicable stock option agreements, which will allow the stock options to be exercised for a period of ninety (90) days following December 31, 2015. As of December 31, 2013, Mr. Gellert holds stock options for an aggregate of 50,000 shares, of which 12,500 shares are vested and exercisable.

(4) As of December 31, 2013, Mr. Perry holds stock options for an aggregate of 170,000 shares, of which 42,500 shares are vested and exercisable.

(5) As of December 31, 2013, Mr. Smithyman holds stock options for an aggregate of 50,000 shares, of which 12,500 shares are vested and exercisable.

(6) On June 26, 2013, Ms. Williams resigned from our board of directors. As of June 26, 2013, Ms. Williams held stock options for an aggregate of 150,000, of which 6,250 shares were vested and exercisable. Pursuant to the terms of her resignation, vesting will continue until December 31, 2015 as if that was her resignation date, at which time all unvested shares will have vested and will be exercisable pursuant to the standard post-termination exercise terms of the applicable stock option agreements, which will allow the stock options to be exercised for a period of ninety (90) days following December 31, 2015. As of December 31, 2013, Ms. Williams holds stock options for an aggregate of 150,000 shares, of which 37,500 shares are vested and exercisable.

(7) Mr. Kirk has served as a member of our board of directors since June 2013.

67

TABLE OF CONTENTS

Item 7. Certain Relationships and Related Transactions, and Director Independence.

Transactions with Related Persons

The following is a summary of transactions since January 1, 2013 to which we have been a participant in which the amount involved exceeded or will exceed $120,000, and in which any of our then directors, executive officers or holders of more than 5% of any class of our capital stock at the time of such transaction, or any members of their immediate family, had or will have a direct or indirect material interest, other than compensation arrangements which are described under the sections of this registration statement titled Non-Executive Director Compensation and Executive Compensation.

Sale of Convertible Notes

Since January 1, 2013, we have sold convertible notes to Pendinas Limited in varying principal amounts for an aggregate total of $2,000,000. Additionally, we issued warrants to purchase an aggregate of up to approximately 7.0 million shares of common stock at an exercise price of $0.14 per share. All such convertible notes have been converted as a result of the completion of our private placement of convertible preferred stock, as of July 15, 2013. The following table summarizes sales of such convertible notes to Pendinas Limited, which was a holder of more than 5% of our common stock as of the dates of each such transaction:

Related Party	Date	Principal Amount
Pendinas Limited	February 4, 2013	$ 500,000.00
	March 12, 2013	$ 500,000.00
	April 12, 2013	$ 500,000.00
	May 13, 2013	$ 500,000.00

Sale of Series B Convertible Preferred Stock

In June 2013, we sold an aggregate of 9,357,935 shares of our Series B Convertible Preferred Stock and warrants to purchase an aggregate of 23,394,835 shares of our common stock. Pendinas Limited, a holder of more than 5% of our common stock as of the date of such transaction, converted all of its outstanding convertible notes into 3,225,061 shares of Series B Convertible Preferred Stock and a warrant to purchase 8,062,652 shares of our common stock in the transaction.

In connection with our June 2013 private placement of convertible preferred stock, we paid a placement fee to Griffin Securities, Inc. in the amount of $270,000 in cash and warrants to purchase 4,285,714 shares of common stock at an exercise price of $0.14 per share, and to Phillip Capital Ltd in the amount of $60,000 in cash and warrants to purchase 714,285 shares of common stock at an exercise price of $0.14 per share.

In addition, in connection with the June 2013 private placement, NRM VII Holdings I, LLC purchased 2,142,857 shares of our Series B Convertible Preferred Stock and warrants to purchase an additional 5,357,142 shares of our common stock. NRM VII Holdings I, LLC is controlled by Randal J. Kirk, the father of Julian P. Kirk, a member of our board of directors. Randal J. Kirk is also deemed a holder of more than five percent of the shares of our common stock, as described in the section entitled Item 4. Security Ownership of Certain Beneficial Owners and Management. Phillip Asset Management Ltd also purchased 714,285 shares of our Series B Convertible Preferred Stock and warrants to purchase an additional 1,785,712 shares of our common stock. Phillip Asset Management Ltd holds its

shares in its capacity as trustee for Bioscience Managers Pty Ltd. Jeremy Curnock Cook, the chairman of our board of directors, is a Managing Director and holds an ownership interest in Bioscience Managers Pty Ltd.

The shares of common stock post-conversion pursuant to the June private placement of our Series B Convertible Preferred Stock will be entitled to piggyback rights and S-1 and S-3 registration rights. See the section of this registration statement entitled Item 11. Description of Registrant s Securities to be Registered Registration Rights for additional information.

68

TABLE OF CONTENTS

Sale of Common Stock

In December 2013, in connection with a private placement of our common stock, we sold an aggregate of 300,000 shares of our common stock to Baxter F. Phillips III, our Vice President, Corporate Strategy and Business Development, for $0.25 per share, which was the same price paid by the other investors participating in the private placement.

In addition, in connection with the December 2013 private placement, NRM VII Holdings I, LLC and Phillip Asset Management Ltd purchased 20,000,000 shares and 6,000,000 shares, respectively, of our common stock at a price per share of $0.25, which was the same price paid by the other investors participating in the offering. NRM VII Holdings I, LLC is controlled by Randal J. Kirk, the father of Julian P. Kirk, a member of our board of directors. Randal J. Kirk is also deemed a holder of more than five percent of the shares of our common stock, as described in the section entitled Item 4. Security Ownership of Certain Beneficial Owners and Management. Phillip Asset Management Ltd holds its shares in its capacity as trustee for Bioscience Managers Pty Ltd. Jeremy Curnock Cook, the chairman of our board of directors, is a Managing Director and holds an ownership interest in Bioscience Managers Pty Ltd.

The shares of common stock purchased in the December 2013 private placement are entitled to certain registration rights, including the registration of shares for resale pursuant to this prospectus. See the section of this registration statement entitled Item 11. Description of Registrant s Securities to be Registered Registration Rights for additional information.

Director Independence

Under the listing requirements and rules of the NYSE MKT, independent directors must compose a majority of a listed company s board of directors within a one-year period following the completion of our initial public offering. In addition, applicable NYSE MKT rules require that, subject to specified exceptions, each member of a listed company s audit, compensation and nominating committees must be independent within the meaning of applicable NYSE rules. Audit committee members must also satisfy the independence criteria set forth in Rule 10A-3 under the Exchange Act.

In October 2013, our board of directors undertook a review of the independence of each director and considered whether any director has a material relationship with us that could compromise his or her ability to exercise independent judgment in carrying out his or her responsibilities. In making this determination, our board of directors considered the current and prior relationships that each non-employee director has with our company and all other facts and circumstances our board of directors deemed relevant in determining their independence, including the beneficial ownership of our capital stock by each non-employee director. As a result of this review, our board of directors determined that Messrs. Jeremy Curnock Cook, Louis Drapeau and Michael Perry qualify as independent directors within the meaning of the NYSE MKT rules. As required under applicable NYSE MKT rules, we anticipate that our independent directors will meet in regularly scheduled executive sessions at which only independent directors are present.

Item 8. Legal Proceedings.

From time to time we are involved in legal proceedings or subject to claims arising in the ordinary course of our business. Although the results of litigation and claims cannot be predicted with certainty, we do not believe we are a party to any legal proceedings that, if determined adversely to us, would individually or taken together have a material adverse effect on our business, operating results, financial condition or cash flows. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management

resources and other factors.

TABLE OF CONTENTS

Item 9. Market Price of and Dividends on the Registrant s Common Equity and Related Stockholder Matters.

Our shares of common stock are quoted on the OTC Pink market under the symbol APHB. Our shares were previously quoted under the symbol TGEN. On February 22, 2011, in connection with our name change to AmpliPhi Biosciences Corporation, our quotation symbol was changed to APHB.

The following table sets forth the range of reported high and low closing bid quotations for our common stock for the fiscal quarters indicated. These quotations reflect inter-dealer prices, without retail markup, markdown or commission, and may not represent actual transactions. Consequently, the information provided below may not be indicative of our common stock price under different conditions.

	High	Low
Fiscal Year 2014		
Period from January 1, 2014 to February 3, 2014	$ 0.74	$ 0.45
Fiscal Year 2013		
Fourth Quarter ended December 31, 2013	$ 0.59	$ 0.31
Third Quarter ended September 30, 2013	$ 0.71	$ 0.15
Second Quarter ended June 30, 2013	$ 0.20	$ 0.10
First Quarter ended March 31, 2013	$ 0.18	$ 0.11
Fiscal Year 2012		
Fourth Quarter ended December 31, 2012	$ 0.22	$ 0.14
Third Quarter ended September 30, 2012	$ 0.20	$ 0.09
Second Quarter ended June 30, 2012	$ 0.23	$ 0.13
First Quarter ended March 31, 2012	$ 0.24	$ 0.11
Fiscal Year 2011		
Fourth Quarter ended December 31, 2011	$ 0.27	$ 0.14
Third Quarter ended September 30, 2011	$ 0.29	$ 0.20
Second Quarter ended June 30, 2011	$ 0.39	$ 0.25
First Quarter ended March 31, 2011	$ 0.17	$ 0.06

Holders of Common Stock

As of January 10, 2014, there were 325 holders of record of our common stock. As of such date, 182,535,505 shares of common stock were issued and outstanding.

Dividends

We have never declared or paid any cash dividends or distributions on our common stock and currently do not plan to declare cash dividends on shares of our common stock in the foreseeable future. We expect that we will retain all of our available funds and future earnings, if any, for use in the operation and expansion of our business. Subject to the foregoing, the payment of cash dividends in the future, if any, will be at the discretion of our board of directors and will depend upon such factors as earnings levels, capital requirements, restrictions imposed by applicable law, our overall financial condition and any other factors deemed relevant by our board of directors.

Securities Authorized for Issuance under Equity Compensation Plans

In October 2012, our board of directors approved and adopted the 2012 Plan. Under the 2012 Plan, we are authorized to issue up to 35,000,000 shares of our common stock in stock incentive awards to employees, directors and consultants.

In March 2009, our board of directors and shareholders adopted the 2009 Plan. Under the 2009 Plan, we are authorized to issue up to 4,200,000 shares of our common stock in stock incentive awards to employees, directors and consultants.

70

TABLE OF CONTENTS

In December 2013, our board of directors adopted the 2013 Plan. Under the 2013 Plan, we are authorized to issue up to 40,000,000 shares of our common stock in stock incentive awards to employees, directors and consultants. We expect that our shareholders will consider approval of the 2013 Plan in February 2014.

The following table provides information as of September 30, 2013 with respect to our equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders[(1)]	166,000	$ 0.90	1,304,760
Equity compensation plans not approved by security holders[(2)]	24,896,677	$ 0.18	9,937,323
Total	25,062,677	$ 0.19	11,242,083

(1) The 2009 Plan.

(2) The 2012 Plan.

Item 10. Recent Sales of Unregistered Securities.

On December 16, 2013, we entered into subscription agreements to issue an aggregate amount of 72,007,000 shares of common stock for an aggregate purchase price of approximately $18 million as part of a private placement. The offers were, and, when completed, the sales and issuances are expected to be, deemed to be exempt from registration under the Securities Act. The purchasers of securities in each of these transactions acquired the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the securities issued in these transactions. Each of such purchasers was an accredited investor under Rule 506 of Regulation D or not a U.S. person under Regulation S.

On June 26, 2013, we completed a private placement of convertible preferred stock and warrants to purchase common stock with gross proceeds of $7.0 million through the sale of shares of our newly-created Series B Convertible Preferred Stock. As part of the same transaction, approximately $5.5 million in outstanding convertible notes were converted into shares of Series B Convertible Preferred Stock and warrants to purchase common stock. On July 15, 2013, we completed a second closing in which we converted approximately $0.8 million of outstanding convertible notes into Series B Convertible Preferred Stock and warrants to purchase common stock. The financing was led by life-sciences investors RA Capital Management and Third Security, LLC, with participation from BioScience Managers Pty Ltd.

Under the terms of the financing, we issued an aggregate amount of approximately 10 million shares of the Series B Convertible Preferred Stock for an aggregate purchase price of approximately $13.3 million (including the conversion of approximately $6.3 million of outstanding convertible notes). Each share of Series B Convertible Preferred Stock is convertible into 10 shares of common stock. Additionally, we issued warrants to purchase an aggregate of up to approximately 25.0 million shares of common stock at an exercise price of $0.14 per share. The offers, sales and issuances of Series B Convertible Preferred Stock and warrants to purchase common stock were deemed to be exempt from registration under the Securities Act. The purchasers of securities in each of these transactions acquired the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the securities issued in these transactions. Each of such purchasers was an accredited investor under Rule 506 of Regulation D or not a U.S. person under Regulation S.

71

TABLE OF CONTENTS

On March 29, 2013, pursuant to a Stock Issuance Agreement, which we refer to as the Issuance Agreement, we issued 24,000,000 shares of our common stock, or 26.4% of our total outstanding capital stock after such issuance, to Intrexon, a privately-held Virginia corporation that develops technology intended to provide synthetic control over cellular functions, in consideration of Intrexon s concurrent entry into the ECC with us to develop new bacteriophage-based therapies to target specific antibiotic-resistant infections. The Issuance Agreement also provides for the potential future issuance by us to Intrexon of shares of our common stock having a fair market value of up to $7,500,000, depending upon the reaching of certain milestones under the ECC. The issuance of shares of common stock under the Issuance Agreement was deemed to be exempt from registration under the Securities Act as Intrexon was an accredited investor under Rule 506 of Regulation D.

Between April 13, 2012 and May 13, 2013, we sold convertible notes to Pendinas Limited in varying principal amounts for an aggregate total of $2,750,000. Additionally, we issued warrants to purchase an aggregate of up to approximately 7.0 million shares of common stock at an exercise price of $0.14 per share. All such convertible notes have been converted as a result of the completion of our private placement of convertible preferred stock, as of July 15, 2013. The offers, sales and issuances of convertible notes and warrants to purchase common stock were deemed to be exempt from registration under the Securities Act. Pendinas Limited was both an accredited investor under Rule 506 of Regulation D and not a U.S. person under Regulation S.

Between November 23, 2010 and February 1, 2012, we sold convertible notes to a total of twenty-two different parties in varying principal amounts for an aggregate total of $1,872,462. All such convertible notes have been converted as a result of the completion of our private placement of convertible preferred stock, as of July 15, 2013. The offer, sales and issuances of convertible notes were deemed to be exempt from registration under the Securities Act. Each of the purchasers was either an accredited investors under Regulation D or not a U.S. person under Regulation S.

In November 2012, under the terms of our acquisition of SPH, we issued 40,000,000 shares of our common stock with 20,000,000 of those shares issued directly to the selling stockholders of SPH upon the closing of the acquisition, and the remaining 20,000,000 shares issued and held in escrow. The issuance of common stock was deemed to be exempt from registration under the Securities Act. Each of SPH s selling stockholders and each of the recipients of such shares was not a U.S. person under Regulation S.

In January 2011, under the terms of our acquisition of Biocontrol, we issued 22,586,073 shares of our common stock to the shareholders of Biocontrol with a total fair value of approximately $8.6 million as of January 6, 2011, resulting in Biocontrol s former shareholders owning approximately 50% of our outstanding equity securities at the time. The issuance of common stock was deemed to be exempt from registration under the Securities Act. Each of Biocontrol s former shareholders was not a U.S. person under Regulation S.

Item 11. Description of Registrant s Securities to be Registered.

The following description of our capital stock, certain provisions of our articles of incorporation and bylaws as currently in effect and our intended certificate of incorporation and bylaws upon our reincorporation in Delaware, and certain provisions of Washington and Delaware law are summaries. You should also refer to the current articles of incorporation and the bylaws, which are filed as exhibits to this registration statement. We refer in this section to our certificate of incorporation and bylaws that we intend to adopt upon Delaware reincorporation as our certificate of incorporation and bylaws, respectively.

General

Prior to our reincorporation in Delaware, our articles of incorporation authorize us to issue up to 445,000,000 shares of common stock, $0.01 par value per share, and 10,000,000 shares of preferred stock, $0.01 par value per share, of which 180,000 shares of preferred stock are designated Series A Participating Cumulative Preferred Stock, 9,357,935 shares of preferred stock are designated Series B Convertible Preferred Stock and 462,065 shares of preferred stock are undesignated. After our reincorporation in Delaware, and without giving effect to the reverse stock split we intend to effect with stockholder approval in connection with such reincorporation, our certificate of incorporation will authorize us to issue up to 445,000,000 shares of common stock, $0.01 par value per share, and 10,000,000 shares of preferred stock,

TABLE OF CONTENTS

$0.01 par value per share, of which 9,357,935 shares of preferred stock will be designated Series B Convertible Preferred Stock and 642,065 shares of preferred stock will be undesignated.

Our board of directors may establish the rights and preferences of the preferred stock from time to time, both before and after our reincorporation in Delaware.

Common Stock

Voting Rights

As of January 10, 2014, there were 182,535,505 shares of common stock issued and outstanding, which excludes 88,599,780 shares of common stock issuable as of such date upon conversion of the Series B Convertible Preferred Stock and other shares issuable or reserved for issuance pursuant to outstanding options or option plans. Each holder of common stock is entitled to one vote for each share of common stock held on all matters submitted to a vote of the stockholders, including the election of directors. Our amended and restated articles of incorporation and amended and restated bylaws do not provide for cumulative voting rights.

Dividends

Subject to preferences that may be applicable to any then outstanding preferred stock, the holders of our outstanding shares of common stock are entitled to receive dividends, if any, as may be declared from time to time by our board of directors out of legally available funds.

Liquidation

In the event of our liquidation, dissolution or winding up, holders of common stock will be entitled to share ratably in the net assets legally available for distribution to stockholders after the payment of all of our debts and other liabilities, subject to the satisfaction of any liquidation preference granted to the holders of any outstanding shares of preferred stock.

Rights and Preferences

Holders of our common stock have no preemptive, conversion or subscription rights, and there are no redemption or sinking fund provisions applicable to the common stock. The rights, preferences and privileges of the holders of common stock are subject to, and may be adversely affected by, the rights of the holders of shares of any series of our preferred stock that are outstanding or that we may designate and issue in the future. All of our outstanding shares of common stock are fully paid and nonassessable.

Common Stock Held in Escrow

In October 2012, the Company announced the acquisition of SPH and its wholly owned subsidiary Special Phage Services Pty Ltd, and the consideration for such acquisition was paid in shares of our common stock. As a condition of the acquisition, 20,000,000 shares of such common stock were held in escrow, with 8,000,000 to satisfy potential warranty claims on behalf of the Company under the acquisition documents and the remaining 12,000,000 shares to be held pending completion of certain milestones. In November 2013, twelve months following the closing, 8,000,000 of the shares then held in escrow were released, with 12,000,000 shares remaining in escrow. Some or all of such

12,000,000 shares of common stock may, in the future, depending on certain circumstances, be returned to the Company as treasury stock.

Preferred Stock

As of January 10, 2014, there were 8,859,978 shares of Series B Convertible Preferred Stock outstanding, which are convertible into 88,599,780 shares of common stock as of such date.

Prior to our reincorporation in Delaware, our board of directors will have the authority, without further action by our stockholders, to issue up to 462,065 shares of preferred stock in one or more series, to establish from time to time the number of shares to be included in each such series, to fix the rights, preferences and privileges of the shares of each wholly unissued series and any qualifications, limitations or restrictions thereon, and to increase or decrease the number of shares of any such series, but not below the number of shares of such series then outstanding. After our reincorporation in Delaware, our board of directors will

73

possess identical authority, except the number of shares of preferred stock authorized for issuance will equal up to 642,065 (without giving effect to the reverse stock split we intend to effect, with stockholder approval, after the reincorporation).

Our board of directors may authorize the issuance of preferred stock with voting or conversion rights that could adversely affect the voting power or other rights of the holders of our common stock. The purpose of authorizing our board of directors to issue preferred stock and determine its rights and preferences is to eliminate delays associated with a stockholder vote on specific issuances. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could, among other things, have the effect of delaying, deferring or preventing a change in control of us and may adversely affect the market price of our common stock and the voting and other rights of the holders of our common stock. It is not possible to state the actual effect of the issuance of any shares of preferred stock on the rights of holders of common stock until the board of directors determines the specific rights attached to that preferred stock.

There currently are no other provisions under our amended and restated articles of incorporation (nor will there be under our Delaware certificate of incorporation after reincorporation) or under any other contractual obligations whereby we are authorized or required to issue or sell shares of preferred stock and we have no present plans to issue any shares of preferred stock.

Series A Participating Cumulative Preferred Stock

The Company s current amended and restated articles of incorporation grant the board of directors authority to issue shares of Series A Participating Cumulative Preferred Stock upon the exercise of certain rights by certain stockholders pursuant to a Rights Agreement, dated October 17, 1996, between the Company and ChaseMellon Shareholder Services, as Rights Agent, as amended, which we refer to as the Rights Agreement. The Rights Agreement and all rights thereunder expired in October, 2006 and the Company currently has no plans to reauthorize or extend the effective term of any rights under the Rights Agreement or enter into a new rights agreement providing the same or similar rights to stockholders. Upon our reincorporation in Delaware, no shares of Series A Participating Cumulative Preferred Stock will be authorized.

Series B Convertible Preferred Stock

Shares of our Series B Convertible Preferred Stock are subject to automatic conversion into common stock upon the completion of an underwritten public offering with aggregate offering proceeds to the Company of at least $7 million dollars (after reduction for underwriting discounts and commissions) and a price per share to the public of at least the purchase price of the shares of Series B Convertible Preferred Stock (subject to adjustment in the event of any stock dividend, stock split, stock distribution or combination with respect to such shares) upon the closing of which the shares of common stock of the company shall be listed for trading on the national securities exchanges operated by the New York Stock Exchange or NASDAQ Stock Market, or (ii) at the election of the holders of two-thirds of the then outstanding shares of Series B Convertible Preferred Stock. The shares of Series B Convertible Preferred Stock are also subject to voluntary conversion by the holders thereof at any time. The number of shares of our common stock to be issued upon the conversion of all outstanding shares of our Series B Convertible Preferred Stock depends on the closing date of our initial public offering that triggers conversion, or the date of election by individual holders or holders of at least two-thirds of the then outstanding shares of Series B Convertible Preferred Stock.

The terms of our Series B Convertible Preferred Stock provide that the shares of Series B Convertible Preferred Stock accrue dividends at the rate of 10% per year, which results in additional shares of our common stock being issuable

upon conversion of our Series B Convertible Preferred Stock as such dividends accrue. Subsequent to June 30, 2013, 1,156,102, shares of Series B Convertible Preferred Stock were converted into shares of common stock. As of January 10, 2014, the outstanding shares of our Series B Convertible Preferred Stock would convert into an aggregate of 88,599,780 shares of our common stock (assuming a conversion ratio of 10 shares of common stock for each share of Series B Convertible Preferred Stock).

74

Prior to the mandatory conversion of the Series B Convertible Preferred Stock, if the Company issues any shares of common stock for consideration per share of less than the conversion price then in effect for the Series B Convertible Preferred Stock, the conversion rate for the Series B Convertible Preferred Stock shall be adjusted to a new rate that equals the product of:

- the conversion rate in effect immediately before such issuance, multiplied by
- a fraction, the numerator of which is the Series B Stated Value (as defined in the Designation of Preferences, Rights and Limitations of Series B Convertible Preferred Stock), and the denominator of which is the consideration per share received in such issue multiplied by the conversion rate in effect immediately before such issuance.

Except for matters requiring the separate approval of the holders of the Series B Convertible Preferred Stock, the holders of the Series B Convertible Preferred Stock are entitled to that number of votes equal to the number of shares of the common stock into which the Series B Convertible Preferred Stock may be converted as of the date such vote is held. Approval of the holders of at least two-thirds of the then outstanding shares of Series B Convertible Preferred Stock is required to:

- authorize, create or issue (by reclassification or otherwise) any other class or series of capital stock having rights, preferences or privileges senior to or in parity with the Series B Convertible Preferred Stock; and
- alter or change the rights, preferences or privileges of the Series B Convertible Preferred Stock, or increase or decrease the authorized or issued and outstanding number of shares of Series B Convertible Preferred Stock.

The holders of the Series B Convertible Preferred Stock are also entitled to preferential payments upon a liquidation event that occurs prior to the mandatory conversion of the Series B Convertible Preferred Stock. In the case of any Liquidation Event (as defined in the Designation of Preferences, Rights and Limitations of Series B Convertible Preferred Stock), the holders of the Series B Convertible Preferred Stock then outstanding shall be entitled to receive and to be paid out of the assets or surplus funds available for distribution to our shareholders, prior to and in preference to any payments to be made to the holders of the shares of common stock, an amount per share equal to the greater of:

(i) the sum of (A) the Series B Stated Value then in effect plus (B) all accrued but unpaid dividends through the Liquidation Event plus (C) after the distribution contemplated by (A) and (B) above and assuming a distribution to the holders of shares of common stock in proportion to the shares of common stock held or that the holder has the right to acquire upon conversion of the Series B Convertible Preferred Stock, such additional aggregate amount that would be distributable with respect to the aggregate number of shares of common stock issuable upon conversion of such shares of Series B Convertible Preferred Stock, assuming conversion of all shares of Series B Convertible Preferred Stock; and

(ii) assuming a distribution to the holders of shares of common stock in proportion to the shares of common stock held or that the holder has the right to acquire upon conversion of the Series B Convertible Preferred Stock, the aggregate amount that would be distributable with respect to the aggregate number of shares of common stock issuable upon conversion of such shares of Series B Convertible Preferred Stock, assuming conversion of all shares of Series B Convertible Preferred Stock.

For purposes of clause (i) above only, the holders of Series B Convertible Preferred Stock shall be entitled to receive remaining assets and funds of the Company of an aggregate value below or equal to, but not to exceed, the aggregate of two times the Series B Stated Value at the time of such Liquidation Event.

Warrants

As of January 10, 2014, there were outstanding warrants to purchase the following shares of our capital stock:

TABLE OF CONTENTS

Description	# of shares subject to such Warrants	Weighted-average exercise price of such Warrants
Common Stock	42,746,165	$ 0.16

In December, 2011, as compensation for certain services provided in connection with our acquisition of Biocontrol, we issued warrants to purchase an aggregate of 1,355,164 shares of our common stock with an initial exercise price of $0.46 per share. These warrants were issued to Rodman & Renshaw LLC and its affiliate, Edward Cappabianca. Rodman & Renshaw LLC subsequently assigned its ownership interest in its warrants (exercisable for 1,016,373 shares of our common stock) to OTA LLC. All of the warrants held by Edward Cappabianca and OTA LLC expire in December 2016.

In February through May 2013, we issued warrants to purchase 7,030,387 shares of common stock at an exercise price of $0.14 per share in connection with the issuance of convertible notes.

In June 2013, we issued warrants to purchase an aggregate of up to approximately 12.5 million shares of common stock at an exercise price of $0.14 per share in connection with the private placement of our Series B Convertible Preferred Stock. In connection with the financing, we issued warrants to purchase approximately 12.5 million shares of common stock at an exercise price of $0.14 per share to holders of our convertible notes that were converted in the financing.

In connection with our June 2013 private placement of convertible preferred stock, we paid a placement fee to Griffin Securities, Inc. in the amount of $270,000 in cash and warrants to purchase 4,285,714 shares of common stock at an exercise price of $0.14 per share and to Phillip Capital Ltd in the amount of $60,000 in cash and warrants to purchase 714,285 shares of common stock at an exercise price of $0.14 per share.

In connection with our December 2013 private placement of common stock, we paid a placement fee to Roth Capital Partners and Griffin Securities, Inc., consisting in the aggregate of $1,080,045 in cash and warrants to purchase 4,320,180 shares of common stock.

Options

As of September 30, 2013, there were 25,062,677, shares of common stock subject to outstanding options.

Anti-Takeover Provisions

Provisions in our current articles of incorporation and bylaws and under Washington law and our intended certificate of incorporation and bylaws (upon reincorporation in Delaware) under Delaware law may delay or prevent an acquisition of us or a change in our management. These provisions include a classified board of directors, a prohibition on shareholder actions by less than unanimous written consent, and a requirement for the vote of shareholders holding at least two-thirds of all shares of our issued and outstanding capital stock to approve certain changes to our articles of incorporation or any business combination, such as a merger or a share exchange with another company. In addition, because we are incorporated in Washington, we are governed by the provisions of Chapter 23B.19 of the WBCA, which, among other things, restricts the ability of shareholders owning ten percent (10%) or more of our outstanding voting stock from merging or combining with us. In addition, these provisions may frustrate or prevent any attempts by our shareholders to replace or remove our current management by making it

difficult for shareholders to replace members of our board of directors, which is responsible for appointing the members of our management. Also, because we are reincorporating in Delaware, we will then be governed by the provisions of Section 203 of the DGCL. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us.

Registration Rights

Holders of warrants to purchase an aggregate of 1,355,164 shares of our common stock at an exercise price of $0.46 per share are entitled to certain registration rights with respect to such shares. In addition, the shares of common stock issued in connection with the ECC with Intrexon, the shares of common stock issuable in connection with the June private placement of our Series B Convertible Preferred Stock (upon conversion of Series B Convertible Preferred Stock and/or exercise of warrants) and the shares of common

76

TABLE OF CONTENTS

stock to be issued in connection with the December 2013 private placement of our common stock are entitled to certain rights with respect to registration of such shares under the Securities Act. These shares are collectively referred to herein as registrable securities. The holders of these registrable securities possess registration rights pursuant to their respective executed agreements and as described in additional detail below.

Piggyback Registration Rights

If we propose to register any of our securities under the Securities Act either for our own account or, in the case of the warrants described above, for the account of other stockholders, the holders of our registrable securities then outstanding will each be entitled to notice of the registration and will be entitled to include their shares of common stock in any such registration statement. These piggyback registration rights are subject to specified conditions and limitations, including, in the case of an underwritten offering, the right of the underwriters to limit the number of shares included in any such registration under specified circumstances.

Demand Registration Rights

From the date that is 180 days after the effective date of the registration statement relating to our initial public offering, holders of at least 50% of our registrable shares from the June private placement of our Series B Convertible Preferred Stock are entitled to request to have such shares registered by us on a Form S-1 registration statement. As of January 10, 2014, approximately 125,200,996 shares of common stock held by those holders post-conversion (assuming a conversion ratio equal to ten (10) common shares for each share of Series B Convertible Preferred Stock and the exercise of all warrants issued in connection with the June private placement) will be entitled to these Form S-1 registration rights.

At any time we are eligible to use a Form S-3 registration statement, holders of at least 30% of our registrable securities from the June private placement of our Series B Convertible Preferred Stock are entitled to request to have such shares registered by us on a Form S-3 registration statement. As of January 10, 2014, approximately 125,200,996 shares of common stock held by those holders post-conversion (assuming a conversion ratio equal to ten (10) common shares for each share of Series B Convertible Preferred Stock and the exercise of all warrants issued in connection with the June private placement) will be entitled to these Form S-3 registration rights.

Resale Registration Statement

Pursuant to the Registration Rights Agreement, dated December 16, 2013, by and between the Company and the purchasers of shares in the December 2013 private placement, the Company agreed to file, within 30 days of the closing of the private placement, a registration statement on Form S-1 covering the resale of the shares purchased in the private placement. The Company would be liable for certain liquidated damages in the event the registration statement is not filed by, or declared or kept effective during, the time periods specified in the Registration Rights Agreement.

Expenses of Registration

We will pay all expenses relating to any piggyback or Form S-1 or S-3 registration, other than underwriting discounts and commissions, subject to specified conditions and limitations.

Transfer Agent

Our shares of common stock are issued in certificated form. The transfer agent and registrar for our common stock is Computershare. The transfer agent s address is 250 Royall Street, Canton, MA 02021.

Item 12. Indemnification of Directors and Officers.

Sections 23B.08.510 and 23B.08.570 of the WBCA authorize Washington corporations to indemnify directors and officers under certain circumstances against expenses and liabilities incurred in legal proceedings in which they are involved by reason of being a director or officer, as applicable. Section 23B.08.560 of the WBCA authorizes a corporation by provision in a bylaw approved by its shareholders to indemnify or agree to indemnify a director made a party to a proceeding, or obligate itself to advance or reimburse expenses incurred in a proceeding, without regard to the limitations imposed by Sections 23B.08.510 through 23B.08.550; provided that no such indemnity shall indemnify any director from or on account of (a) acts

77

TABLE OF CONTENTS

or omissions of the director finally adjudged to be intentional misconduct or a knowing violation of law, (b) conduct of the director finally adjudged to be in violation of Section 23B.08.310 of the WBCA (which section relates to unlawful distributions) or (c) any transaction with respect to which it was finally adjudged that such director personally received a benefit in money, property or services to which the director was not legally entitled.

Article 11 of the Company s current articles of incorporation, provides that, to the fullest extent that the WBCA permits the limitation or elimination of the liability of a director, a director shall not be liable to the Registrant or its shareholders for monetary damages for conduct as a director. Section 10 of the Company s amended and restated bylaws requires the Company to indemnify every present or former director or officer against expenses, liabilities and losses incurred in connection with serving as a director or officer, as applicable, and to advance expenses of such director or officer incurred in defending any proceeding covered by the indemnity.

Upon reincorporation in Delaware, we intend to adopt provisions in our certificate of incorporation that limit the liability of our directors for monetary damages for breach of their fiduciary duty as directors, except for liability that cannot be eliminated under Delaware law. Under Delaware law, our directors have a fiduciary duty to us which will not be eliminated by this provision in our certificate of incorporation. In addition, each of our directors will continue to be subject to liability under Delaware law for breach of the director s duty of loyalty to us for acts or omissions which are found by a court of competent jurisdiction to be not in good faith or which involve intentional misconduct or knowing violations of law for actions leading to improper personal benefit to the director and for payment of dividends or approval of stock repurchases or redemptions that are prohibited by Delaware law. This provision does not affect the directors responsibilities under any other laws, such as the Federal securities laws. Delaware law further provides that directors of a company will not be personally liable for monetary damages for breach of their fiduciary duty as directors, except for liability for the following: (i) any breach of the director s duty of loyalty to us or our stockholders; (ii) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) unlawful payment of dividends or unlawful stock repurchases or redemptions; or (iv) any transaction from which the director derived an improper personal benefit. Additionally, Delaware law provides that the indemnification permitted thereunder shall not be deemed exclusive of any other rights to which the directors and officers may be entitled under our bylaws, any agreement, a vote of stockholders or otherwise. Our certificate of incorporation and bylaws, upon reincorporation, will eliminate the personal liability of directors to the maximum extent permitted by Delaware law. In addition, such certificate of incorporation and bylaws will provide that we may fully indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding (whether civil, criminal, administrative or investigative) by reason of the fact that such person is or was one of our directors, officers, employees or other agents, against expenses (including attorneys fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding.

The Company maintains a policy of directors and officers liability insurance that insures the directors and officers against the cost of defense, settlement or payment of a judgment under certain circumstances. The Company has also entered into indemnification agreements with its executive officers and directors that provide for the indemnification of directors and executive officers to the fullest extent permitted by the WBCA against expenses reasonably incurred by such persons in any threatened, pending or completed action, suit, investigation or proceeding in connection with their service as (i) a director or officer or (ii) as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, at the registrant s request. In addition, the indemnification agreements provide the Company with the obligation to advance expenses under certain circumstances and provide for procedural protections, including a determination by a reviewing party whether the indemnitee is permitted to be indemnified under applicable law. In addition, the Company acknowledges that it will be the indemnitor of first resort should the indemnitee have rights to indemnification provided by other persons. Upon reincorporation in Delaware, the Company intends to enter into

substantially similar indemnification agreements with the same persons to indemnify such persons to the fullest extent permitted under the DGCL.

78

TABLE OF CONTENTS

At present, there is no pending litigation or proceeding involving any of our directors or executive officers as to which indemnification is required or permitted, and we are not aware of any threatened litigation or proceeding that may result in a claim for indemnification.

Item 13. Financial Statements and Supplementary Data.

See the financial statements and related notes beginning on page F-1 of this registration statement.

Item 14. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

TABLE OF CONTENTS

Item 15. Financial Statements and Exhibits.

(a) Financial Statements

The following financial statements are being filed as a part of this registration statement:

AmpliPhi Biosciences Corporation	
Consolidated Balance Sheets as of September 30, 2013 (Unaudited) and December 31, 2012	F-2
Consolidated Statements of Operations and Comprehensive Income (Loss) for the Nine Months Ended September 30, 2013 (Unaudited) and September 30, 2012 (Unaudited) and the Year Ended December 31, 2012	F-3
Consolidated Statements of Stockholders Equity (Deficit) for the Nine Months Ended September 30, 2013 (Unaudited) and the Year Ended December 31, 2012	F-4
Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2013 (Unaudited) and September 30, 2012 (Unaudited) and the Year Ended December 31, 2012	F-5
Notes to Consolidated Financial Statements for the Nine Months Ended September 30, 2013 (Unaudited)	F-6
Report of Independent Registered Public Accounting Firm	F-14
Consolidated Balance Sheets as of December 31, 2012 and 2011 (Audited)	F-15
Consolidated Statements of Operations and Comprehensive Loss for the Years Ended December 31, 2012 and 2011 (Audited)	F-16
Consolidated Statements of Stockholders Equity (Deficit) for the Years Ended December 31, 2012 and 2011 (Audited)	F-17
Consolidated Statements of Cash Flows for the Years Ended December 31, 2012 and 2011 (Audited)	F-18
Notes to Consolidated Financial Statements for the Years Ended December 31, 2012 and 2011 (Audited)	F-19
Special Phage Holdings Pty Ltd	
Report of Independent Registered Public Accounting Firm	F-30
Balance Sheet	F-31
Statement of Operations and Comprehensive Loss	F-32
Statement of Stockholders Equity (Deficit)	F-33
Statement of Cash Flows	F-34
Notes to Financial Statements	F-35

(b) Exhibits

The exhibits to the registration statement are listed in the Exhibit Index to this registration statement and are incorporated herein by reference.

TABLE OF CONTENTS

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 4, 2014	AMPLIPHI BIOSCIENCES CORPORATION By: /s/ Philip J. Young Name: Philip J. Young Title: President and Chief Executive Officer

81

TABLE OF CONTENTS

AMPLIPHI BIOSCIENCES CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

AmpliPhi Biosciences Corporation	
Consolidated Balance Sheets as of September 30, 2013 (Unaudited) and December 31, 2012	F-2
Consolidated Statements of Operations and Comprehensive Income (Loss) for the Nine Months Ended September 30, 2013 (Unaudited) and September 30, 2012 (Unaudited) and the Year Ended December 31, 2012	F-3
Consolidated Statements of Stockholders Equity (Deficit) for the Nine Months Ended September 30, 2013 (Unaudited) and the Year Ended December 31, 2012	F-4
Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2013 (Unaudited) and September 30, 2012 (Unaudited) and the Year Ended December 31, 2012	F-5
Notes to Consolidated Financial Statements for the Nine Months Ended September 30, 2013 (Unaudited)	F-6
Report of Independent Registered Public Accounting Firm	F-14
Consolidated Balance Sheets as of December 31, 2012 and 2011 (Audited)	F-15
Consolidated Statements of Operations and Comprehensive Loss for the Years Ended December 31, 2012 and 2011 (Audited)	F-16
Consolidated Statements of Stockholders Equity (Deficit) for the Years Ended December 31, 2012 and 2011 (Audited)	F-17
Consolidated Statements of Cash Flows for the Years Ended December 31, 2012 and 2011 (Audited)	F-18
Notes to Consolidated Financial Statements for the Years Ended December 31, 2012 and 2011 (Audited)	F-19
Special Phage Holdings Pty Ltd	
Report of Independent Registered Public Accounting Firm	F-30
Balance Sheet	F-31
Statement of Operations and Comprehensive Loss	F-32
Statement of Stockholders Equity (Deficit)	F-33
Statement of Cash Flows	F-34
Notes to Financial Statements	F-35

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Balance Sheets

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	$4,859,000	$862,000
Accounts receivable	11,000	23,000
Tax refund	136,000	618,000
Prepaid expenses and other current assets	302,000	148,000
Total current assets	5,308,000	1,651,000
Property and equipment, net of accumulated depreciation of $364,000 and $294,000 as of September 30, 2013 and December 31, 2012, respectively	169,000	138,000
Goodwill	17,567,000	17,567,000
Total assets	$23,044,000	$19,356,000
Liabilities and stockholders equity		
Current liabilities		
Accounts payable and accrued expenses	$1,487,000	$1,937,000
Convertible loan notes and accrued interest expense		4,113,000
Total current liabilities	1,487,000	6,050,000
Long term liabilities		
Warrant liability	14,865,000	
Total long term liabilities	14,865,000	
Total liabilities	16,352,000	6,050,000
Stockholders equity		
Preferred stock, $0.01 par value, 10,000,000 shares authorized; 8,883,205 shares issued and outstanding at September 30, 2013	89,000	
Preferred stock, $0.01 par value Additional paid-in capital	8,342,000	
Common stock, $0.01 par value, 445,000,000 shares authorized, 102,235,274 shares issued and outstanding at September 30, 2013 and 66,908,810 shares issued and outstanding at December 31, 2012	1,022,000	669,000
Common stock, $0.01 par value Additional paid-in capital	333,673,000	329,707,000
Paid-in-capital Contingent shares	3,400,000	3,400,000
Accumulated other comprehensive loss	(81,000)	(106,000)
Accumulated deficit	(339,753,000)	(320,364,000)
Total stockholders equity	21,557,000	13,306,000
Total liabilities and stockholders equity	$23,044,000	$19,356,000

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

F-2

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Statements of Operations and Comprehensive Income (Loss)

	Nine Months Ended September 30,		Year Ended December 31,
	2013 (Unaudited)	2012 (Unaudited)	2012
Revenue	$333,000	$647,000	$664,000
Operating expenses			
Research and development	5,379,000	919,000	1,480,000
General and administrative	4,027,000	2,292,000	3,177,000
Total operating expenses	9,406,000	3,211,000	4,657,000
Loss from continuing operations	(9,073,000)	(2,564,000)	(3,993,000)
Loss from change in fair value of warrant liability	(10,089,000)		
Tax refund			133,000
Loss on disposal of assets			(30,000)
Interest expense	(227,000)	(247,000)	(339,000)
Net loss from continuing operations	(19,389,000)	(2,811,000)	(4,229,000)
Discontinued Operations			
Gain on sale of assets of discontinued operations		3,150,000	3,150,000
Net income (loss)	$(19,389,000)	$339,000	$(1,079,000)
Net loss per share from continuing operations basic & diluted	$(0.23)	$(0.06)	$(0.09)
Gain per share from discontinued operations basic & diluted	$	$0.07	$0.07
Net income (loss) per share basic & diluted	$(0.23)	$0.01	$(0.02)
Weighted average number of shares of common stock outstanding basic & diluted	85,688,356	44,908,810	48,034,493
Other comprehensive loss			
Net unrealized gain (loss) on foreign currency translations	25,000	(44,000)	(14,000)
Comprehensive income (loss)	$(19,364,000)	$295,000	$(1,093,000)

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

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Statements of Stockholders   Equity (Deficit)

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

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Statements of Cash Flows

	Nine Months Ended September 30,		Year Ended December 31,
	2013	2012	2012
	(Unaudited)	(Unaudited)	
Cash flows from operating activities			
Net loss	$(19,389,000)	$(2,811,000)	$(4,229,000)
Adjustments required to reconcile net loss to cash used in operating activities:			
Loss from change in fair value of warranty liability	10,089,000		
Intrexon fee paid in shares	3,000,000		
Depreciation	70,000	40,000	60,000
Loss on sale/disposal of fixed assets			30,000
Stock-based compensation	1,206,000		9,000
Changes in operating assets and liabilities net of acquisitions:			
Accounts receivable	12,000	104,000	99,000
Tax refund	482,000	(219,000)	(133,000)
Accounts payable and accrued expenses	(450,000)	(171,000)	(458,000)
Prepaid expenses and other assets	(154,000)	19,000	2,000
Interest on loan notes	227,000	247,000	339,000
Net cash used in operating activities	(4,907,000)	(2,791,0000)	(4,281,000)
Cash flows from investing activities			
Gain on sale of discontinued operations assets		3,150,000	3,150,000
Purchases of property and equipment	(101,000)	(41,000)	(53,000)
Net cash provided by (used in) investing activities	(101,000)	3,109,000	3,097,000
Cash flows from financing activities			
Payment of convertible loan note	(20,000)		
Proceeds from issuance of Series B Convertible Preferred Stock	7,000,000		
Proceeds from issuance of convertible loan notes	2,000,000	950,000	950,000
Net cash provided by financing activities	8,980,000	950,000	950,000
Effect of exchange rates on cash and cash equivalents	25,000	(44,000)	
Net increase (decrease) in cash and cash equivalents	3,997,000	1,224,000	(234,000)
Cash and cash equivalents, beginning of period	862,000	1,096,000	1,096,000
Cash and cash equivalents, end of period	$4,859,000	$2,320,000	$862,000
Supplemental Schedule of non-cash financing activities:			
Conversion of convertible loan notes and accrued interest to Series B Convertible Preferred Stock	$6,316,000	$	$

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

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

1. Nature of Business and Significant Accounting Policies

Nature of Business

AmpliPhi Biosciences Corporation (the Company) was incorporated in the state of Washington in 1989 under the name Targeted Genetics Corporation. In February 2011, Targeted Genetics Corporation changed its name to AmpliPhi Biosciences Corporation. The Company, headquartered in Richmond, Virginia, is dedicated to developing novel antibacterial solutions called bacteriophage (phage). Phages are naturally occurring viruses that preferentially target and kill their bacterial targets.

Basis of Presentation

The interim consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries Biocontrol and AmpliPhi Australia. All significant intercompany accounts and transactions have been eliminated. All numbers on the financial statements and disclosures have been rounded to the nearest 1,000 except share and per share data.

The interim consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or SEC. In the opinion of the Company s management, all adjustments (consisting of normal recurring adjustments and reclassifications and non-recurring adjustments) necessary to present fairly our results of operations for the nine months ended September 30, 2013 and 2012, our cash flows for the nine months ended September 30, 2013 and 2012 and our financial position as of September 30, 2013 have been made. The results of operations for such interim periods are not necessarily indicative of the operating results to be expected for the full year.

Certain information and disclosures normally included in the notes to the annual financial statements have been condensed or omitted from these interim consolidated financial statements. Accordingly, these interim consolidated financial statements should be read in conjunction with the 2012 audited consolidated financial statements and notes.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers cash equivalents to be short-term investments that have a maturity at the time of purchase of three months or less, are readily convertible into cash and have an insignificant level of valuation risk attributable to potential changes in interest rates. Cash equivalents are recorded at cost, which approximates fair market value, and consist primarily of money market accounts.

Restricted Cash

The Company maintains a cash account for the payment of employee wages through HR Novations.

Accounts Receivable

Accounts receivable amounts are stated at their face amounts less any allowance. Provisions for doubtful accounts are estimated based on assessment of the probable collection from specific customer accounts and other known factors. If an account was determined to be uncollectible (payment has not been made in accordance with contract terms), it would be written off against the allowance. As of September 30, 2013 and December 31, 2012, management determined no allowance for doubtful accounts was required.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

1. Nature of Business and Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are recorded at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets, generally three to seven years.

Prepaid Expenses and Other Current Assets

Prepaid and other current assets as of September 30, 2013 and December 31, 2012 consist primarily of prepaid insurance and deposits.

Goodwill

Costs of investments in purchased companies in excess of the underlying fair value of net assets at the date of acquisition are recorded as goodwill and assessed annually for impairment. If considered impaired, goodwill will be written down to fair value and a corresponding impairment loss recognized.

During the year ended December 31, 2012, the rights to SPH Holdings Pty Ltd s know-how and phage libraries were acquired by the business combination described in Note 3 for $6,800,000. At December 31, 2012, goodwill in the amount of $7,841,000 has been recorded for these patents as SPH Holdings Pty Ltd s had a negative stockholders equity balance of approximately $800,000 at the time of the transaction. In management s opinion, no goodwill has been impaired as of September 30, 2013 and December 31, 2012.

During the year ended December 31, 2011, the rights to Biocontrol Limited s patents and phage libraries were acquired by the business combination described in Note 3 for $8,584,000. At December 31, 2011, goodwill in the amount of $9,726,000 has been recorded for these patents as Biocontrol had a negative stockholders equity balance of approximately $3.5 million at the time of the transaction. In management s opinion, no goodwill has been impaired as of September 30, 2013 and December 31, 2012.

Stock-Based Compensation

The Company accounts for stock-based payments under the guidance of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 718-10, *Stock Compensation*, which requires measurement of compensation cost for all share-based payment awards at fair value on the date of grant and recognition of compensation cost over the requisite service period (typically the vesting period) for awards expected to vest.

Warrant Liability

The Company accounts for warrants with anti-dilution (down-round) provisions under the guidance of ASC 815, *Accounting for Derivative Instruments*, and Hedging Activities and Emerging Issue Task Force Statement 07-5: *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock*, which require the warrants to be recorded as a liability and adjusted to fair value in each reporting period.

Revenue Recognition

The Company generates revenue from technology licenses, collaborative research arrangements and agreements to provide research and development services. Revenue under technology licenses typically consists of nonrefundable, up-front license fees, technology access fees and various other payments. The Company recognizes revenue associated with performance milestones as earned, typically based upon the achievement of the specific milestones defined in the applicable agreements.

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

1. Nature of Business and Significant Accounting Policies (continued)

The Company recognizes revenue under research and development contracts as the related costs are incurred. When contracts include multiple elements, the Company follows ASC 605-25, *Multiple Element Arrangements*, which requires the Company to satisfy the following before revenue can be recognized:

The delivered items have value to the customer on a stand-alone basis;
Any undelivered items have objective and reliable evidence of fair value; and
Delivery or performance is probable and within the Company s control for any delivered items that have a right of return.
The Company classifies advance payments received in excess of amounts earned as deferred revenue.

Based upon the terms specified in its collaboration agreements, the Company receives advance payments from some of its collaboration partners before the project has been performed. These payments are deferred and recognized as revenue when the costs are incurred.

Research and Development Costs

Research and development costs include salaries, costs of outside collaborators and outside services, royalty and license costs and allocated facility, occupancy and utility expenses. The Company expenses research and development costs as incurred.

Net Loss per Common Share

Net loss per common share is based on net loss divided by the weighted average number of common shares outstanding during the period. For each fiscal year reported, the diluted net loss per share is the same as the basic net loss per share because all stock options, warrants, contingent shares, and Series B Preferred shares are antidilutive with respect to computing the net loss per share and therefore are excluded from the calculation of diluted net loss per share. The total number of shares that the Company excluded from the calculations of net loss per share were 70,007,901 shares for the nine month period ending September 30, 2013, 1,691,632 shares for the nine month period ending September 30, 2012, and 4,370,105 for the year ending December 30, 2012.

Recent Accounting Pronouncements

On February 5, 2013, the FASB issued ASU no. 2013-02 which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income (AOCI). The ASU is intended to help entities improve the transparency of changes in other comprehensive income (OCI) and items reclassified out of AOCI in their

financial statements. It does not amend any existing requirements for reporting net income or OCI in the financial statements. For public entities, the new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. For nonpublic entities, the ASU is effective for fiscal years beginning after December 15, 2013, and interim and annual periods thereafter. The Company elected to early adopt this standard which did not result in any changes to the consolidated financial statements.

2. Liquidity

The Company has prepared the accompanying consolidated financial statements on a going concern basis, which assumes that the Company will realize its assets and satisfy its liabilities in the normal course of business. However, the Company has incurred net losses since its inception, has negative operating cash flows and has an accumulated deficit of $330 million and $320.4 million as of September 30, 2013 and December 31, 2012, respectively. These circumstances raise substantial doubt about the Company s ability to continue as a going concern. The accompanying financial statements do not include any adjustments to reflect

F-8

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

2. Liquidity (continued)

the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of the uncertainty concerning the Company s ability to continue as a going concern.

The Company believes that its current resources will only be sufficient to fund operations into the first quarter of 2014. This estimate is based on the Company s ability to manage its staffing expenses and its working capital and actual results could differ from its estimates. The Company is seeking additional financing in order to fund operations through 2014; however, the Company cannot provide assurances that it will be successful in obtaining additional financing for these periods or as needed in the future. If the Company does not raise additional funds by the first quarter of 2014, it plans to implement cost reduction measures, such as a reduction in workforce, reducing its intellectual property prosecution, reducing other operating activities, and/or the pursuit of alternative financing transactions that would likely be on terms disadvantageous to the Company and dilutive to its shareholders. The Company could also be required to relinquish rights to its technology or product candidates or in-licensed technology on unfavorable terms, either of which would reduce the ultimate value of the technology or product candidates, or to sell assets likely at values significantly below their potential worth. If the Company is unable to secure additional capital, it may be required to cease operations, declare bankruptcy or otherwise wind up its business.

3. Business Combinations

On November 9, 2012, the Company acquired Australia-based Special Phage Services (SPS). The combination of the two companies results in the creation of a leading anti-infective company focused on developing phage-based therapies to combat the growing threat of antibiotic-resistant infection. In a share exchange transaction, AmpliPhi Australia Pty Limited, a wholly owned subsidiary of US-based AmpliPhi, acquired Sydney-based SPH, the holding company of SPS. Under the terms of the acquisition the Company offered 40 million shares of its common stock in exchange for 100% of the fully diluted share capital of SPH. 20 million shares are held in escrow, 8 million to satisfy potential warranty claims under the transaction documents and the remaining 12 million shares are held pending completion of certain milestones. As part of this transaction, the Company acquired $260,000 in assets to include a $221,000 receivable for an Australian research and development tax refund, $37,000 in equipment, and $2,000 in cash. The Company also assumed liabilities of $613,000.

On January 6, 2011, the Company acquired Biocontrol, a clinical development stage biotechnology company in the United Kingdom (the Acquisition). Biocontrol was formed in 1997 to develop bacteriophage-based therapeutics. The Acquisition allows the Company to extend its product reach into bacteriophage-based products. The Company acquired 100% of the voting stock of Biocontrol and issued 22,817,198 shares of its common stock to the Biocontrol shareholders with a total fair value of approximately $8.6 million as of January 6, 2011. The Acquisition was made through an acquisition subsidiary, which has continued post-Acquisition as Biocontrol.

4. Collaborative and Other Agreements

In June 2013, the Company entered into a Collaborative Research and Development Agreement (CRADA) with the United States Army Medical Research and Materiel Command (USAMRMC) and the Walter Reed Army Institute of Research (WRAIR). The CRADA will focus on developing and commercializing bacteriophage therapeutics to treat *S. aureus*, *E. coli* and *P. aeruginosa* infections.

In March 2013, the Company entered into an Exclusive Channel Collaboration Agreement with Intrexon Corporation. This agreement allows the Company to utilize Intrexon s synthetic biology platform for the identification, development and production of bacteriophage-containing human therapeutics. The Company paid a one-time technology access fee to Intrexon of $3,000,000 in common stock. The Company shall pay Intrexon, in cash or stock, milestone fees for the initiation of a Phase 2 trial of $2,500,000 upon

F-9

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

4. Collaborative and Other Agreements (continued)

commencement of the first Phase 2 trial and $5,000,000 upon the first regulatory approval of any product in any major market country. With regard to each product sold by the Company, the Company will pay, in cash, tiered royalties on a quarterly basis based on net sales of AmpliPhil Products, calculated on a product-by-product basis.

In June 2012, the Company sold all of its assets used in its gene therapy business including process development, quality control, quality assurance, manufacturing and bioanalytical functions for $3.0 million. In addition to this cash consideration, the Company may receive a long-term royalty of 1.75% on certain product sales. This royalty may be completely canceled at any time by a one-time payment of $1.75 million.

5. Preferred Shares

On June 13, 2013, the Company s Board of Directors approved a resolution designating 9,357,935 shares of Preferred Stock as Series B Convertible Preferred Stock with an initial stated value of $1.40 and par value of $0.01. Each Series B preferred share is convertible into 10 shares of common stock and is entitled to the number of votes equal to the number of shares of common stock. These Series B shares may be converted to common stock by the holder of the shares at any time. The Series B shares shall be automatically converted into common shares upon the closing of an underwritten initial public offering with aggregate proceeds to the Company of at least $7 million and a price per share to the public of at least the Series B stated value upon the closing of which the shares of common stock of the Company shall be listed for trading on the New York Stock Exchange. Until conversion, the holders of Series B Preferred shares shall be entitled to receive dividends of 10% of the Series B stated value per annum.

On June 26, 2013, the Company issued 4,999,999 shares of the Company s newly-created Series B Convertible Preferred Stock and warrants to purchase 12,499,996 shares of common stock at an exercise price of $0.14 per share for an aggregate purchase price of $6,999,998. As part of the same transaction, the Company converted $5,491,001 in outstanding convertible loan notes into 4,357,936 shares of Series B Convertible Preferred Stock and warrants to purchase 10,894,839 shares of common stock at an exercise price of $0.14 per share. On July 15, 2013, the remaining outstanding convertible loan notes, totaling $829,277, were converted into 658,145 shares of Series B Convertible Preferred Stock and warrants to purchase 1,645,361 shares of common stock at an exercise price of $0.14 per share. As a result of this financing, all outstanding convertible notes were converted into shares of Series B Convertible Preferred Stock and warrants to purchase common stock.

6. Convertible Loan Notes

On February 1, 2013, the Company s Board of Directors approved the issuance of new convertible promissory notes in an aggregate principal amount not to exceed $7,500,000, together with warrants to purchase shares of common stock of the Company. Interest on the unpaid principal balance of these notes shall accrue from the investment date at the

rate of ten percent (10%) per annum. The warrants have the right to purchase the number of shares of the Company s common stock equal to twenty five percent (25%) of the principal amount of such holder s note divided by $0.14. The company issued $2,000,000 in new convertible loan notes from February through May 2013, converted $1,900,000 of previous convertible loan notes and accrued interest into this new security, and issued warrants for 7,030,387 share of common stock. $229,000 of interest expense was accrued for all convertible loan notes held through September 30, 2013.

As a result of the private placement of Series B Convertible Preferred Stock that consisted of two closings, occurring on June 26, 2013 and July 15, 2013, respectively, all outstanding convertible notes were converted into shares of Series B Convertible Preferred Stock and warrants to purchase shares of common stock at an exercise price of $0.14 per share. On June 26, 2013, as part of the first closing, the Company converted $5,491,001 in outstanding convertible loan notes into 4,357,936 shares of Series B Convertible Preferred Stock and warrants to purchase 10,894,839 shares of common stock at an exercise price of

F-10

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

6. Convertible Loan Notes (continued)

$0.14 per share. On July 15, 2013, the remaining outstanding convertible loan notes, totaling $829,277, were converted into 658,145 shares of Series B Convertible Preferred Stock and warrants to purchase 1,645,361 shares of common stock at an exercise price of $0.14 per share.

7. Stock Options and Warrants

The Company follows ASC 815-40, *Contracts in an Entity s Own Equity*, as it relates to outstanding warrants. No warrants were exercised through September 30, 2013.

In connection with the private placement of Series B Convertible Preferred Stock, which occurred through two closings on June 26, 2013 and July 15, 2013, respectively, the Company issued an aggregate of warrants to purchase 30,040,194 shares of common stock at an exercise price of $0.14 per share. These warrants expire June 2018. These warrants contain provisions that protect holders from a decline in the issue price of the Company s common stock (down-round provision) and contain net settlement provisions. Due to these provisions, the Company accounted for these warrants as liabilities instead of equity. The Company measured the fair value of these warrants on June 26, 2013 and July 15, 2013 and recorded the initial liability as part of the private placement proceeds. The Company re-measured the fair value of these warrants and recorded a $10,089,000 charge to record the liabilities associated with these warrants at their estimated fair values totaling $14,865,000 as of September 30, 2013. We estimate the fair values of these securities using a Black Scholes valuation model.

From February through May 2013, in connection with the issuance of new convertible promissory notes, the Company issued warrants to purchase up to 7,030,387 shares of its common stock. These warrants expire February through May 2018 and are exercisable at a price of $0.14 per share. These warrants are considered to be equity.

On December 22, 2011, in connection with the Biocontrol business combination, the Company issued warrants to purchase up to 1,355,164 shares of its common stock. These warrants expire in December 2016 and are exercisable at a price of $0.46 per share. These warrants are considered to be equity.

Stock-Based Compensation

The Company s Stock Incentive Plan provides for the issuance of long-term incentive awards, or Awards, in the form of non-qualified and incentive stock options, or Options, stock appreciation rights, stock grants and restricted stock units. The Awards may be granted by the Company s Board of Directors to its employees, directors and officers and to consultants, agents, advisors and independent contractors who provide services to the Company. The exercise price for Options must not be less than the fair market value of the underlying shares on the date of grant. Options expire no later than ten years from the date of grant and generally vest and become exercisable over a four-year period following

the date of grant. Every non-employee member of the Company s Board of Directors receives an annual non-qualified Option or restricted stock unit grant. Upon the exercise of Options, the Company issues the resulting shares from shares reserved for issuance under the Company s Incentive Plan.

Under ASC 718-10, *Share-Based Payment*, the Company is required to expense the fair value of share-based payments granted over the vesting period. The Company values Awards granted at their grant date fair value in accordance with the provisions of ASC 718-10 and recognizes stock-based compensation expense on a straight-line basis over the service period of each award.

Stock-based compensation expense is reduced by an estimated forfeiture rate derived from historical employee termination behavior. If the actual number of forfeitures differs from the Company s estimates, the Company may record adjustments to increase or decrease compensation expense in future periods. There were no significant adjustments related to changes in the Company s estimates for the nine months ended September 30, 2013 and year ended December 31, 2012.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

7. Stock Options and Warrants (continued)

Following is a summary of the amount included as stock-based compensation expense in the accompanying consolidated statements of operations and comprehensive gain (loss):

	Nine Months Ended September 30, 2013 (Unaudited)	Year Ended December 31, 2012
Stock options:		
Research and development expense	$ 153,000	$
General and administrative expense	1,053,000	2,000
Restricted stock units:		
Research and development expense		
General and administrative expense		7,000
Total stock-based compensation expense	$ 1,206,000	$ 9,000

The following table summarizes Option activity:

	Shares	Weighted Average Exercise Price	Average Remaining Contractual Term (Years)	Intrinsic Value
Outstanding at December 31, 2012	13,749,552	$ 0.21		
Granted	11,600,000	0.16		
Exercised				
Forfeited	(284,375)	0.20		
Expired	(2,500)	5.70		
Outstanding at September 30, 2013	25,062,677	$ 0.19	9.36	$ 6,400,060
Exercisable at September 30, 2013	7,149,503	$ 0.19	9.40	$ 2,381,189

The aggregate intrinsic value is determined using the closing price of the Company s common stock of $0.51 on September 30, 2013.

As of September 30, 2013, the Company had unrecognized compensation cost related to unvested Options of approximately $2,032,854 net of estimated forfeitures, which the Company expects to recognize over a weighted average period of approximately three years.

The fair value of each Option is estimated on the date of the grant using the Black-Scholes-Merton option pricing model. The following are the assumptions for the periods in which there were Options granted:

Expected Dividend: The Company does not anticipate any dividends.

Expected Life: The expected life represents the period that the Company expects its stock-based Awards to be outstanding. The Company determines life based on historical experience and vesting schedules of similar awards.

Expected Volatility: The Company s expected volatility represents the weighted average historical volatility of the shares of its common stock for the most recent four-year periods.

Risk-Free Interest Rate: The Company based the risk-free interest rate used on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term. Where the expected term of its stock-based awards does not correspond with the terms for which interest rates are quoted, the Company performs a straight-line interpolation to determine the rate from the available term maturities.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Nine Months Ended September 30, 2013 (Unaudited)

7. Stock Options and Warrants (continued)

Forfeiture Rate: The Company applies an estimated forfeiture rate that is derived from historical forfeited shares. If the actual number of forfeitures differs from its estimates, the Company may record additional adjustments to compensation expense in future periods.

Reserved Shares

As of September 30, 2013, the Company had reserved shares of its common stock for future issuance as follows:

	Shares Reserved
Stock options outstanding	25,062,677
Available for future grants under the Stock Incentive Plan	11,242,083
Warrants	38,425,745
Total Shares reserved	**74,730,505**

F-13

TABLE OF CONTENTS

Report of Independent Registered Public Accounting Firm

To the Board of Directors
AmpliPhi Biosciences Corporation and Subsidiaries
Richmond, Virginia

We have audited the accompanying consolidated balance sheets of AmpliPhi Biosciences Corporation and Subsidiaries (Company) (a Washington corporation) as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income (loss), stockholders equity, and cash flows for each of the years in the two-year period ended December 31, 2012. AmpliPhi Biosciences Corporation and Subsidiaries management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AmpliPhi Biosciences Corporation and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has had recurring losses from operations and has an accumulated deficit that raise substantial doubt about its ability to continue as a going concern. Management s plans in regard to those matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 12 to the financial statements, the 2012 financial statements have been restated to correct a misstatement.

/s/ PBMares, LLP

Richmond, Virginia
October 28, 2013, except for Note 12, as to which date is February 3, 2014

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Balance Sheets

	December 31, 2012	2011
Assets		
Current assets		
Cash and cash equivalents	$862,000	$1,096,000
Accounts receivable	23,000	122,000
Tax refund	618,000	250,000
Prepaid expenses and other current assets	148,000	150,000
Total current assets	1,651,000	1,618,000
Property and equipment, net of accumulated depreciation of $294,000 and $268,000 as of December 31, 2012 and December 31, 2011, respectively	138,000	138,000
Goodwill	17,567,000	9,726,000
Total assets	$19,356,000	$11,482,000
Liabilities and stockholders equity		
Current liabilities		
Convertible loan notes	$3,648,000	$
Accounts payable and accrued expenses	1,937,000	1,506,000
Accrued interest	465,000	
Total current liabilities	6,050,000	1,506,000
Long term liabilities		
Convertible loan notes		2,698,000
Accrued interest		126,000
Total long term liabilities		2,824,000
Total liabilities	6,050,000	4,330,000
Commitments and Contingencies (Note 5)		
Stockholders equity		
Preferred stock, $0.01 par value, 10,000,000 shares authorized; none issued and outstanding		
Common stock, $0.01 par value, 445,000,000 shares authorized, 66,908,810 shares issued and outstanding at December 31, 2012 and 44,908,810 shares issued and outstanding at December 31, 2011	669,000	449,000
Additional paid-in capital	329,707,000	326,080,000
Paid-in-capital Contingent shares	3,400,000	
Accumulated other comprehensive loss	(106,000)	(92,000)
Accumulated deficit	(320,364,000)	(319,285,000)
Total stockholders equity	13,306,000	7,152,000
Total liabilities and stockholders equity	$19,356,000	$11,482,000

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

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Statements of Operations and Comprehensive Loss

	Year Ended December 31,	
	2012	2011
Revenue		
Licensing revenue	$664,000	$120,000
Total revenue	664,000	120,000
Operating expenses		
Research and development	1,480,000	707,000
General and administrative	3,177,000	3,326,000
Total operating expenses	4,657,000	4,033,000
Loss from continuing operations	(3,993,000)	(3,913,000)
Other income (expense)		
Interest expense, net	(339,000)	(128,000)
Tax refund and other income	133,000	264,000
Loss on disposal of assets	(30,000)	(10,000)
Other income (expense), net	(236,000)	126,000
Net loss from continuing operations	(4,229,000)	(3,787,000)
Discontinued Operations		
Gain on sale of discontinued operations assets	3,150,000	
Net Loss	$(1,079,000)	$(3,787,000)
Net loss from continuing operations per share basic & diluted	$(0.09)	$(0.08)
Gain from discontinued operations per share basic & diluted	$0.07	$
Net loss per share basic & diluted	$(0.02)	$(0.08)
Weighted average number of shares of common stock outstanding basic & diluted	48,034,493	44,564,027
Other comprehensive loss		
Net unrealized foreign currency translations	(14,000)	(92,000)
Comprehensive loss	$(1,093,000)	$(3,879,000)

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

F-16

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Statements of Stockholders Equity (Deficit)

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

F-17

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2012	2011
Cash flows from operating activities		
Net loss	$(4,229,000)	$(3,787,000)
Adjustments required to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation	60,000	80,000
Loss on sale/disposal of fixed assets	30,000	10,000
Stock-based compensation	9,000	85,000
Changes in operating assets and liabilities net of acquisitions:		
Accounts receivable	99,000	157,000
Tax refund	(133,000)	(250,000)
Accounts payable and accrued expenses	(458,000)	(1,001,000)
Prepaid expenses and other assets	2,000	(85,000)
Interest on loan notes	339,000	126,000
Net cash used in operating activities	(4,281,000)	(4,665,000)
Cash flows from investing activities		
Gain on sale of discontinued operations assets	3,150,000	
Purchases of property and equipment	(53,000)	(106,000)
Net cash provided by (used in) investing activities	3,097,000	(106,000)
Cash flows from financing activities		
Proceeds from issuance of convertible loan notes	950,000	2,492,000
Net cash provided by financing activities	950,000	2,492,000
Net increase (decrease) in cash and cash equivalents	(234,000)	(2,279,000)
Cash and cash equivalents, beginning of year	1,096,000	3,375,000
Cash and cash equivalents, end of year	$862,000	$1,096,000

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

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

1. Nature of Business and Significant Accounting Policies

Nature of Business

AmpliPhi Biosciences Corporation (the Company) was incorporated in the state of Washington in 1989 under the name Targeted Genetics Corporation. In February 2011, Targeted Genetics Corporation changed its name to AmpliPhi Biosciences Corporation. The Company, headquartered in Richmond, Virginia, is dedicated to developing novel antibacterial solutions called bacteriophage (phage). Phages are naturally occurring viruses that preferentially target and kill their bacterial targets.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries Ampliphi Australia Pty Ltd, Biocontrol Limited, Genovo, Inc. (inactive), and TGCF Manufacturing Corporation (inactive). All significant intercompany accounts and transactions have been eliminated. All numbers on the financial statements and disclosures have been rounded to the nearest 1,000.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers cash equivalents to be short-term investments that have a maturity at the time of purchase of three months or less, are readily convertible into cash and have an insignificant level of valuation risk attributable to potential changes in interest rates. Cash equivalents are recorded at cost, which approximates fair market value, and consist primarily of money market accounts.

Restricted Cash

The Company maintains a cash account for the payment of employee wages through HR Novations.

Accounts Receivable

Accounts receivable amounts are stated at their face amounts less any allowance. Provisions for doubtful accounts are estimated based on assessment of the probable collection from specific customer accounts and other known factors. If an account was determined to be uncollectible (payment has not been made in accordance with contract terms), it would be written off against the allowance. As of December 31, 2012 and 2011, management determined no allowance for doubtful accounts was required.

Property and Equipment

Property and equipment are recorded at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets, generally three to seven years.

Prepaid Expenses and Other Current Assets

Prepaid and other current assets as of December 31, 2012 and 2011 consist primarily of prepaid insurance and deposits.

Goodwill

Costs of investments in purchased companies in excess of the underlying fair value of net assets at the date of acquisition are recorded as goodwill and assessed annually for impairment. If considered impaired, goodwill will be written down to fair value and a corresponding impairment loss recognized.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

1. Nature of Business and Significant Accounting Policies (continued)

During the year ended December 31, 2012, the rights to SPH Holdings Pty Ltd s know-how and phage libraries were acquired by the business combination described in Note 9 for $6,800,000. At December 31, 2012, goodwill in the amount of $7,841,000 has been recorded for these patents as SPH Holdings Pty Ltd had a negative stockholders equity balance of approximately $800,000 at the time of the transaction. In management s opinion, no goodwill has been impaired as of December 31, 2012.

During the year ended December 31, 2011, the rights to Biocontrol Limited s patents and phage libraries were acquired by the business combination described in Note 9 for $8,584,000. At December 31, 2011, goodwill in the amount of $9,726,000 has been recorded for these patents as Biocontrol had a negative stockholders equity balance of approximately $3.5 million at the time of the transaction. In management s opinion, no goodwill has been impaired as of December 31, 2012.

Stock-based Compensation

The Company accounts for stock-based payments under the guidance of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 718-10, *Stock Compensation*, which requires measurement of compensation cost for all share-based payment awards at fair value on the date of grant and recognition of compensation cost over the requisite service period (typically the vesting period) for awards expected to vest.

Revenue Recognition

The Company generates revenue from technology licenses, collaborative research arrangements and agreements to provide research and development services. Revenue under technology licenses typically consists of nonrefundable, up-front license fees, technology access fees and various other payments. The Company recognizes revenue associated with performance milestones as earned, typically based upon the achievement of the specific milestones defined in the applicable agreements.

The Company recognizes revenue under research and development contracts as the related costs are incurred. When contracts include multiple elements, the Company follows ASC 605-25, *Multiple Element Arrangements*, which requires the Company to satisfy the following before revenue can be recognized:

The delivered items have value to the customer on a stand-alone basis;
Any undelivered items have objective and reliable evidence of fair value; and
Delivery or performance is probable and within the Company s control for any delivered items that have a right of return.

The Company classifies advance payments received in excess of amounts earned as deferred revenue.

Based upon the terms specified in its collaboration agreements, the Company receives advance payments from some of its collaboration partners before the project has been performed. These payments are deferred and recognized as revenue when the costs are incurred.

Research and Development Costs

Research and development costs include salaries, costs of outside collaborators and outside services, royalty and license costs and allocated facility, occupancy and utility expenses. The Company expenses research and development costs as incurred.

Net Loss per Common Share

Net loss per common share is based on net loss divided by the weighted average number of common shares outstanding during the period. For each fiscal year reported, the diluted net loss per share is the same as the basic net loss per share because all stock options, warrants and contingent shares are antidilutive with

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

1. Nature of Business and Significant Accounting Policies (continued)

respect to computing the net loss per share and therefore are excluded from the calculation of diluted net loss per share. The total number of shares that the Company excluded from the calculations of net loss per share were 4,370,105 shares for the year ending December 31, 2012 and 374,283 for the year ending December 31, 2011.

Recent Accounting Pronouncements

In September 2011, the FASB issued Accounting Standards Update (ASU) no. 2011-08, Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment that simplifies how public and nonpublic entities test goodwill for impairment. The amendments permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in FASB Accounting Standards Codification Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50%. The guidance also includes examples of the types of events and circumstances to consider in conducting the qualitative assessment. The amendments will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company elected to early adopt this standard and used these new guidelines in assessing goodwill impairment for the consolidated financial statements.

On February 5, 2013, the FASB issued ASU no. 2013-02 which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income (AOCI). The ASU is intended to help entities improve the transparency of changes in other comprehensive income (OCI) and items reclassified out of AOCI in their financial statements. It does not amend any existing requirements for reporting net income or OCI in the financial statements. For public entities, the new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. For nonpublic entities, the ASU is effective for fiscal years beginning after December 15, 2013, and interim and annual periods thereafter. The Company elected to early adopt this standard which did not result in any changes to the consolidated financial statements.

On February 5, 2013, the FASB issued ASU no. 2013-02 which adds new disclosure requirements for items reclassified out of accumulated other comprehensive income (AOCI). The ASU is intended to help entities improve the transparency of changes in other comprehensive income (OCI) and items reclassified out of AOCI in their financial statements. It does not amend any existing requirements for reporting net income or OCI in the financial statements. For public entities, the new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. For nonpublic entities, the ASU is effective for fiscal years beginning after December 15, 2013, and interim and annual periods thereafter. The Company elected to early adopt this standard which did not result in any changes to the consolidated financial statements.

2. Liquidity

The Company has prepared the accompanying consolidated financial statements on a going concern basis, which assumes that the Company will realize its assets and satisfy its liabilities in the normal course of business. However, the Company has incurred net losses since its inception, has negative operating cash flows and has an accumulated deficit of $320.4 million as of December 31, 2012. These circumstances raise substantial doubt about the Company s ability to continue as a going concern. The Company s cash balance as of December 31, 2012 was $862,000, the accounts receivable balance was $641,000 and the current liabilities were $6,050,000. $4,113,000 of the current liabilities are the convertible loan notes and accrued interest that may be converted to another security and extend the maturity date. The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of the uncertainty concerning the Company s ability to continue as a going concern.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

2. Liquidity (continued)

The Company believes that its current resources, in addition to the revenue received in February and March 2013 detailed in the Subsequent Events disclosure (Note 12), will only be sufficient to fund operations into the second quarter of 2013. This estimate is based on the Company s ability to manage its staffing expenses and its working capital and actual results could differ from its estimates. The Company is seeking additional financing in order to fund operations through 2013; however, the Company cannot provide assurances that it will be successful in obtaining additional financing for these periods or as needed in the future. If the Company does not raise additional funds by the second quarter of 2013, it plans to implement cost reduction measures, such as a reduction in workforce, reducing its intellectual property prosecution, reducing other operating activities, and/or the pursuit of alternative financing transactions that would likely be on terms disadvantageous to the Company and dilutive to its shareholders. The Company could also be required to relinquish rights to its technology or product candidates or in-licensed technology on unfavorable terms, either of which would reduce the ultimate value of the technology or product candidates, or to sell assets likely at values significantly below their potential worth. If the Company is unable to secure additional capital, it may be required to cease operations, declare bankruptcy or otherwise wind up its business.

3. Property and Equipment

Property and equipment consist of the following:

	December 31,	
	2012	2011
Furniture and equipment	$ 529,000	$ 406,000
Less: accumulated depreciation	(391,000)	(268,000)
Total furniture and equipment, net	$ 138,000	$ 138,000

Depreciation expense totaled $60,000 and $80,000 for the years ended December 31, 2012 and 2011, respectively.

During the periods ending December 31, 2012 and 2011, the Company sold or disposed of certain property and equipment no longer used as a result of the reprioritization of its business priorities. The Company recognized net losses of $30,000 and $10,000 on the disposal of property and equipment in the consolidated statements of operations and comprehensive loss for the years ended December 31, 2012 and 2011, respectively.

4. Income Taxes

At December 31, 2012, the Company had US and UK net operating loss carry-forwards, or NOLs, of approximately $170.4 million and research tax credit carry-forwards of approximately $4.3 million. The carry-forwards began to expire in 2012, and may be further subject to the application of Section 382 of the Code, as discussed further below.

The Company has provided a valuation allowance to offset the deferred tax assets due to the uncertainty of realizing the benefits of the net deferred tax asset.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

4. Income Taxes (continued)

Significant components of our US deferred tax assets and liabilities were as follows:

	December 31, 2012	2011
Deferred tax assets		
Net operating loss carry-forwards	$ 57,774,000	$ 62,391,000
Capital loss carry-forwards		109,000
Research and orphan drug credit carry-forwards	4,297,000	4,847,000
Depreciation and amortization	2,000	53,000
Restructure and other	467,000	666,000
Gross deferred tax assets	62,540,000	68,066,000
Valuation allowance for deferred tax assets	(62,540,000)	(68,066,000)
Net deferred tax asset	$	$

The change in the valuation allowance was a $5.5 million decrease in 2012 and a $3.9 million decrease in 2011. All of the capital losses generated by the sale of CellExSys and Chromos have expired as of 2012.

The past sales and issuances of stock have likely resulted in ownership changes as defined by Section 382 of the Code. A study has not been done at this time because the full valuation allowance eliminating potential profit and loss adjustments due to changes in the gross amount of the NOLs and credits would be offset by a change in the valuation allowance. It is possible that a future analysis may result in the conclusion that a substantial portion, or perhaps substantially all, of the NOLs and credits will expire due to the limitations of Sections 382 and 383 of the Code. As a result, the utilization of our net operating losses and tax credits may be limited and a portion of the carry-forwards may expire unused.

The Company adopted the provisions of ASC 740, *Income Taxes*, the successor of FASB Interpretation 48, Accounting for Uncertainty in Income Taxes, or FIN 48, on January 1, 2007. Previously, the Company had accounted for tax contingencies in accordance with ASC 450, *Contingencies*, the successor of SFAS 5*, Accounting for Contingencies*. As required by FIN 48, the Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, the Company applied FIN 48 to all tax positions for which the statute of limitations remained open. The Company does not have any material unrecognized tax benefits as of December 31, 2012.

The Company is subject to income taxes in the U.S. federal jurisdiction as well as in the United Kingdom for any activity of Biocontrol Ltd and in Australia for any activity of Special Phage Holdings Pty Ltd. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, the Company is no longer subject to U.S. federal tax examinations by tax authorities for the years before 2009. However, tax years from 1998 to 2008 may be subject to examination in the event that the Company utilizes the NOLs from those years in our current or future year tax returns.

The Company has a policy of recognizing interest and penalties accrued related to unrecognized tax benefits as additional tax expense for all periods presented. During the years ended December 31, 2012, 2011 and 2010 the Company did not recognize any interest and penalties. The Company has not accrued any interest and penalties at December 31, 2012 and December 31, 2011.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

4. Income Taxes (continued)

For the year ending December 31, 2012, the Company had a UK research and development tax refund of $135,000 (£85,000) for the losses in the UK subsidiary and an Australian research and development tax refund of $221,000 (USD) for the losses in the Australian subsidiary. The Company also has a 2011 UK research and development tax refund as of December 31, 2012 of $262,000 which was received in January 2013.

5. Commitments and Contingencies

As part of the acquisition of SPH Holdings Pty Ltd (Note 9), the Company paid $100,000 and issued an additional 2,000,000 shares of common stock to Cellabs Pty Ltd (Cellabs) as part of a repayment agreement for its outstanding loans to SPH Holdings Pty Ltd. In July 2013, the Company will pay an additional $50,000 to Cellabs. The remaining loan balance of $200,000 will be repaid either by 10% of any proceeds received by the Company until Cellabs has received $200,000, or, starting in May 2014; the Company shall pay the remaining balance in monthly installments equal to the lesser of $10,000 or the amount remaining unpaid at the time of payment.

In February 2011, the Company entered into an agreement with Virginia Biotechnology Research Partnership Authority for Richmond, Virginia laboratory space. This agreement has a contractual expiration date of February 29, 2012 at which time it converted to a rolling three-month lease. At December 31, 2012, the Company s minimum payment commitment for the Company s Richmond, Virginia laboratory space was $4,800.

In December 2011, the Company entered into an agreement with Nevis Limited and Charter Limited for laboratory space in Bedfordshire, United Kingdom. This agreement has a minimum period of 3 years and a contractual expiration date of December 8, 2016. At December 31, 2012, the Company s minimum payment commitment for the Company s Bedfordshire laboratory space was $266,000.

The Company recognized rent expense under operating leases of $146,000 in 2012 and $148,000 in 2011.

The Company is subject to legal claims and actions related to the operations of its business. The Company does not expect the ultimate outcome of any such actions to have a material impact on its consolidated financial position or results of operations.

6. Stock Options and Warrants

On December 22, 2011, in connection with the Biocontrol business combination in Note 9, the Company issued warrants to purchase up to 1,355,164 shares of its common stock. These warrants expire in December 2016 and are exercisable at a price of $0.46 per share.

On June 27, 2007, in connection with a private placement, the Company issued additional warrants to purchase up to 7.6 million shares of its common stock. These warrants were to originally expire in June 2012 and were originally exercisable at a price of $3.25 per share. The Company also issued a warrant to purchase 334,989 shares of its common stock, with the same terms as those issued pursuant to this private placement, as compensation to the placement agent in this transaction. In connection with the acquisition of Biocontrol Limited (see Note 9), and in return for suspension or waiver of certain provisions within the June 27, 2007 warrant agreements, the Company modified these warrant agreements in November 2010. The exercise price of the warrants was reset to $1.50 per share and the warrants now expire in June 2013.

On January 11, 2007, in connection with a private placement, the Company issued warrants to purchase up to 763,000 shares of its common stock. These warrants expired in January 2012.

The Company follows ASC 815-40, *Contracts in an Entity s Own Equity*, as it relates to outstanding warrants. All of the Company s outstanding warrants are considered to be equity under this guidance. No warrants were exercised in 2012 or 2011.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

6. Stock Options and Warrants (continued)

Stock-Based Compensation

The Company s Stock Incentive Plan provides for the issuance of long-term incentive awards, or Awards, in the form of non-qualified and incentive stock options, or Options, stock appreciation rights, stock grants and restricted stock units. The Awards may be granted by the Company s Board of Directors to its employees, directors and officers and to consultants, agents, advisors and independent contractors who provide services to the Company. The exercise price for Options must not be less than the fair market value of the underlying shares on the date of grant. Options expire no later than ten years from the date of grant and generally vest and become exercisable over a four-year period following the date of grant. Restricted stock units generally vest over a three-year period following the date of grant. Every non-employee member of the Company s Board of Directors receives an annual non-qualified Option or restricted stock unit grant. Upon the exercise of Options and the vesting of restricted stock units, the Company issues the resulting shares from shares reserved for issuance under the Company s Incentive Plan.

Under ASC 718-10, *Share-Based Payment*, the Company is required to expense the fair value of share-based payments granted over the vesting period. The Company values Awards granted at their grant date fair value in accordance with the provisions of ASC 718-10 and recognizes stock-based compensation expense on a straight-line basis over the service period of each award.

Stock-based compensation expense is reduced by an estimated forfeiture rate derived from historical employee termination behavior. If the actual number of forfeitures differs from the Company s estimates, the Company may record adjustments to increase or decrease compensation expense in future periods. There were no significant adjustments related to changes in the Company s estimates for the years ending December 31, 2012 or 2011.

Following is a summary of the amount included as stock-based compensation expense in the accompanying consolidated statements of operations:

Year ended December 31,	2012	2011
Stock options:		
Research and development expense	$	$
General and administrative expense	2,000	
Restricted stock units:		
Research and development expense		
General and administrative expense	7,000	85,000
Total stock-based compensation expense	$ 9,000	$ 85,000

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

6. Stock Options and Warrants (continued)

The following table summarizes Option activity:

	Shares	Weighted Average Exercise Price	Average Remaining Contractual Term (Years)	Intrinsic Value
Outstanding at December 31, 2010	1,116,096	1.64		
Granted				
Exercised				
Forfeited	(82,032)	0.27		
Expired	(743,196)	2.21		
Outstanding at December 31, 2011	340,868	0.74		
Granted	13,581,052	0.20		
Exercised				
Forfeited				
Expired	(172,368)	0.52		
Outstanding at December 31, 2012	13,749,552	$ 0.21	6.49	$
Exercisable at December 31, 2012	194,552	$ 0.87	6.49	$

The aggregate intrinsic value is determined using the closing price of the Company s common stock of $0.18 on December 31, 2012.

As of December 31, 2012, the Company had unrecognized compensation cost related to unvested Options of approximately $1,679,000 net of estimated forfeitures, which the Company expects to recognize over a weighted average period of approximately four years.

The fair value of each Option is estimated on the date of the grant using the Black-Scholes-Merton option pricing model. There were 13,581,052 options granted in the year ended December 31, 2012 and no options granted in 2011. The following are the assumptions for the periods in which there were Options granted:

Expected Dividend: The Company does not anticipate any dividends.

Expected Life: The expected life represents the period that the Company expects its stock-based Awards to be outstanding. The Company determines life based on historical experience and vesting schedules of similar awards.

Expected Volatility: The Company s expected volatility represents the weighted average historical volatility of the shares of its common stock for the most recent four-year and five-year periods.

Risk-Free Interest Rate: The Company based the risk-free interest rate used on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term. Where the expected term of its stock-based awards does not correspond with the terms for which interest rates are quoted, the Company performs a straight-line interpolation to determine the rate from the available term maturities.

Forfeiture Rate: The Company applies an estimated forfeiture rate that is derived from historical forfeited shares. If the actual number of forfeitures differs from its estimates, the Company may record additional adjustments to compensation expense in future periods.

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

6. Stock Options and Warrants (continued)

The following table summarizes activity related to the Company s restricted stock units:

	Shares	Weighted-Average Grant Date Fair Value per Share
December 31, 2010	157,669	$ 0.44
Granted		
Vested	(97,669)	0.50
Forfeited		
December 31, 2011	60,000	$ 0.34
Granted		
Vested	(60,000)	$ 0.34
Forfeited		
December 31, 2012		$

The fair value of each Award is estimated on the date of the grant using the closing market price of the Company s common stock. As of December 31, 2012, there is no unrecognized compensation cost related to unvested restricted stock units.

Reserved Shares

As of December 31, 2012, the Company had reserved shares of its common stock for future issuance as follows:

	Shares Reserved
Stock options and restricted stock units outstanding	13,749,552
Available for future grants under the Stock Incentive Plan	22,741,689
Warrants	8,389,946
Total Shares reserved	**44,881,187**

7. Discontinued Operations

In June 2012, the Company sold all of its assets used in its gene therapy business including process development, quality control, quality assurance, manufacturing and bioanalytical functions for $3.0 million. In addition to this cash consideration, the Company may receive a long term royalty of 1.75% on certain product sales. This royalty may be completely canceled at any time by a one-time payment of $1.75 million.

8. Employee Retirement Plan

The Company sponsors an employee retirement plan under Section 401(k) of the Internal Revenue Code of 1986, as amended. All of the Company s employees who meet minimum eligibility requirements are eligible to participate in the plan. Matching contributions to the 401(k) plan are made at the discretion of the Company s Board of Directors. The Company suspended matching contributions effective January 1, 2009.

9. Business Combinations

On November 9, 2012, the Company acquired Australia-based Special Phage Services (SPS). The combination of the two companies results in the creation of a leading anti-infective company focused on developing phage-based therapies to combat the growing threat of antibiotic-resistant infection. In a share exchange transaction, AmpliPhi Australia Pty Limited, a wholly owned subsidiary of US-based AmpliPhi, acquired Sydney-based Special Phage Holdings Pty Ltd (SPH), the holding company of SPS. Under the terms of the acquisition, the Company offered 40 million shares of its common stock in exchange for 100% of the fully diluted share capital of SPH. 20 million shares were held in escrow, 8 million to satisfy potential

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

9. Business Combinations (continued)

warranty claims under the transaction documents and the remaining 12 million shares are held pending completion of three clinical and developmental milestones related to SPH s phage therapy projects, with one third of the number of shares subject to release upon the attainment of each such milestone or two years following the closing of the acquisition if the Company is found to not have used its best endeavors to have caused such milestones to occur. As part of this transaction, the Company acquired $260,000 in assets to include a $221,000 receivable for an Australian research and development tax refund (Note 4), $37,000 in equipment, and $2,000 in cash. The Company also assumed liabilities of $613,000.

On January 6, 2011, the Company acquired Biocontrol Limited (Biocontrol), a clinical development stage biotechnology company in the United Kingdom (the Acquisition). Biocontrol was formed in 1997 to develop bacteriophage-based therapeutics. The acquisition of Biocontrol allows the Company to extend its product reach into bacteriophage-based products. The Company acquired 100% of the voting stock of Biocontrol and issued 22,817,198 shares of its common stock to the Biocontrol shareholders with a total fair value of approximately $8.6 million as of January 6, 2011. The Acquisition was made through an acquisition subsidiary, which has continued post-Acquisition as Biocontrol Limited. The Company evaluated this acquisition using the guidance of ASC 805-10-55-11 through 55-15, Business Combinations, to determine the accounting acquirer. Based on the relative voting rights in the combined entity, the larger size of the Company, and the make-up of the combined Board of Directors, the Company determined Ampliphi Biosciences (then Targeted Genetics) was the acquirer.

10. Convertible Loan Notes

During 2012 and 2011, the Company issued $950,000 and $2,492,000 in convertible loan notes respectively. The Company is required to pay the holders of the notes the outstanding principal amount and all accrued interest by June 18, 2013. Interest on the unpaid principal balance of these notes accrues at the rate of ten percent (10%) per annum. As of December 31, 2012, $465,000 of interested expense was accrued. $126,000 of interest expense was accrued through December 31, 2011.

In the event the Company shall raise a minimum of $3,000,000 in gross proceeds, in connection with an offering of debt or equity securities of the Company at any time following the issuance of these notes and prior to the maturity date of June 18, 2013 or the payment in full of the principal balance and all accrued interest due under these notes, the Company may, at its option, elect to convert the principal balance and unpaid accrued interest into securities of the Company. If the Company completed the subsequent funding event and determined to exercise the conversion option, the Company shall notify the note holders that it has determined to exercise the conversion option and the holders shall elect to convert the unpaid principal balance and unpaid accrued interest into either of the following: (1) the number and type of securities issued in the subsequent funding event at a conversion rate that shall be equal to a ten percent (10%) discount on the effective price per share or per unit, as applicable, of the subsequent funding event

securities; or (2) the number of shares of common stock of the Company equal to the conversion amount divided by $0.20.

11. Related Parties

During 2012, $30,000 was recognized in General and Administrative expenses for management and accounting consultancy fees provided by two shareholders. The Company shares resources in the new Australian operations such as facility space, electricity, insurance, equipment and staffing with Cellabs, owned by a shareholder, and receives a quarterly invoice for these services. The total expense for these services for the period November 8 through December 31, 2012 was $6,000. As part of the acquisition of SPH (Note 9), the Company also entered into a loan repayment agreement with Cellabs (Note 5). As of December 31, 2012, $562,000 of current liabilities are due to related parties.

F-28

TABLE OF CONTENTS

AmpliPhi Biosciences Corporation

Notes to Consolidated Financial Statements Year Ended December 31, 2011 and 2012

12. Correction of an Error

The Company s previously issued financial statements have been restated to reclassify the revenue from the sale of assets that was previously reported as part of revenue to a gain on sale of assets from discontinued operations. As a result of this correction, revenue for 2012 was reduced $3,150,000 and a gain on sale of assets from discontinued operations was recorded for $3,150,000. The net loss per share remained the same, but additional disclosures were added to the Consolidated Statements of Operations and Comprehensive Loss for net loss per share from continuing operations and gain from discontinued operations per share.

13. Subsequent Events

On February 1, 2013, the Company s Board of Directors approved the issuance of new convertible promissory notes in an aggregate principal amount not to exceed $7,500,000, together with warrants to purchase shares of common stock of the Company. Interest on the unpaid principal balance of these notes shall accrue from the investment date at the rate of ten percent (10%) per annum. The warrants have the right to purchase the number of shares of the Company s common stock equal to twenty-five percent (25%) of the principal amount of such holder s note divided by $0.14 (subject to adjustment to reflect forward or reverse stock splits, stock dividends, recapitalizations and the like).

In the event the Company shall raise a minimum of $3,000,000 in gross proceeds, in connection with an offering of debt or equity securities of the Company at any time following the issuance of these new notes and prior to the maturity date of one year from issuance or the payment in full of the principal balance and all accrued interest due under these notes, the Company may, at its option, elect to convert the principal balance and unpaid accrued interest into securities of the Company. If the Company completed the subsequent funding event and determined to exercise the conversion option, the Company shall notify the note holders that it has determined to exercise the conversion option and the holders shall elect to convert the unpaid principal balance and unpaid accrued interest into either of the following: (1) the number and type of securities issued in the subsequent funding event at a conversion rate that shall be equal to a ten percent (10%) discount on the effective price per share or per unit, as applicable, of the subsequent funding event securities; or (2) the number of shares of common stock of the Company equal to the conversion amount divided by $0.14.

Through March 29, the Company issued $1,000,000 in new convertible loan notes and converted $1,900,000 of previous convertible loan notes and accrued interest into the new security. As part of these transactions, warrants for 5,244,673 shares were also issued.

On March 29, 2013, the Company entered into an Exclusive Channel Collaboration Agreement with Intrexon Corporation. This agreement allows the Company to utilize Intrexon s synthetic biology platform for the identification, development, and production of bacteriophage-containing human therapeutics. The Company paid a one-time technology access fee to Intrexon of $3,000,000 in common stock. The Company shall pay Intrexon, in cash or stock,

milestone fees for the initiation of a Phase 2 trial of $2,500,000 upon commencement of the first Phase 2 trial and $5,000,000 upon the first regulatory approval of any product in any major market country. With regard to each product sold by the Company, the Company will pay, in cash, royalties of 6 10% based on net sales to Intrexon.

F-29

TABLE OF CONTENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of AmpliPhi Biosciences Corporation

We have audited the accompanying balance sheet of Special Phage Holdings Pty Ltd (Company) as of June 30, 2012, and the related statements of operations and comprehensive loss, stockholders equity (deficit), and cash flows for the year then ended. Special Phage Holdings Pty Ltd s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Special Phage Holdings Pty Ltd as of June 30, 2012, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has had recurring losses from operations and has an accumulated deficit that raise substantial doubt about its ability to continue as a going concern. Management s plans in regard to those matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ PBMares, LLP

Richmond, VA

February 3, 2014

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Balance Sheet

	June 30, 2012
Assets	
Current Assets	
Cash and cash equivalents	**$ 38,962**
Tax refund	**216,615**
Total Current Assets	**255,577**
Property and equipment, net	**35,628**
Trademarks, net	**2,164**
Total Assets	**$ 293,369**
Liabilities and Stockholders' Equity (Deficit)	
Current Liabilities	
Related parties payables	**$ 884,406**
Accounts payable and other accrued expenses	**77,249**
Accrued employee expenses	**44,937**
Total Current Liabilities	**1,006,592**
Total Liabilities	**1,006,592**
Commitments and Contingencies (Note 6)	
Stockholders' Equity (Deficit)	
Common stock, no par value, 22,347,952 shares issued and outstanding	
Additional paid-in capital	**1,526,300**
Accumulated other comprehensive loss	**(47,436)**
Accumulated deficit	**(2,192,087)**
Total Stockholders' Equity (Deficit)	**(713,223)**
Total Liabilities and Stockholders' Equity (Deficit)	**$ 293,369**

See accompanying notes to financial statements.

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Statement of Operations and Comprehensive Loss

	Year ended June 30, 2012
Consulting Revenue	**$ 19,613**
Operating Expenses	
Research and development	**320,989**
General and administrative	**328,238**
Total Operating Expenses	**649,227**
Loss from Operations	**(629,614)**
Other Income	
Interest income	**5**
Tax refund	**220,112**
Other Income	**220,117**
Net Loss	**$ (409,497)**
Other comprehensive loss	
Net unrealized loss on foreign currency translations	**(5,082)**
Comprehensive loss	**$ (414,579)**

See accompanying notes to financial statements.

F-32

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Statements of Stockholders' Equity (Deficit)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity (Deficit)
	Shares	Amount				
Balances, June 30, 2011	**19,953,272**	**$**	**$1,190,675**	**$(1,782,590)**	**$(42,354)**	**$(634,269)**
Net loss				(409,497)		(409,497)
Shares issued	2,394,680		$335,625			335,625
Foreign Currency Translations					(5,082)	(5,082)
Balances, June 30, 2012	**22,347,952**	**$**	**$1,526,300**	**$(2,192,087)**	**$(47,436)**	**$(713,223)**

See accompanying notes to financial statements.

F-33

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Statement of Cash Flows

	Year ended June 30, 2012
Operating Activities	
Net loss	**$ (409,497)**
Adjustments to reconcile net loss to net cash used in operating activities:	
Adjustment of loan balances to purchase agreement limits	**136,915**
Depreciation	**4,777**
Amortization	**472**
Changes in operating assets and liabilities:	
Accounts receivable	**976**
Tax refund	**(11,904)**
Current liabilities	**151,306**
Net Cash Used in Operating Activities	**(126,955)**
Investing Activities	
Purchases of trademarks	**(1,078)**
Purchases of property and equipment	**(30,144)**
Net Cash Used in Investing Activities	**(31,222)**
Financing Activities	
Proceeds from shares issued	**198,710**
Net Cash Provided by Financing Activities	**198,710**
Effect of Foreign Currency Translations on Cash	**(5,082)**
Net Increase in Cash and Cash Equivalents	**35,451**
Cash and Cash Equivalents, beginning of year	**3,511**
Cash and Cash Equivalents, end of year	**$ 38,962**
Supplemental Schedule of non-cash financing activities:	
Conversion of debt to shares	**$ 136,915**

See accompanying notes to financial statements.

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Notes to Financial Statements

1. Nature of Business and Significant Accounting Policies

Nature of Business

Special Phage Holdings Pty Ltd (the Company) was incorporated in New South Wales, Australia in 2004. The Company is dedicated to developing novel antibacterial solutions called bacteriophage (phage). Phage are naturally occurring viruses that preferentially target and kill their bacterial targets. This novel approach to antimicrobial therapy positions the Company as one of the leaders in phage therapy.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers cash equivalents to be short-term investments that have a maturity at the time of purchase of three months or less, are readily convertible into cash and have an insignificant level of valuation risk attributable to potential changes in interest rates. Cash equivalents are recorded at cost, which approximates fair market value, and consist primarily of money market accounts.

Accounts Receivable

Accounts receivable amounts are stated at their face amounts less any allowance. Provisions for doubtful accounts are estimated based on assessment of the probable collection from specific customer accounts and other known factors. If an account was determined to be uncollectible (payment has not been made in accordance with contract terms), it would be written off against the allowance. As of June 30, 2012, management determined no allowance for doubtful accounts was required.

Property and Equipment

Property and equipment are recorded at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets, generally three to seven years.

Revenue Recognition

The Company recognizes revenue under research and development contracts as the related costs are incurred.

Concentration of Risk

The Company s primary source of funding to continue operations is from one related party, Cellabs. As of June 30, 2012, 91% of the balance in related parties payables is due to Cellabs.

Research and Development Costs

Research and development costs include salaries, costs of outside collaborators and outside services, and supplies. The Company expenses research and development costs as incurred.

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Notes to Financial Statements

1. Nature of Business and Significant Accounting Policies (continued)

Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. To increase the compatibility of fair value measures, the following hierarchy prioritizes the inputs to valuation methodologies used to measure fair value:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 inputs are unobservable inputs based on the Company s own assumptions used to measure assets and liabilities at fair value

A financial asset or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

All of the Company s cash equivalents are invested in money market accounts that are based on quoted prices in active markets for identical assets and are included within Level 1 of the fair value hierarchy.

The Company believes that the carrying amounts of financial instruments such as cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term nature of these items.

2. Liquidity

The Company has prepared the accompanying financial statements on a going concern basis, which assumes that the Company will realize its assets and satisfy its liabilities in the normal course of business. However, the Company has incurred net losses since its inception, has negative operating cash flows and has an accumulated deficit of $2.19 million as of June 30, 2012. These circumstances raise substantial doubt about the Company s ability to continue as a going concern. The Company s cash balance as of June 30, 2012 was $38,962, the accounts receivable balance was $216,615 and the current liabilities were $1,006,592. The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of the uncertainty concerning the Company s ability to continue as a going concern.

The Company believes that its current resources, in addition to the acquisition of the Company by Ampliphi Biosciences detailed in the Subsequent Events disclosure (Note 10), will be sufficient to fund operations into the first quarter of 2015. This estimate is based on the Company s ability to manage its staffing expenses and its working capital and actual results could differ from its estimates. The Company will be seeking additional financing in order to fund operations through 2015; however, the Company cannot provide assurances that it will be successful in obtaining additional financing for these periods or as needed in the future. If the Company does not raise additional funds by the first quarter of 2015, it plans to implement cost reduction measures, such as a reduction in workforce, reducing its intellectual property prosecution, reducing other operating activities, and/or the pursuit of alternative financing transactions that would likely be on terms disadvantageous to the Company and dilutive to its shareholders. The Company could also be required to relinquish rights to its technology or product candidates or in-licensed technology on unfavorable terms, either of which would reduce the ultimate value of the technology or product candidates, or to sell assets likely at values significantly below their potential worth. If the Company is unable to secure additional capital, it may be required to cease operations, declare bankruptcy or otherwise wind up its business.

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Notes to Financial Statements

3. Property and Equipment

Property and equipment consist of the following:

	June 30, 2012
Furniture and equipment	**$189,452**
Less: accumulated depreciation	**(153,824)**
Total furniture and equipment, net	**$35,628**

Depreciation expense totaled $4,777 for the year ended June 30, 2012.

4. Income Taxes

As of June 30, 2012, the Company had an Australian research and development tax refund of $216,615.

5. Commitments and Contingencies

The Company has an informal month to month lease with Cellabs, a related party. The Company recognized rent expense under this informal operating lease of $37,280 in 2012.

The Company is subject to legal claims and actions related to the operations of its business. The Company does not expect the ultimate outcome of any such actions to have a material impact on its financial position or results of operations.

6. Other Comprehensive Loss

Comprehensive loss is the total of net loss and all other non-owner changes in equity. For the year ended June 30, 2012, the Company s net loss was $409,497 and other comprehensive loss was $5,082.

7. Stock Options

As part of the 2005 Subscription Agreement, the Company issued one option for every share purchased by the investor in 2005 totaling 3,125,000 options granted at $.20 each. Under the terms of the agreement, the investor must give the Company written notice of the exercise together with payment for the options. All options held by an investor must be exercised at the same time and one occasion. During 2012, 8 shareholders exercised 925,000 options. As of June 30, 2012, 2,200,000 options remain outstanding. These options expired on the acquisition of the Company by Ampliphi Biosciences described in the Subsequent Events disclosure (Note 10).

8. Superannuation

The Company contributed, as required by the Superannuation Guarantee (Administration) Act 1992, 9% of employees salaries and wages into a superannuation fund. For the year ended June 30, 2012, the Company s contributions to superannuation totaled $17,465.

9. Related Parties

During 2012, $180,929 was recognized in operating expenses for research consulting, management consulting, accounting, and housekeeping provided by 8 shareholders. The following is a schedule of the expenses:

Related Party	Total Expense	Description of Service
Cellabs Pty Ltd	$ 41,341	Management Consulting
A.P.G. Nominees Pty Ltd	41,291	Management Consulting
HGM Biopharma	28,154	Management Consulting
Dr. Bernie Hudson	28,153	Management Consulting

F-37

TABLE OF CONTENTS

Special Phage Holdings Pty Ltd

Notes to Financial Statements

9. Related Parties (continued)

Related Party	Total Expense	Description of Service
Doug Crease	21,792	Accounting
Argylle Europe Limited	15,485	Management Consulting
Colleen Black	3,949	Housekeeping
Biofirm Pty Ltd	764	Research Consulting
	$ 180,929	

The Company also shares resources such as facility space, electricity, insurance, equipment, and staffing with Cellabs Pty Ltd, which is owned by a shareholder, Dr. Anthony Smithyman, and receives a quarterly invoice for these services. The total expense for these services for the year ending June 30, 2012 was $134,146.

As of June 30, 2012, $884,406 of current liabilities are due to related parties. The following is a schedule of the liabilities.

Related Party	Payables Balance	Description of Service
Cellabs Pty Ltd	$ 815,768	Facility and Services
A.P.G. Nominees Pty Ltd	35,557	Management Consulting
HGM Biopharma	15,583	Management Consulting
Doug Crease	10,666	Accounting
Dr. Bernie Hudson	5,080	Management Consulting
Colleen Black	1,752	Housekeeping
	$ 884,406	

10. Subsequent Events

The Company has evaluated subsequent events through February 3, 2014, the date on which the financial statements were available to be issued.

In November 2012, the Company was acquired by Ampliphi Biosciences (Ampliphi) in a share exchange transaction. The combination of the two companies results in the creation of a leading anti-infective company focused on developing phage-based therapies to combat the growing threat of antibiotic-resistant infection. Under the terms of the acquisition, Ampliphi offered 40 million shares of its common stock in exchange for 100% of the fully diluted share capital of the Company. 20 million shares will be held in escrow, 8 million to satisfy potential warranty claims under the transaction documents and the remaining 12 million shares to be held pending completion of certain milestones.

As part of the acquisition, existing loan balances for services provided by Cellabs Pty Ltd, a related party (see Note 9), were capped at $782,000. The Cellabs Pty Ltd balances for services were adjusted to this cap for these financial statements as of June 30, 2012. In addition to these services, lab equipment and supplies totaling $33,768 which were purchased by Cellabs Pty Ltd and transferred to the Company as part of the acquisition were recognized as an additional related party liability.

In November 2013, 8 million of the escrow shares were released. The remaining 12 million shares continue to be in escrow until November 2014 or completion of the milestones. As of February 3, 2014 the agreed upon milestones have not been achieved.

F-38

TABLE OF CONTENTS

EXHIBIT INDEX

Exhibit Number	Description of Document
3.1#	Amended and Restated Articles of Incorporation, effective May 21, 2009.
3.2#	Articles of Amendment to Amended and Restated Articles of Incorporation, effective June 26, 2013.
3.3#	Articles of Correction to Amended and Restated Articles of Incorporation, effective June 26, 2013.
3.4#	Amended and Restated Bylaws.
4.1#	Specimen stock certificate evidencing shares of common stock.
4.2#	Form of Warrant to Purchase Shares of Common Stock.
4.3#	Subscription Agreement to Purchase Series B Preferred Stock and Warrants, dated June 26, 2013.
4.4#	Registration Rights Agreement, dated December 16, 2013.
4.5#	Subscription Agreement, dated December 16, 2013.
10.1#	Loan Repayment Deed, dated September 28, 2012, by and among the Company, Cellabs Pty Ltd and Special Phage Holdings Pty Ltd.
10.2#	Exclusive Channel Collaboration Agreement, dated as of March 29, 2013, by and between the Company and Intrexon Corporation.
10.3#	Stock Issuance Agreement, dated as of March 28, 2013, by and between the Company and Intrexon Corporation.
10.4*#	Collaboration Agreement, dated as of April 24, 2013, by and between the Company and the University of Leicester.
10.5*#	Collaboration Agreement, dated as of August 1, 2013, by and among the Company, the University of Leicester and the University of Glasgow.
10.6*#	License, dated as of September 5, 2013, by and between the Company and the University of Leicester.
10.7#	Cooperative Research and Development Agreement, dated as of June 13, 2013, by and between the Company and United States Army Medical Research and Materiel Command.
10.8#	License Agreement, dated as of February 18, 2013, by and between the Company and Office Suites Plus Properties, Inc.
10.9#	Agreement of Lease, dated as of February 23, 2011, by and between the Company and Virginia Biotechnology Research Partnership Authority.
10.10#	Client Services Agreement, dated as of September 1, 2011, by and between the Company and PBC Carlsbad LLC.
10.11#	Lease, dated as of December 8, 2011, by and between Biocontrol Limited, Nevis Limited and Charter Limited.
10.12+#	2009 Targeted Genetics Stock Incentive Plan.
10.13+#	2012 Stock Incentive Plan.
10.14+#	Form of Stock Option Agreement under 2012 Stock Incentive Plan.
10.15+#	Employment Agreement, dated as of October 19, 2011, by and between the Company and Philip J. Young.
10.16+#	Amendment No. 1 to Employment Agreement, dated as of June 25, 2013, by and between the Company and Philip J. Young.
10.17+#	

	Offer of Employment, dated October 7, 2013, by and between the Company and Baxter Phillips, III.
10.18*	License Agreement, dated July 3, 2007, by and between the Company and United Kingdom Health Protection Agency, Centre for Emergency Preparedness and Response (incorporated by reference to Exhibit 10.18 to the Registration Statement on Form S-1 filed January 21, 2014).

TABLE OF CONTENTS

Exhibit Number	Description of Document
10.19	Shareholder Sale Agreement, dated as of September 8, 2012, by and between the Company, Anthony Smithyman and Margaret Smithyman, AmpliPhi Australia Pty Ltd, Special Phage Holdings Pty Ltd, and the other parties listed therein (incorporated by reference to Exhibit 10.19 to the Registration Statement on Form S-1 filed January 21, 2014).
10.20	Agreement and Plan of Merger, dated November 12, 2010, by and between the Company, Sheffield Acquisition 1, Inc., and Sheffield Acquisition 2, Inc. (incorporated by reference to Exhibit 10.20 to the Registration Statement on Form S-1 filed January 21, 2014).
21.1#	Subsidiaries of the registrant.

+ Indicates management contract or compensatory plan or arrangement.

* Indicates confidential treatment has been requested.

Previously filed.